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Inherited IRA's: What You Should Know

By Financial Media Exchange

The rules pertaining to Individual Retirement Account (IRA) beneficiaries are complicated. Here is a quick look at the limitations the Internal Revenue Service (IRS) places on the beneficiaries of IRAs.

The biggest difference in the rules pertaining to IRA beneficiaries revolves around two separate issues: 1) when the IRA owner dies; and 2) who is the IRA beneficiary. If the IRA owner dies after required minimum distributions (RMDs) begin, the IRS rules are generally clear. Distributions must be made to the IRA beneficiary at least as rapidly as the distributions would have been made at the time of the IRA owner's death, unless a spouse is the designated beneficiary and chooses to treat the IRA as his or her own.

If the IRA owner dies before the RMDs begin, the rules are a bit more complex. If an IRA owner fails to designate a beneficiary, the IRA proceeds must be distributed to the IRA owner's estate within five years. If the IRA owner designates his or her spouse as the beneficiary, the spousal beneficiary has several options.

Surviving Spouse as Beneficiary

The spousal beneficiary can either maintain the IRA under the deceased spouse's name, or roll over the proceeds into his or her own IRA. If the spousal beneficiary maintains the IRA in the deceased spouse's name, minimum distributions do not have to begin until December 31st of the year after the

decedent would have reached age 70½. Distribution amounts would be based on the life expectancy of the spousal beneficiary alone or, if the spouse is more than ten years younger, based on the joint life and last survivor expectancy. If the spousal beneficiary opts to roll over the IRA proceeds into his or her own IRA, he or she can then select a beneficiary of his or her own choice.

Nonspouse as Original Beneficiary

If the original IRA owner had selected a nonspousal beneficiary, withdrawals would be based on the life expectancy of the beneficiary and must commence by December 31st of the year after the decedent's death. If the decedent had begun taking distributions

prior to the mandatory starting date, future distributions from the IRA would be calculated using the nonspousal beneficiary's life expectancy, as well. The nonspousal beneficiary may not roll over the IRA into his or her own IRA, or name additional beneficiaries.

Recent Legislative Changes

Recent legislative changes raised life expectancy figures, which lengthened distribution periods and, thereby, essentially lowered minimum distribution requirements for all IRA holders, including beneficiaries. The changes also provide greater flexibility for an IRA holder to change beneficiaries. Account holders who have begun receiving payouts may postpone the designation of one or more beneficiaries or change beneficiaries.

This change will be welcomed, for example, by couples who want to ensure that IRA assets are available to surviving spouses, who, if financially secure, could then disclaim the amounts and pass them on to children or grandchildren.

A Final Thought

The wide array of complexity can easily lead to confusion for an IRA beneficiary. Therefore, if you are an IRA owner or have been named an IRA beneficiary, it's important that you become aware of the various rules and tax consequences of IRA beneficiary arrangements.



for calculating distributions that generally allows the smallest distribution possible under the original rules. If your only other beneficiary is your spouse, and he or she is more than ten years younger than you, a second table (joint life and last survivor expectancy) is available that calculates the distribution period based on your actual joint life expectancy, thus resulting in an even lower minimum distribution.

To calculate your minimum distribution, you need to divide the total balance of your IRA assets as of the end of the preceding year by the divisor published by the IRS in the appropriate table based on your current age. Be aware that you must consider the values of all your IRA accounts in determining your minimum distribution amount, although taking a distribution from each account is not required. Rather, once the minimum distribution is calculated, you may withdraw it from any of your accounts in any combination you choose.

Furthermore, primary beneficiaries may refuse or "disclaim" the account, allowing it to pass to a contingent beneficiary, who can then receive distributions based on his or her life expectancy. The lower tax liability on the smaller distributions and the continuation of tax-deferred growth also pass on to the named contingent beneficiary.

Calculating RMD's

The original rules involved elaborate calculations and restrictive elections using multiple tables to determine the RMD each year. Current rules greatly simplify this process by establishing one uniform table, generally referred to as the Minimum Distribution Incidental Benefit (MDIB) table,

There are no penalties for taking a distribution greater than the minimum required in any particular year, though doing so will not directly reduce the amount you must take the following year. However, your minimum distributions in future years will be affected indirectly because the total balance in your IRA accounts will be less than it otherwise would have been.

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