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Inheriting an IRA as a Nonspouse Eligible Designated Beneficiary

When you inherit an IRA and are a nonspouse eligible designated beneficiary (EDB), you will have many planning and distribution considerations. An Eligible Nonspouse Designated Beneficiary is:

- Disabled or chronically ill individuals
- Individuals not more than 10 years younger, the same age, or older than IRA owner
- Child of the account owner who has not reached age of majority

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. Please note if the IRA holder dies on or before December 31, 2019, and a non-spouse or qualified trust inherited the account, they have the same options as an EDB.

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.

Beneficiary distribution options

The table below summarizes the options you have as an EDB and non-spouse beneficiary or qualified trust of IRA owners who died on or before 12/31/19.

Beneficiary	Life expectancy	Ten-year rule
-Non-spouse or qualified trust beneficiary of IRA owners who died on or before 12/31/19	X	X
-Disabled or chronically ill individuals	X	X
-Individuals not more than 10 years younger, the same age, or older than IRA owner	X	X
-Child of the account owner who has not reached age of majority[1]	X	X

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

Understanding your options

You have a few distribution options as a nonspouse EDB. It's important to note certain distribution methods preserve the IRA asset's tax-advantaged status while others do not.

- **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 a longer period of time and are taxed only on the amount included in gross income.

Inherited IRA distribution options are:

  - **Life expectancy** — This option is available for both Inherited Roth and Inherited Traditional IRAs and is often referred to as the stretch IRA strategy.[2] You will take annual required minimum distributions (RMDs) 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 instead of using a new divisor from the table (see page 5), one is subtracted from the original divisor in each subsequent year. These RMDs will begin the year following the IRA owner's death. You may always take more than the RMD, but by taking only the minimum, the rest of the money invested remains tax-advantaged over a longer time frame. Any RMD not taken in the year due is subject to a 50% IRS excise tax for every dollar under-distributed.
    - 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.
  - **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.
  - **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. Generally, 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.

Common beneficiary strategies

A beneficiary who chooses wisely may avoid paying income taxes on an Inherited IRA all at once. Here are a few common strategies to help you understand how to best take advantage of the inherited funds.

Stretch IRA strategy

Stretching an IRA simply refers to the ability for you to take just RMDs from both Inherited Traditional and Inherited Roth IRAs. Below is an example of the potential benefits of choosing to implement the stretch IRA strategy, instead of taking a lump-sum distribution or emptying the account in a few years. As you can see, the younger you are when you inherit the funds, the greater the potential growth of the account.

2. Stretching an IRA simply refers to the ability to take RMDs over the benefciary's single life expectancy (using the term-certain calculation method) rather than over the life expectancy of the original IRA owner.

The stretch IRA concept

Total IRA distributions over beneficiary's lifetime				
		Value of IRA when inherited by beneficiary		
		$100,000	**$500,000**	**$1,000,000**
Age	**Life expectancy**	**Total projected distributions**		
20	63.0 years	1,740,307	8,701,264	17,402,515
30	53.3 years	1,045,316	5,226,414	10,452,821
40	43.6 years	640,394	3,201,872	6,403,739
50	34.2 years	407,695	2,038,414	4,076,824

Assumptions: RMDs only taken, 7% annual return. This chart is hypothetical and is provided for informational purposes only. It is not intended to represent any specific investment. Please Note: Stretch IRA strategies are 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.

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 just taking RMDs 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. It is important to note that the Internal Revenue Code (IRC) does not let your successor start over and stretch inherited assets out over his or her own lifetime. A successor beneficiary should be named when opening an Inherited IRA as part of a complete estate plan.

Aggregating RMDs

- RMDs need to be taken separately from both Inherited Traditional and Inherited Roth IRAs in order to take advantage of the stretch IRA strategy for both accounts.
- You can aggregate RMDs from the same type of IRA you inherited as long as they are from the same IRA owner. For example, if you inherited two Traditional IRAs from your aunt, you could determine the RMD for each IRA but satisfy both RMDs from only one of the IRAs. However, if you inherited both a Traditional and Roth IRA from your Aunt you would need to take an RMD from each IRA in order to stretch them over your life expectancy.
- You cannot aggregate RMDs you take as an IRA beneficiary with any RMDs you take as an IRA owner.

Calculating your Inherited IRA RMDs

One option available to an eligible designated beneficiary is to take annual RMDs based on your life expectancy. This term-certain calculation uses a divisor from the IRS Single Life Table and the previous year-end IRA value. Term-certain means that instead of using a new divisor from the table (see page 5) one is subtracted from the original divisor in each subsequent year. Keep in mind that this option requires the first distribution to be taken no later than December 31 following the year of death. Subsequent RMDs must be taken each year by December 31.

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 RBD, 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."
- Any RMD not taken in the year due is subject to a 50% IRS excise tax for every dollar under-distributed.
- Nonspouse beneficiaries cannot convert a Traditional IRA they inherit to an Inherited Roth IRA.
- Beneficiaries who chose the life expectancy option take a yearly RMD from the Inherited IRA by December 31 beginning the year following the year of death.
- You may always take more than the RMD.

Nonspouse RMD Formula

$$\frac{\text{Value at last year's end}}{\left(\begin{array}{c}\text{Single Life Table divisor}\\\text{for your age as of your}\\\text{birthday in year}\\\text{following IRA owner's}\\\text{year of death}\end{array} - \begin{array}{c}\text{1 for each}\\\text{subsequent}\\\text{year}\end{array}\right)} = \text{RMD}$$

Calculating first RMD hypothetical example[3]

John, who is a disabled adult child of the IRA owner, inherited his dad Ed's IRA when Ed died last year. The 12/31 value is $100,000. John will be 35 years old this year and his Single Life Table divisor is 48.5 years. John's RMD is $2,062 ($100,000 ÷ 48.5 = $2,062).

Calculating subsequent years' RMD hypothetical example

Judy inherited her sister Maxine's IRA when Maxine died 3 years ago. Judy was 50 two years ago and her Single Life Table divisor was 34.2. That divisor must be reduced by 2 to reflect the subsequent years (last year and this year). Therefore, the divisor for this year is 32.2. The 12/31 value is $250,000 so Judy's RMD for this year is $7,764 ($250,000 ÷ 32.2 = $7,764).

3. These hypothetical examples are provided for informational purposes only. Wells Fargo Advisors is not a tax or legal advisor. Be sure to consult with your own tax and legal advisors before taking any action that may have tax or legal consequences.

Single Life Expectancy Table[4]

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	82.4	20	63.0	40	43.6	60	25.2	80	10.2	100	2.9
1	81.6	21	62.1	41	42.7	61	24.4	81	9.7	101	2.7
2	80.6	22	61.1	42	41.7	62	23.5	82	9.1	102	2.5
3	79.7	23	60.1	43	40.7	63	22.7	83	8.6	103	2.3
4	78.7	24	59.1	44	39.8	64	21.8	84	8.1	104	2.1
5	77.7	25	58.2	45	38.8	65	21.0	85	7.6	105	1.9
6	76.7	26	57.2	46	37.9	66	20.2	86	7.1	106	1.7
7	75.8	27	56.2	47	37.0	67	19.4	87	6.7	107	1.5
8	74.8	28	55.3	48	36.0	68	18.6	88	6.3	108	1.4
9	73.8	29	54.3	49	35.1	69	17.8	89	5.9	109	1.2
10	72.8	30	53.3	50	34.2	70	17.0	90	5.5	110	1.1
11	71.8	31	52.4	51	33.3	71	16.3	91	5.2	111+	1.0
12	70.8	32	51.4	52	32.3	72	15.5	92	4.9		
13	69.9	33	50.4	53	31.4	73	14.8	93	4.6		
14	68.9	34	49.4	54	30.5	74	14.1	94	4.3		
15	67.9	35	48.5	55	29.6	75	13.4	95	4.1		
16	66.9	36	47.5	56	28.7	76	12.7	96	3.8		
17	66.0	37	46.5	57	27.9	77	12.1	97	3.6		
18	65.0	38	45.6	58	27.0	78	11.4	98	3.4		
19	64.0	39	44.6	59	26.1	79	10.8	99	3.1		

4. Source: IRS Publication 590b

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.

With you every step of the way

Everyone has a different vision of retirement that requires a unique financial strategy. Wells Fargo Advisors can support you in your retirement planning process by providing the guidance needed to make informed choices. We will meet with you and help create a comprehensive plan that takes into account your complete financial picture. Your Financial Advisor will be with you every step of the way to monitor your progress and adapt your plan as needed. Working together, we'll design and implement a retirement plan that will help you live out your unique vision of retirement.