WELLS FARGO Advisors

What to know when you inherit an IRA

When you inherit an IRA you will have many planning and distribution considerations. Your options will depend on if the IRA holder died before 2020 or after 2019. Some of your decisions will be based on your current needs, but your ultimate goal may be to maximize the value of the assets you received. We have prepared this information, based on the understanding of the current legislation, to help you be informed so that you can avoid common mistakes and make the most of this opportunity.

Tax considerations

Managing the amount you will pay in taxes is a key consideration when you inherit a Traditional IRA. When you inherit a Roth IRA, you need to understand if you will owe taxes when taking distributions.

No matter your age, you will avoid the IRS 10% additional tax for early or pre-59½ distributions (10% additional tax) on taxable amounts taken from the IRA you inherited. If you don't have an immediate need for the assets, it makes sense to have a plan to minimize distributions of the inherited assets so that you can preserve their tax-advantaged features.

Distributions from Inherited Roth IRAs

Whether you will take a lump-sum distribution, disclaim, or open an Inherited IRA, you first should understand the two types of Roth IRA distributions: ***qualified*** and ***non-qualified***.

- **Qualified distributions** from an Inherited Roth IRA are tax-free. Distributions are qualified if the Roth has been open for more than five years.
- **Non-qualified distributions** from Inherited Roth IRAs may be subject to tax, but not the 10% additional tax. When the Roth IRA owner died before the account had been funded for more than five years, distributions are ***non-qualified***. The five-year clock will continue in the Inherited IRA and until that fifth year has been reached, the Roth ordering rules for distribution are followed. As long as your distributions are equal to or less than the total amount the IRA owner contributed and/or converted, you have no taxes due. Any earnings distributed before the account has been open for more than five years will be taxable.

Distributions from Inherited Traditional IRA

Income tax will apply to taxable amounts when distributions are taken from an Inherited Traditional IRA. Larger dollar amounts can quickly put you into a higher tax bracket, whereas taking smaller distributions over time can help avoid a significant tax bill.

Three categories of beneficiaries

Your beneficiary category will determine your options for distributing the money.

Below are the three categories of beneficiaries.

Non-Designated Beneficiary (NDB)	Designated Beneficiary (DB)	Eligible Designated Beneficiary (EDB)
• Estate • Non-qualified trust • Charity	• Non-spouse individuals more than 10 years younger than IRA owner • Non-spouse individuals who are not disabled or chronically ill • Primary beneficiary of qualified "look-through" trust who is **not** the surviving spouse, or disabled or chronically ill individual • Child of the IRA owner who has exceeded age 21	• Surviving spouses • Disabled or chronically ill individuals • Individuals not more than 10 years younger, the same age as, or older than IRA owner • Primary beneficiary of qualified "look-through" trust who is the surviving spouse, or disabled or chronically ill individual • Child of the IRA owner who has not reached age 21

Understanding your options

You have a few decisions to make if you have been named as the beneficiary of an IRA. It is important to understand each option because certain distribution methods preserve the account's tax-advantaged status while others do not. Keep in mind that after a distribution is taken from IRA assets you inherit, unless you are the spouse, you are not able to put it back.

Beneficiary distribution options when an IRA holder dies after 2019

The following tables summarize the options you have, in an Inherited IRA, depending on if the IRA owner died before or on or after their required beginning date (RBD), generally April 1 following the year they turn RMD age. RMD age is generally the year the IRA owner turned age 73 (if born after 1950), 72 (if born after 6/30/1949), or 70 ½ (born before 7/1/1949).
Please note: If an IRA owner died before 2020, a non-spouse or qualified trust beneficiary has most of the options as an EDB. The 10-year rule only applies to beneficiaries when the IRA owner dies after 2019.

Beneficiary category — Individual	Life expectancy	10-year rule	10-year rule with RMDs [1]
Designated beneficiary:			
Non-spouse more than 10 years younger than IRA owner, not chronically ill, or disabled, or minor not IRA owner's child			
- original IRA owner dies **before** RBD		X	
- original IRA owner dies **on or after** RBD			X
Eligible designated beneficiary:			
Spouse			
- original IRA owner dies **before** RBD	X	X	
- original IRA owner dies **on or after** RBD	X		X
Disabled or chronically ill individuals			
- original IRA owner dies **before** RBD	X	X	
- original IRA owner dies **on or after** RBD	X		X
Individuals not more than 10 years younger, the same age as, or older than IRA owner			
- original IRA owner dies **before** RBD	X	X	
- original IRA owner dies **on or after** RBD	X		X
Child of the IRA owner who has not reached age of 21. Then they are subject to the 10-Year Rule. The account balance must distributed by 12/31 of the 10th year after reaching age 21 (age 31).			
- original IRA owner dies **before** RBD	X	X	
- original IRA owner dies **on or after** RBD	X		X

Beneficiary category - Entity	Life expectancy	5-year rule	10-year rule	10-year rule with RMDs [1]
Non-Designated beneficiary:				
Non-Qualified Trust or Estate or Charity				
- original IRA owner dies **before** RBD		X		
- original IRA owner dies **on or after** RBD	X[2]			
Designated beneficiary:				
Primary beneficiary of qualified trust[3] is a DB				
- original IRA owner dies **before** RBD			X	
- original IRA owner dies **on or after** RBD				X
Eligible Designated beneficiary:				
Primary beneficiary of qualified trust[3] is an EDB				
- original IRA owner dies **before** RBD	X		X	
- original IRA owner dies **on or after** RBD	X			X

[1] These regulations are proposed, IRS notice 2022-53 states RMDs and related provisions will apply no earlier than the 2023 distribution calendar year. Review the full IRS proposal via the Federal Register to learn more. Please consult your tax professional for further guidance.
[2] RMDs based on owner's age in year of death, divisor reduced by one each subsequent year.
[3] The type of qualified trust (e.g. conduit or accumulation) and who the original trust beneficiary is makes a difference in how long the Inherited IRA for the trust can remain open. It also depends on if the trust that inherited the IRA has one or more than one beneficiary. Please note WFA does not interpret the trust and the trustee should seek competent advice to determine their exact distribution options based on their situation.

Designated beneficiary

Under the SECURE Act, these beneficiaries will now be subject to the 10-Year Rule.

<u>10-Year Rule</u> — This option is available for Inherited Roth and Inherited Traditional IRAs. The Inherited IRA must be emptied by the 10th year following the year of the IRA owner's death. If the IRA owner died on or after their RBD, under the proposed IRS regulations[1] the DB must take required minimum distributions (RMDs) based on their life expectancy during the 10-year period. If the IRA owner died before their RBD or the IRA is a Roth then no distributions are required before the 10th year. Depending on the size of the account, you may want to spread distributions over the 10-year period.

Eligible designated beneficiary

This category has the most favorable distribution options. Beneficiaries can take distributions from their Inherited IRA based on their own life expectancies. The life expectancy option is often referred to as the stretch IRA strategy.[4]

- Minor children of the IRA owner can take RMDs based on their life expectancy until they reach age 21. Then they are subject to the 10-Year Rule. If the IRA owner died on or after their RBD, under the proposed regulations[1] RMDs would be required during the 10-year period.

Inherited IRA distribution options when an IRA owner died before 2020 and for EDB:

- **Life expectancy:** This option is available for Inherited Roth and Inherited Traditional IRAs. The Wells Fargo Clearing Services, (WFCS) LLC IRA Disclosure Statement and Custodial Agreement default is the Life Expectancy option. You may be subject to an IRS 25% excise tax for every dollar under-distributed. This tax can be reduced to 10% if corrected within two years from the date the tax is imposed.
- **Non-spouse beneficiary:** You will take annual RMDs but you can always take more than that amount. RMDs are based on your life expectancy using a divisor from the IRS Single Life Table and the prior year-end IRA value, on a term-certain basis. Qualified trusts use the age of the oldest trust beneficiary. Term-certain means that one is subtracted from the original divisor in each subsequent year. These RMDs will begin the year following the death of the IRA owner.

Non-spouse RMD Formula

$$\frac{\text{Prior Year-End Value}}{\left(\text{Single Life Table divisor for attained age in year following IRA owner's year of death} - \text{1 for each subsequent year}\right)} = \text{RMD}$$

- **Spouse beneficiary:** Establishing an Inherited IRA when you are under age 59½ allows you to avoid the 10% additional tax on pre-59½ distributions (10% additional tax) that you might have if the assets were taken from your own IRA. You always have the ability to transfer the Inherited IRA to your own IRA, even if you have been taking distributions. RMDs from this Inherited IRA will start:
  - The year your deceased spouse would have reached RMD age, or
  - The year following your spouse's death, if your spouse died on or after their RBD.

Annual RMD calculations are based on your life expectancy using a divisor from the IRS Single Life Table, the prior year-end IRA value, and utilizes the recalculation method. The recalculation method uses a new divisor from the table each year.

Spouse RMD Formula

$$\frac{\text{Prior Year-End Value}}{\text{Single Life Table divisor}} = \text{RMD}$$

Please note that the stretch IRA strategy is designed for investors who will not need the money in the account for their own retirement. There is no guarantee that there will be assets remaining in the account at the time of the IRA owner's death.[5]

Rollover/Transfer to own IRA — Only a spouse can roll over or transfer the funds into an IRA in his/her own name. An IRA keeps the funds in a tax-advantaged account and defers income taxes, if due, until distributions are taken.

[4] Stretching an IRA simply refers to the ability to take RMDs over the beneficiary's single life expectancy (using the term-certain calculation method) rather than over the life expectancy of the original IRA owner.
[5] When deciding whether to initiate a stretch IRA strategy, an investor should consider such factors as possible changes to tax laws, the impact of inflation, and other risks. Please note that designating a beneficiary two or more generations below the IRA owner may result in additional taxes when the distribution is made (exemptions may apply). Please consult with your tax advisor for more information.

IRA distribution rules will apply based on the surviving spouse's age — meaning no RMDs from their Traditional IRA until he/she reaches RMD age and no RMDs from their Roth IRA. However, it may make sense for your surviving spouse to open an Inherited IRA because distributions taken from their own IRA, prior to age 59½ , may incur the 10% additional tax.

Non-designated beneficiary

This category includes estates, charities, and non-qualified trusts. If the owner died on or after their RBD, RMDs are based on the IRA owner's age in year of death, divisor reduced by one each subsequent year. If the owner died before their RBD the 5-year rule is followed.

5-Year Rule — Empty the Inherited IRA by December 31 of the year containing the fifth anniversary of the owner's death.

Other options

These distributions choices are available to most beneficiaries.

- **Disclaim:** If you do not need or want the asset, you can disclaim, or refuse, all or a portion of the assets generally, within nine months after the IRA owner's death. The person who disclaims is considered to have predeceased the IRA owner and cannot dictate who will inherit the assets. If the per stirpes option has been selected then the disclaimed assets will go to that beneficiary's lineal descendants, generally children. If not, then the IRA passes to any other named primary beneficiaries or, if none, then to the named contingent beneficiary(ies). The IRA default beneficiaries may be used if there are no valid beneficiaries on file. Estates or trusts may be able to disclaim; please seek advice from your legal professional.

The beneficiary defaults on a WFCS IRA are:

– First, a surviving spouse
– Second, surviving children (as defined under state law)
– Third, the IRA holder's estate

- **Lump-sum:** This strategy will exhaust the entire account in one distribution, with retirement assets losing their tax-advantaged status. Taxes will be due on the taxable portion of the distribution in the year received and may place you in a higher tax bracket. Once a non-spouse beneficiary chooses to take a lump-sum distribution, it cannot be undone because contributions including 60-day IRA-to-IRA rollover contributions are not allowed in Inherited IRAs. In this situation, a spouse beneficiary would have 60 days to roll over the inherited assets into his or her own IRA, if they meet the roll over requirements.

Beneficiary Category - Successor	10-year rule	10-year rule with RMDs [1]	Remaining years of 10 year rule	Remaining years of 10 year rule with RMDs [1,6]
Original Beneficiary - EDB				
- original IRA owner dies **before** RBD	X			
- original IRA owner dies **on or after** RBD		X		
Original Beneficiary - DB				
- original IRA owner dies **before** RBD			X	
- original IRA owner dies **on or after** RBD				X

[6] RMDs based on original beneficiary's age and date of death of the original IRA owner.

Successor beneficiary of an EDB: If you inherit an Inherited IRA from an EDB, you are a "successor" beneficiary and will have an Inherited/Inherited IRA. It is important to note that the Internal Revenue Code (IRC) does not let you start over and stretch inherited assets out over your own lifetime. Instead, you will use the 10-Year Rule. If the owner died on or after their RBD, under the proposed IRS regulations[1] you must take RMDs based on the EDB's life expectancy using a divisor from the IRS Single Life Table and the prior year-end IRA value, on a term-certain basis during the 10 year period. If the owner died before their RBD or the IRA is a Roth then no distributions are required before the 10th year.

Successor beneficiary of an DB: If you inherit an Inherited IRA from a DB, you are a "successor" beneficiary and will have an Inherited/Inherited IRA. If the DB dies before the end of the 10th year and the account is still funded, you will have the remaining years of the DB's 10-Year Rule to empty the Inherited IRA. If the owner died on or after their RBD, under the proposed IRS regulations[1] you must take RMDs based on the DB's life expectancy using a divisor from the IRS Single Life Table and the prior year-end IRA value, on a term-certain basis during the remaining years of the 10-year period. If the remaining single-life expectancy is less than the remaining years of the 10-year period, the account may be emptied sooner. If the owner died before their RBD or the IRA is a Roth then no distributions are required before the last year of the remaining years of the DB's 10-Year time frame.

Review your choices

Wells Fargo Advisors understands your desire to maximize the benefits you can receive from your IRA inheritance. Please investigate all the options you have in regard to these assets with your tax and legal advisors before enacting a strategy. We look forward to helping you and your family with your financial goals and objectives.

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