

Learning the Hard Way About Re-Investing Inherited IRAs

By Ed Slott June 7, 2012 financial-planning.com

Question 1: I recently took out all of my IRAs in order to put them into annuities. I am no longer willing to risk the stock market. The company sent me checks for the IRAs made payable to me and I deposited them in my personal checking account. A week later my insurance agent told me that the inherited IRA was a fully taxable distribution and not eligible for a rollover like my other IRAs. Now I'm facing a \$25,000 tax bill for the inherited IRA and the company won't do anything to help. Do you have any solutions?

Rick R.

Answer: *Unfortunately, no. Once a non-spouse beneficiary receives a death distribution (checks made payable to you), the funds can't be redeposited (rolled over) into an IRA and the distribution is fully taxable. The funds should have been transferred to an inherited IRA and then invested in annuities (i.e., the check made payable to an inherited IRA elsewhere).*

Question 2: I inherited an IRA from my father and have been taking the required minimum distributions (RMDs) for several years. In addition, as he had a large estate that owed estate tax, I have been recognizing a deduction for income in respect of a decedent (IRD) associated with the distributions I have received.

My wife has been named as the beneficiary of my father's IRA if I were to pass away. My questions are: will the remaining balance of the deduction in respect of a decedent, the amount that hasn't been used in prior years, follow the IRA? Or is it like a capital loss carry forward which must be used by the surviving spouse in the year of the other spouse's death? Or is it simply lost?

Answer: *The IRD deduction will "follow the IRA." Your successor beneficiary will be able to continue to use the IRD deduction. In addition, if there is an estate tax at your death, the successor beneficiary will be able to use the IRD deduction from your estate as well.*

Question 3: If a person just rolled an old 401(k) into a traditional IRA, do they have to wait a certain amount of time before they can roll the Traditional IRA into another Traditional IRA?

Answer: *No. They can immediately roll over (or transfer) the funds to another Traditional IRA. The once-per-year rule for rollovers applies to IRA to IRA or Roth to Roth rollovers. It does not apply when funds are rolled from a plan to an IRA. Note: Transfers (where you don't have use of the money) between IRAs are usually preferred because they avoid the rollover rules such as the 60-day rule and the one-rollover-per-year rule.*

Question 4: I inherited a \$350,000 rollover IRA from my husband, who had already been taking RMDs. I also have an IRA in my name with the same custodian. Should I roll over my husband's IRA to my own?

My husband also had another Traditional IRA with a different custodian. What is the advantage of assuming vs. inheriting the second IRA?

Is there any disadvantage with having a large IRA in regards to tax? Thank you.

Answer: *If you roll over or assume your deceased husband's IRA as your own IRA, the required minimum distributions (RMDs) will be much less than if you leave the funds as an inherited IRA. After*

making it your own, you have all the rights of an IRA owner, such as naming beneficiaries and taking lifetime RMDs.

One disadvantage of making it your own IRA is that creditor protection might be less, based on state law.

If you remain as a beneficiary, then you will have to calculate RMDs based on your age using the Single Life Table. This will mean larger RMDs each year – accelerating the depletion of the account and the amount of income tax that must be paid each year. You should name a beneficiary, if the IRA custodian allows. This beneficiary will be a successor beneficiary and at death will “succeed” to your benefit and continue taking distributions over your life expectancy. Again, this will accelerate distributions and taxation.

The rules for a spouse inheriting are different if the spouse is under age 70 ½. You can find more information in IRS Publication 590 which is available on their website, www.irs.gov. On the left hand side of the screen, click on “Forms and Publications.”

The question of consolidating accounts is one that should be made based on the spouse’s overall financial and estate plans. She should consult with a qualified advisor before making those decisions. You can find a listing of Ed Slott trained advisors on our website, www.irahelp.com.