



# What to know when you inherit an IRA

When you inherit an IRA you will have many planning and distribution considerations. Your options will depend on if the IRA holder died before or after January 1, 2020. 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 a key consideration when you inherit a Traditional IRA. When you inherit a Roth IRA, you need to understand if you will owe taxes when taking distributions.

No matter your age, you will avoid the IRS 10% additional tax for early or pre-59½ distributions (10% additional tax) on distributions from the IRA you inherited. If you don't have an immediate need for the assets, it makes sense to have a plan to minimize distributions of the inherited assets so that you can preserve their tax-advantaged features.

## Distributions from Inherited Roth IRAs

Whether you will take a lump-sum distribution, disclaim, or open an Inherited IRA, you first should understand the two types of Roth IRA distributions: **qualified** and **non-qualified**.

- **Qualified distributions** from an Inherited Roth IRA are tax-free. Distributions are qualified if the Roth has been open for more than five years.
- **Non-qualified distributions** from Inherited Roth IRAs may be subject to tax, but not the 10% additional tax. When the Roth IRA owner died before the account had been funded for more than five years, distributions are **non-qualified**. The five-year clock will continue in the Inherited IRA and until that fifth year has been

reached, the Roth ordering rules for distribution are followed. As long as your distributions are equal to or less than the total amount the IRA owner contributed and/or converted, you have no taxes due. Any earnings distributed before the account has been open for more than five years will be taxable.

## Distributions from Inherited Traditional IRA

Income tax will apply to taxable amounts when distributions are taken from an Inherited Traditional IRA. 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.

## Three categories of beneficiaries

The Setting Every Community Up for Retirement Enhancement (SECURE) Act has changed the distribution options for certain beneficiaries who inherit an IRA on or after January 1, 2020. Your beneficiary category will determine your options for distributing the money. Below are the three categories of beneficiaries.

Non-Designated Beneficiary (NDB)	Designated Beneficiary (DB)	Eligible Designated Beneficiary (EDB)
<ul style="list-style-type: none"> <li>• Estate</li> <li>• Non-qualified trust</li> <li>• Charity</li> </ul>	<ul style="list-style-type: none"> <li>• Non-spouse individual</li> <li>• Qualified "look-through" trust</li> </ul>	<ul style="list-style-type: none"> <li>• Surviving spouses</li> <li>• Disabled or chronically ill individuals</li> <li>• Individuals not more than 10 years younger, the same age as, or older than IRA owner</li> <li>• Child of the account owner who has not reached the age of majority</li> </ul>

## Understanding your options

You have a few decisions to make if you have been named as the beneficiary of an IRA. It is important to understand each option because certain distribution methods preserve the account's tax-advantaged status while others do not. Keep in mind that after a distribution is taken from IRA assets you inherit, unless you are the spouse, you are not able to put it back.

*The following table summarizes the options you have depending on your beneficiary type.*

*Remember, you will need to take distributions whether you inherit a Roth or a Traditional IRA.*

## Beneficiary distribution options when an IRA holder dies on or after 1/1/2020

Beneficiary category	Open an Inherited IRA		
	Life expectancy	Five-year rule	Ten-year rule
<b>Designated beneficiary:</b>			
-Non-spouse			X
-Qualified trust			X
<b>Eligible designated beneficiary:</b>			
-Spouse	X		X
-Disabled or chronically ill individuals	X		X
-Individuals not more than 10 years younger, the same age as, or older than IRA owner	X		X
-Child of the account owner who has not reached age of majority <sup>1</sup>	X		X
<b>Non-designated beneficiary (owner died before RBD):</b>			
-Estate/non-qualified trust		X	
-Charity		X	
<b>Non-designated beneficiary (owner died after RBD):</b>			
-Estate/non-qualified trust	X <sup>2</sup>		
-Charity	X <sup>2</sup>		

### Designated beneficiary

Under the SECURE Act, these beneficiaries will now be subject to the 10 Year Rule.

**10 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.

### Eligible designated beneficiary

This category has the most favorable distribution options. Beneficiaries can take distributions from their Inherited IRA based on their own life expectancies. The life expectancy option is often referred to as the stretch IRA strategy.

- Except for the minor child of the IRA owner, EDB options are the same as before the SECURE Act and are detailed on page 3.
- Minor children of the IRA owner can take RMDs based on their life expectancy until they reach the age of majority. Then they are subject to the 10 Year Rule.

*Please Note: If an IRA owner dies before January 1, 2020, a non-spouse or qualified trust beneficiary has the same options as an EDB.*

### Non-designated beneficiary

This category includes estates, charities, and non-qualified trusts. The options available to them are dependent on when the IRA owner died—either before or after their required beginning date (RBD), generally April 1 following the year they reached age 72. If the owner died after their RBD, RMDs are based on the IRA owner's age in year of death, divisor reduced by one each subsequent year. If the owner died before their RBD the 5 year rule is followed.

**5 Year Rule** – Empty the Inherited IRA by December 31 of the year containing the fifth anniversary of the owner's death.

### Inherited IRA distribution options when an IRA owner dies on or before 12/31/2019 and for EDB:

- **Life expectancy:** This option is available for Inherited Roth and Inherited Traditional IRAs. The Wells Fargo Clearing Services, (WFCS) LLC IRA Custodial Agreement default is the Life Expectancy option. You may be subject to an IRS 50% excise tax for every dollar under-distributed.

1. The age of majority has not been defined yet.

2. RMDs based on owner's age in year of death, divisor reduced by one each subsequent year.

- **Non-spouse beneficiary:** You will take annual RMDs but you can always take more than that amount. RMDs are based on your life expectancy using a divisor from the IRS Single Life Table and the prior year-end IRA value, on a term-certain basis. Term-certain means that one is subtracted from the original divisor in each subsequent year. These RMDs will begin the year following the death of the IRA owner.
- **Spouse beneficiary:** Establishing an Inherited IRA when you are under age 59½ allows you to avoid the 10% additional tax on distributions that you might have if the assets were taken from your own IRA. You always have the ability to transfer the Inherited IRA to your own IRA, even if you have been taking distributions. RMDs from this Inherited IRA will start:
  - Beginning the year your deceased spouse would have reached age 72, or
  - Beginning in the year following your spouse's death, if your spouse died on or after their RBD.

Annual RMD calculations are based on your life expectancy using a divisor from the IRS Single Life Table, the prior year-end IRA value, and utilizes the recalculation method. The recalculation method uses a new divisor from the table each year.

*Please note that the stretch IRA strategy is designed for investors who will not need the money in the account for their own retirement. There is no guarantee that there will be assets remaining in the account at the time of the IRA owner's death.*<sup>3</sup>

### Other options

These distributions choices are available to all beneficiaries no matter the IRA holder's year of death.

- **Disclaim:** If you do not need or want the asset, you can disclaim, or refuse, all or a portion of the assets generally, within nine months after the IRA owner's death. The person who disclaims is considered to have predeceased the IRA owner and cannot dictate who will inherit the assets. If the per stirpes option has been selected then the disclaimed assets will go to

that beneficiary's lineal descendants. If not, then the IRA passes to any other named primary beneficiaries 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 beneficiary defaults on a WFCS IRA are:

- First, a surviving spouse
- Second, surviving children (as defined under state law)
- Third, the IRA holder's estate
- **Lump-sum:** 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 of the distribution in the year received and may place you in a higher tax bracket. Once a non-spouse beneficiary chooses to take a lump-sum distribution, it cannot be undone. In this situation, a spouse beneficiary would have 60 days to roll over the inherited assets into his or her own IRA if they meet the roll over requirements.

**Successor beneficiary of an EDB:** If you inherit an Inherited IRA from an EDB, you are a "successor" beneficiary and will have an Inherited/Inherited IRA. It is important to note that the Internal Revenue Code (IRC) does not let you start over and stretch inherited assets out over your own lifetime. Instead, you will use the 10 Year Rule.

**Successor beneficiary of an DB:** If you inherit an Inherited IRA from a DB, you are a "successor" beneficiary and will have an Inherited/Inherited IRA. If the DB dies before the end of the 10th year and the account is still funded, you will have the remaining years of the DB's 10-Year Rule to empty the Inherited IRA.

## Review your choices

Wells Fargo Advisors understands your desire to maximize the benefits you can receive from your IRA inheritance. Please investigate all the options you have in regard to these assets with your tax and legal advisors before enacting a strategy. We look forward to helping you and your family with your financial goals and objectives.

3. When deciding whether to initiate a stretch IRA strategy, an investor should consider such factors as possible changes to tax laws, the impact of inflation, and other risks. Please note that designating a beneficiary two or more generations below the IRA owner may result in additional taxes when the distribution is made (exemptions may apply). Please consult with your tax advisor for more information.

*Please Note: This material has been prepared for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading or distribution strategy. The accuracy and completeness of the information is not guaranteed and is subject to change. It is based on current tax information and legislation as of October 2020. Since each investor's situation is unique, you need to review your specific investment objectives, risk tolerance, and liquidity needs with your financial professional(s) before an appropriate investment or distribution strategy can be selected. Also, since Wells Fargo Advisors does not provide tax or legal advice, investors need to consult with their own tax and legal advisors before taking any action that may have tax or legal consequences.*

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