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Inheriting an IRA as a Designated Beneficiary

The Setting Every Community Up for Retirement Enhancement (SECURE) Act has changed the distribution options for some beneficiaries when they inherit an IRA. As a Designated Beneficiary (DB) who inherits an IRA from someone who dies in 2020 or after, you should understand your options so you can decide the best way to distribute the assets. A DB is a:

- Non-spouse individual
- Qualified "look-through" trust

Some of your decisions will be based on your current needs, but your ultimate goal may be to maximize the value of the assets you received. We have prepared this information to help you be informed so that you can avoid common mistakes and make the most of this opportunity.

Tax considerations

Managing the amount you will pay in taxes is one of the most important considerations when deciding how to handle distributing money from the IRA you inherited.

- Qualified distributions from the Roth IRA you inherited are tax-free. An Inherited Roth IRA offers the opportunity for tax-free compounding of potential earnings.
- Income tax, but not the IRS 10% additional tax for early or pre-59½ distributions (10% additional tax), will apply to taxable amounts when withdrawals are taken from the Traditional IRA you inherited. Larger dollar amounts can quickly put you into a higher tax bracket, whereas taking smaller distributions over time can help avoid a significant tax bill. An Inherited Traditional IRA offers the opportunity for tax-deferred compounding of potential earnings.

Designated Beneficiary distribution options

The table below summarizes the options you have as a designated beneficiary.

Designated beneficiary:	Ten-year rule	Lump-Sum/ Disclaimer
Designated beneficiary:		
- Nonspouse	X	X
- Qualified trust	X	X[1]

Distribution options

You have a few distribution options as a DB. It is important to understand the features and things to keep in mind of each option.

Open an Inherited IRA — An Inherited IRA allows you a way to keep the funds growing tax-advantaged in an IRA while taking distributions. The account titling will always refer to the deceased IRA owner with you listed as the beneficiary. Since you aren't the owner, you may not make contributions or 60-day rollover deposits to this account. The benefit of this arrangement is that you have the option to distribute the funds over time and are taxed only on the amount included in gross income.

Inherited IRA distribution options:

- **Ten-year rule** — This option is available for Inherited Roth and Inherited Traditional IRAs. The Inherited IRA must be emptied by the 10th year following the year of the IRA owner's death. No distributions are required before the 10th year. Depending on the size of the account, you may want to spread distributions over the 10-year period.

1. In some instances a trust can disclaim.

- **Disclaim** — If you do not need or want the IRA, you can disclaim, or refuse, all or a portion of the assets, generally within nine months after the IRA owner's death. Usually, you cannot receive any benefit from the disclaimed property, such as moving the assets to an Inherited IRA. The person who disclaims is considered to have predeceased the IRA owner so you will not be able to dictate who will inherit the IRA. If the per stirpes option has been selected then the disclaimed assets will go to your lineal descendants. If not, then the IRA passes to any other named primary beneficiary(ies) or, if none, then to the named contingent beneficiary(ies). The IRA default beneficiaries may be used if there are no valid beneficiaries on file. The defaults on a Wells Fargo Clearing Services IRA are:
  - First, a surviving spouse
  - Second, surviving children (as defined under state law)
  - Third, the owner's estate
- **Lump-sum distribution** — This strategy will exhaust the entire account in one distribution, with retirement assets losing their tax-advantaged status. Taxes will be due on the taxable portion in the year received and may place you in a higher tax bracket. Once you choose to take a lump-sum distribution, it cannot be undone.

Roth IRAs

Beneficiaries who inherit a Roth IRA that has been opened more than five years will receive all distributions income tax-free. So, by not taking any distributions until the 10th year, you can have potential earnings growing tax-free that could be used to help fund your own retirement.

Naming a beneficiary to your Inherited IRA

As a beneficiary, you'll want to designate your own "successor" beneficiary to your Inherited IRA. If you die before the end of the 10th year and the account is still open, your successor beneficiary will have the remaining years of your 10-year rule to empty the Inherited IRA. A successor beneficiary should be named when opening an Inherited IRA as part of a complete estate plan.

Key considerations

There are a few things to consider when inheriting the deceased person's IRA and managing the funds.

- The division of the deceased's account into separate Inherited IRAs is a plan-to-plan transfer and not a taxable event.
- Nonspouse beneficiaries do not have the ability to roll over an IRA they inherit to their own IRA.
- You will need to satisfy any RMD the deceased should have taken by December 31 of the year of death of the IRA owner.
- Generally, you are responsible for the portion of the deceased's RMD based on the portion of the IRA that you inherited.
- A Roth IRA owner is always considered to have died before their required beginning date (RBD), which is generally April 1 following the year they turn age 72, so they will have no RMD due in the year of death.
- You will avoid the 10% additional tax on distributions from the Inherited IRA, no matter your age, because such distributions are coded as a "death distribution."
- Nonspouse beneficiaries cannot convert a Traditional IRA they inherit to an Inherited Roth IRA.

Talk to Wells Fargo Advisors

At Wells Fargo Advisors, we understand your desire to maximize the benefits of your inheritance. It is always wise to discuss your options on how to handle your IRA inheritance with your Financial Advisor as well as your tax and legal advisors before executing any strategy. Please contact your Financial Advisor with any questions you may have. We look forward to working with you today and in the future.

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