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TIPS FROM YOUR
Financial Coach

What Happens When You Inherit an IRA?

When a loved one dies, you may be named as a beneficiary on their IRA account. This is called an inherited IRA. The rules for inherited IRAs are different than the rules for your own IRA. In addition, the rules for inherited IRAs will depend upon your relationship to the deceased. Different rules apply if:

(1) You are the spouse

(2) You are a non-spouse (such as a child, sibling, or friend)

(3) You are a trust, estate or non-profit organization

These rules will dictate the minimum distribution that you must withdraw from the IRA and when you must take that distribution. Failure to take the appropriate distribution could result in a 50% penalty.

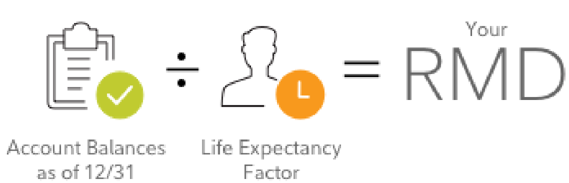
Sandy Worner, CPA, CFP®,
Vice President,
Director of Financial Planning

Bobbi Putman, CFP®
Financial Planner

The Choices

1. You may have the option to defer taxes by holding assets in an IRA. A surviving spouse may choose to roll the assets to a Spousal IRA. Other beneficiaries (and some surviving spouses) will hold the assets in an Inherited IRA. Either way, you must follow Required Minimum Distribution (RMDs) rules. The RMD calculation is dependent upon your relationship to the original account owner, your age, the age of the original account owner at death, and the end of year market value of the IRA. If you hold assets in an inherited IRA, you will <u>not</u> be subject to the 10% penalty for withdrawals prior to 59 ½.
2. You have the option to withdraw all funds in one lump sum within 5 years of death and pay taxes at your ordinary income tax rate for that year. With this option, you don't have to bother with opening or transferring funds into an IRA. In addition, you will <u>not</u> be subject to a 10% early withdrawal penalty.
3. You may choose not to take the money by disclaiming the funds. You will not have to pay taxes on these funds when withdrawn. They will pass to an alternate beneficiary who may be in a much lower tax bracket and who you would ultimately want to receive the money.

Required Minimum Distributions (RMDs) for Inherited IRAs



RMDs are based on two factors: (1) the market value of the IRA as of the end of the previous year; and (2) the divisor in the distribution table that is appropriate for your situation. Inherited IRAs from different people cannot be combined. Inherited IRAs cannot be combined with your own IRA, with the exception of a Spousal IRA.

In most cases, the beneficiary of an inherited IRA will use the IRS Single Life Expectancy Table when calculating RMDs. However, surviving spouses who roll their IRA into a Spousal IRA will use the IRS Uniform Life Expectancy Table. This allows a surviving spouse to have the option to delay distributions.

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1004 N. Michigan Ave.
Saginaw, MI 48602
(989) 921-0010

160 S. Main St., Ste 2
Frankenmuth, MI 48734
(989) 652-6600

3511 Coolidge Rd.,Ste 300
East Lansing, MI 48823
(517) 827-0045

200 E. Main St., Suite 100
Midland, MI 48640
(989) 492-7620

RMD Rules for a Spouse

- **Surviving spouses have the option to treat the inherited IRA as their own IRA by rolling the balance into a Spousal IRA**

  This option may be beneficial to a surviving spouse when they do not need income prior to age 59 1/2. It also provides a higher level of creditor protection. By transferring assets to a spousal IRA, the RMDs can be delayed until the surviving spouse turns 70 ½. However, the surviving spouse will now be subject to the 10% penalty for any withdrawals prior to age 59 ½.

- **As an alternative, surviving spouses can transfer the assets into an Inherited IRA**

  This option may be beneficial to a surviving spouse that is younger than 59 ½ and requires current income. The RMD calculation depends upon the age of the original owner at death and are not subject to the 10% penalty for early withdrawals.

  - If the owner died before age 70 ½, RMDs will be based on the surviving spouse's life expectancy and begin by the later of December 31st of the year the owner would have turned 70 ½ or December 31st of the year after death.

  - If the owner died after age 70 ½, RMDs will continue by December 31st of the year after death over the longer of the surviving spouse's life expectancy or the owner's remaining life expectancy. Additionally, the surviving spouse must be sure to take the full RMD in the year of death, if the owner had not.

RMD Rules for a Non-Spouse

- **Non-spouse beneficiaries can transfer the assets into an Inherited IRA**
  - When the IRA has multiple beneficiaries, you should set up separate accounts for each beneficiary by December 31st of the year following death.

  - If the owner died prior to age 70 ½, RMDs must begin by December 31st of the year after death and are based on the beneficiary's life expectancy.

  - If the owner died after age 70 ½, RMDs will continue by December 31st of the year after death over the longer of the beneficiary's life expectancy or the owner's remaining life expectancy. Again, the beneficiary must take the full RMD in the year of death, if the owner has not.

RMD Rules for a Trust, Estate, or Non-Profit Organization

- **If the trust qualifies as a designated beneficiary:**

  If a trust is drafted in such a way that each beneficiary is "identifiable" and the trust creates separate accounts by December 31st of the year following the year of death, the RMD is based upon each beneficiary's life expectancy. If the trust does not separate the accounts, the RMD will be based upon the life expectancy of the oldest beneficiary. However, if the owner was younger than the oldest trust beneficiary and the IRA owner died after his/her RMD date, the RMD will be based upon the owner's life expectancy.

- **Charity, estates & trusts that do not qualify as a designated beneficiary:**
  - If the owner died prior to age 70 ½, the IRA must be completely distributed within 5 years.

  - If the owner died after age 70 ½, RMDs will be based upon the life expectancy of the decedent.

Conclusion

Many individuals pass away with a balance in their retirement accounts that is left to family, friends, a trust, charities, alma maters and other organizations. The IRS establishes complex rules, requirements and deadlines for an IRA beneficiary, and the best course of action for transitioning these funds is influenced by age, tax bracket, and need.

Please reach out to your financial advisor at Tri-Star, if you have any questions or would like further guidance on being named or naming an IRA beneficiary.

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