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The 10 vital things you need to know about inherited IRAs

By [Robert Powell](#), MarketWatch

Nov. 12, 2009, 12:01 a.m. EST

BOSTON (MarketWatch) -- It's not a certainty, but odds are high that you might inherit an IRA some day. Doing so is bittersweet. On the one hand, it means that someone you know and love has died. On the other, it likely means that your net worth has increased as well.

Inheriting an IRA should also come with a bottle of ibuprofen because it also means that you now have to become familiar with and, more importantly, compliant with some retirement rules and laws and regulations that you never knew existed.

Here's an overview of what experts say are the most important things you need to know about inheriting IRAs. But first this disclaimer: We're talking here about inheriting IRAs when you are someone other than a spouse. Inheriting your spouse's IRA comes with a different set of rules.

1. Name and maintain correct beneficiaries of an inherited IRA

"The beneficiary form on an IRA is the first and most important part of receiving an inherited IRA," said Matthew Curfman, a senior vice president at Richmond Brothers Financial Management Specialists. "If you fail to name a beneficiary on your IRA it is highly likely that your beneficiaries will not be able to 'stretch' the inherited IRA over their life."

After becoming the owner of an inherited IRA, you have to think about how that account fits into your own estate plan, said Bruce Steiner, an attorney with Kleinberg, Kaplan, Wolff & Cohen.

"Divorces, remarriages, deaths, and the birth of or adoption of children are all great reasons to reevaluate who the beneficiaries are on your newly inherited IRA," said Aaron Skloff, CEO of Skloff Financial Group. "Keep you beneficiaries current. Remember, the designated beneficiaries on your IRA supersede the instructions of your will."

2. Inherited IRAs cannot be commingled with other assets

If you inherit multiple IRAs from the same person you can combine those IRAs into one inherited IRA, according to Denise Appleby, the CEO of Appleby Retirement Consulting and founder of RetirementDictionary.com. "However, you cannot combine assets inherited from different individuals; neither can you combine inherited IRAs of different types," she said. "For instance, you cannot combine a traditional inherited IRA and a Roth inherited IRA, even if they were both inherited from the same person."

3. Excluding the decedent's name from the registration does not make the amount taxable

Contrary to popular belief, Appleby said that transferring the assets into your own non-inherited IRA does not result in the amount being taxable. It's true that the IRS requires the inherited IRA to be registered in the combined names of the decedent and the beneficiary.

"However, if the assets were transferred into an IRA in just the beneficiary's name, that can be easily corrected as long as the funds are not commingled with non-inherited-IRA assets," Appleby said. "The correction can be accomplished by simply adding the name of the decedent to the registration."

She said examples of acceptable registrations, by IRS standards, include the following: "IRA FBO Tom Smith as beneficiary of John Smith" and "IRA FBO Tom Smith (Dec'd); John Smith (bene)."

4. Distributions from inherited IRAs are not subject to the 10% penalty

Distributions from inherited IRAs are not subject to the 10% early distribution penalty, regardless of the age of the beneficiary at the time the distribution occurs, Appleby said. The IRA custodian or trustee should code or flag the inherited IRA, so that distributions are reported as "death distributions" with a code 4 in Box 7 of IRS Form 1099-R, she said.

5. Your IRA doesn't always allow what the tax code and the IRS allow

According to Appleby, the tax code and IRS regulations allow the beneficiary two sets of distribution options for inherited IRAs: "1) If the IRA owner dies before the required beginning date, the beneficiary can distribute the assets within five years of the owner's death, or over the beneficiary's single life expectancy. Or 2) if the IRA owner dies on or after the required beginning date, the beneficiary can distribute the assets over the longer of the remaining life expectancy of the decedent or the life expectancy of the beneficiary."

"However, not all IRA agreements allow these options," said Appleby. In fact, Appleby said some firms might force you to take a distribution within one year of the original owner's death.

6. Transfer your inherited IRA to a more beneficiary-friendly custodian

If you inherit an IRA that is held with a custodian or trustee that does not allow you to stretch distributions under the options provided by the tax code, Appleby said you can transfer the inherited IRA to a custodian or trustee that does.

"Try to complete the transfer before Dec. 31 of the year that follows the year in which the IRA owner dies, so that you can make any required election under the new IRA agreement," she said.

Barry C. Picker, of Picker & Auerbach, CPAs, and author, "Barry Picker's Guide to Retirement Distribution Planning" recommends that you move the money via a trustee-to-trustee transfer.

7. Stretch that IRA

Once you have your inherited IRA at a beneficiary-friendly custodian or trustee, Picker recommends that you use life expectancy payout if at all possible. That payout option will let you stretch the distributions from the inherited IRA over your lifetime. You can find the rules about distributions in IRS Publication 590 at this Web site.

If the original IRA owner was required to take a distribution in the year of death and didn't, then the beneficiary must take it, said Sean Cook, a partner at Harvest Advisers.

8. No 60-day rollover

Now, it's likely you've heard about 60-day rollover rule for IRAs. With this rule, you can take a distribution from your IRA and so long as you put the money back in the account within 60 days you won't have to pay a tax or penalty. Some use this rule as a way to fund expenses in anticipation of getting cash within two months. Unfortunately, you can't do this with inherited IRAs. "There is no 60-day rollover rule for inherited IRAs," Picker said. "If you withdraw the money, it's taxed."

9. Do nothing

In some cases, you might want to "disclaim" the IRA you've been assigned to inherit, said Steiner, the attorney with Kleinberg, Kaplan, Wolff & Cohen. When would that be the case? According to Steiner you would disclaim for these reasons: "To keep the inheritance out of your estate for estate tax purposes. Depending on state law, to keep the inheritance from being subject to your creditors. To save income taxes if the contingent beneficiary is in a lower income tax bracket. To get the IRA to the deceased IRA owner's spouse (perhaps as the contingent beneficiary) so he or she can roll it over, name new beneficiaries, get a longer stretchout, and possibly convert to a Roth; and so it will qualify for the marital deduction."

10. Trust no one except a qualified professional

According to Picker, when it comes to inherited IRAs, there's a very, very good chance that the information you're getting from the IRA custodian is incorrect. Not surprisingly, and perhaps rightfully so, he recommends getting outside help from a qualified professional.

Robert Powell is the editor of Retirement Weekly. [Learn more about Retirement Weekly here](#) .