

10 Things Everyone Should Know When a Spouse Inherits an IRA



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Statistics may be hard to find but it's likely that a large percentage of IRA owners could name their spouse as their IRA beneficiary. As a result, some advisors see spouses inheriting IRAs on a regular basis. A wrong move could be costly for you. Here are ten things everyone should know when a spouse inherits an IRA

1. How to ensure all options for a Spouse Beneficiary

Spouses may have options not available to other beneficiaries. One of the first critical steps for ensuring those options is for the spouse to be named as the beneficiary on the IRA's beneficiary designation form. If an IRA owner names his estate as the beneficiary of his IRA and his spouse receives the IRA funds under his will, the estate and not the spouse would be the beneficiary of the IRA. This would mean the spouse would not have the special options available only for spouse beneficiaries.

There have been many private letter rulings (PLRs) over the years where a trust or an estate was named as the IRA beneficiary and surviving spouses have gone to the IRS to request the ability to do a spousal rollover. While the IRS has allowed such requests when the spouse has complete control over the trust or estate and its distributions, relief comes at a high price. All of this can be avoided if the spouse is simply named on the beneficiary designation form.

To have all the options available, the spouse must also be the sole beneficiary. What does sole beneficiary mean? Many married couples will name each other as their sole beneficiary on their respective IRA beneficiary designation forms. In those cases, the sole spouse requirement is already met. Sometimes, however, a spouse will be named as one of several beneficiaries.

If the right moves are taken after death, even if a spouse has been named along with others as a beneficiary, the spouse can be treated as a sole spouse beneficiary. The other beneficiaries must either cash out their shares or the IRA must be timely split into separate accounts. The deadline to timely cash out is September 30 of the year after the year of death of the account owner. The deadline for separate accounting is December 31 of the year after the year of death.

2. Strategies to Consider

What are the special options available to a spouse beneficiary? Well, there are two strategies for you and your financial advisor to carefully consider. A spouse beneficiary can keep the IRA as an inherited IRA or do a spousal rollover.



Many clients can benefit from a spousal rollover. . . but not all. Some could be better off sticking with a beneficiary IRA, at least for a while. Don't jump the gun with a spousal rollover until you are sure that is the appropriate option for you. This decision can make a big difference in determining when required minimum distributions (RMDs) begin, and whether the 10% early distribution penalty applies.

3. Spousal Rollover

A spousal rollover is when the surviving spouse moves a deceased spouse's retirement account into their own IRA. The term "spousal rollover" is a little misleading. A spousal rollover can be done by a 60-day rollover, a transfer, or by the surviving spouse electing to treat the IRA as their own.

After a spousal rollover, the funds in the surviving spouse's IRA are treated as though they were always in the surviving spouse's IRA. In other words, the spouse is no longer treated as a beneficiary.

For many spouse beneficiaries, the spousal rollover can be a good strategy. It can allow the inherited IRAs to be consolidated with other IRAs that the spouse beneficiary may have. For many, it can result in smaller RMDs. This is because RMDs from an inherited IRA are calculated based on a single life expectancy while RMDs from the spouse's own IRA are calculated using a joint life expectancy. For some, the spousal rollover can even allow RMDs to be delayed for years.

Example: Doug, age 65, inherited an IRA from his wife Debbie who was age 75 when she died. If Doug does a spousal rollover of the inherited IRA, he can delay RMDs until the year he turns age 70½.

4. Watch out for a Default Spousal Rollover

You might think of a spousal rollover as a strategy that is affirmatively elected by the surviving spouse. In many cases this may be true. However, sometimes the IRA can become the surviving spouse's own IRA by default. One common way this could occur is if a surviving spouse fails to take an RMD from an inherited IRA. When this happens, the inherited IRA becomes the spouse's own IRA by default. Another less common way this can happen is if the spouse makes a contribution to the inherited IRA.



5. When Can an Inherited IRA Makes Sense

For some clients keeping the funds in an inherited IRA can be a good planning strategy. Why? Well, distributions from inherited IRAs are never subject to the 10% early distribution penalty. If the spouse beneficiary is under age 59½ and wants to access the IRA funds, staying with an inherited IRA can make that possible. If on the other hand, a younger spouse beneficiary does a spousal rollover, the account is no longer an inherited IRA and distributions will be subject to the 10% early distribution penalty.

Example: Larry, age 52, inherited an IRA from his wife, Louisa. Louisa died at age 50. If Larry keeps the inherited IRA, he can take penalty-free distributions (would still owe income tax). If Larry does a spousal rollover, the withdrawals from his IRA will be early distributions subject to the 10% penalty (in addition to income taxes).

6. Special Rules for Spousal Beneficiaries of Inherited IRAs

When a surviving spouse chooses to keep an inherited IRA, they are not likely subject to RMDs until the later of December 31 of the year following the year of death or December 31 of the year their deceased spouse would have been 70½. This allows the spouse beneficiary of an IRA owner who died at a young age to potentially delay RMDs for decades. This can be a good planning strategy because while no RMDs are required, if the spouse needs the money, they can take distributions from the inherited IRA without the early distribution penalty applying.

Example: Ben died at age 30. His wife, Allie, age 28, is his beneficiary. If Allie keeps the funds in an inherited IRA she will not need to take RMDs for forty years. That would be the year that Ben would have been age 70½. Allie can take distributions at any time without the 10% early distribution penalty applying. If Allie does a spousal rollover, she will be subject to the 10% penalty on any distribution she takes from her IRA.

Spouse beneficiaries also can have the advantage of being able to recalculate their life expectancy. This means that spouse beneficiaries should look at the Single Life Expectancy Table each year to determine their factor. Non-spouse beneficiaries are never allowed to recalculate their life expectancy. This may seem like an obscure rule but it generally results in smaller RMDs for spouse beneficiaries.



7. Spousal Rollovers Are Irrevocable

There is no going back with a spousal rollover. This is an irrevocable decision. Once the inherited funds have been rolled or transferred into a surviving spouse's own IRA by affirmative action or even by default, there is no magic "undo" button that can be pressed. The IRS can't help because it has no authority to undo this transaction.

8. Never Too Late for a Spousal Rollover

On the other hand, the decision to stick with an inherited IRA is NOT irrevocable. A spouse beneficiary can elect a spousal rollover at any time. There is no deadline. It may make sense for some clients to keep the IRA as an inherited IRA for a very long time and then years later do a spousal rollover. A client may want to keep the funds in an inherited IRA when they are under age 59½ and then do a spousal rollover when the early distribution penalty is no longer an issue. A spouse beneficiary through oversight or bad advice may have simply kept an inherited IRA. Even years later it is not too late to do a spousal rollover.

Example: Five years ago, Jane, age 60, inherited her husband Jason's IRA. Jason died at age 72. Jane has been taking RMDs from the inherited IRA for five years. She can still do a spousal rollover at any time. By doing so, she can delay RMDs on the funds until she reaches the year she turns age 70½.

9. Titling Matters

The titling on the account is important. Usually when the IRA custodian is informed of the death of the IRA owner, the custodian will change the titling on the IRA. The account will be retitled as a beneficiary IRA. For example, the account would be titled "Martin Malloy (deceased 3/12/2016) IRA FBO Mary Malloy."

If Mary as the sole spouse beneficiary decides to do a spousal rollover, the IRA will be titled in her name alone. The account will no longer be a beneficiary IRA. This may seem like a minor detail but the titling will be used on all the required reporting to the IRS from the custodian and will dictate how IRS will treat the account for tax purposes.



10. Titling Matters

If a spouse inherits an IRA from a spouse who died after their required beginning date (April 1 of the year following the year they reach age 70½), the inheriting spouse must take the RMD for the year of death if their deceased spouse had not already taken it. The RMD can be taken from the inherited IRA, or if the spouse beneficiary elects to do a spousal rollover by transferring the funds, the RMD can be taken from the spouse's own IRA. The IRS does not care as long as it comes out during the year. If the client inherits a Roth IRA or an IRA from a spouse who has not reached their required beginning date, no RMD is required for the year of death.

An RMD can be transferred to another IRA, but it cannot be rolled over in a 60-day rollover. When a surviving spouse receives a check payable to them personally, they must keep the RMD amount and can only roll over the remaining balance of the distribution. A 60-day rollover of the RMD amount results in an excess contribution in the receiving IRA.

This information can be overwhelming but we are here to help and walk you through your unique situation and help make the best decision for you.

Contact our team of professionals today.



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