IRAs - The Basics: If You Inherit One

by vcmorris - Thursday, December 10, 2009

http://thethinpinkline.com/2009/12/10/ira-postscript-if-you-inherit-one/

The idea of estate planning is taking on more importance because multiple generations are more openly discussing money issues and realizing/acknowledging that since money flows up and down generations, *how* it flows between generations should always be a consideration (and is the reason I so strongly suggest finding a good estate planning attorney sooner than later).

This made me think about my 11/19/2009 post "IRAs - The Basics" (http://thethinpinkline.com/2009/11/19/iras-the-basics/) which talked about traditional and Roth Individual Retirement Accounts. I thought I should add a basic postscript about what you need to know if you inherit someone's IRA.

Inheriting an IRA is more involved than inheriting a savings account or a valuable piece of jewelry or an expensive painting. If someone leaves you their IRA, the decisions you have to make regarding what you're going to do with it can be tricky and they can be taxing - as in having an impact on your tax bill.

There are several options.

You can choose the "cash out" option and get the money in one lump sum but since you will owe taxes on it *all at once* - most financial advisors would say the "cash out" option is rarely the right choice.

If you inherit an IRA from someone *other than* your spouse, you have two options:

- Starting December 31st of the year following the death of the original IRA owner, you can establish a beneficiary IRA and take annual distributions based on *your* life expectancy as calculated by the Internal Revenue Service *and* have the option to take a lump sum payout at any time.
- Or, you can opt to take no distribution and cash out the IRA completely by December 31st of the fifth year following the original owner's death but you *cannot* continue making contributions.

If you inherit an IRA from your spouse, things are much simpler:

- You can claim the IRA as yours by just rolling it over into a new IRA in your name.
- Or, you can merge it with an existing IRA of your own
- Unlike *non-spouse beneficiaries*, you can keep contributing to it.

As you make your decision on which option is right for you, a couple of positive consequences you need to remember. The longer you stretch your distributions over time, the longer you have to deal with any tax bill payments. And, the more money you leave in a traditional IRA, the longer the funds have to grow tax-deferred which affords you the benefit of the magic of compounding.

It's your money so take it personally!

Here's to your health and wealth.
