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MontGuide

Inheriting an IRA: Planning Techniques for Successor Beneficiaries

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When the owner of an IRA dies, the IRA account passes to his/her primary beneficiaries. When one or more of the primary beneficiaries dies, certain rules govern how successor beneficiaries inherit the IRA balance.

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INDIVIDUAL RETIREMENT ACCOUNTS (IRAS) are tax-advantaged savings plans available to people who meet certain eligibility requirements. IRA contributions are placed in custodial accounts at financial institutions, insurance companies, mutual funds or investment brokerage firms.

IRA owners who withdraw money from their traditional IRAs during a tax year should consider the tax implications. Different tax consequences apply depending upon the IRA owner's age—under 59½, between ages 59½ and 70½, or over 70½. Other regulations govern the taxation of withdrawals made after an owner's death and if an IRA beneficiary dies before receiving the balance in the account.

This MontGuide focuses on the rules about withdrawals by successor beneficiaries after a primary IRA beneficiary dies. The MontGuide incorporates regulations generally effective Jan. 1, 2003, as a result of the Economic Growth and Tax Relief Reconciliation Act of 2001. Three other Montguides discuss withdrawals from IRAs:

1. Withdrawals from IRAs when the owner is under age 59½ (MT200308 HR).
2. Withdrawals from IRAs when the owner is between 59½ and 70½; and when owner turns 70½ (MT200309 HR).
3. Inheriting an IRA: Planning techniques for primary beneficiaries (MT200310 HR).

Successor beneficiaries

Owners of IRAs should specify clearly who they want to receive the remaining IRA balance if they die. If a primary beneficiary dies before the account has been completely distributed, and if an IRA owner does not specify a successor beneficiary, the terms of the IRA contract will determine who becomes the successor beneficiary.

The terminology for designating successor beneficiaries varies from financial institution to financial institution. Some IRA contracts specify that the remaining balance is payable to the IRA owner's "heirs at law." Other IRA contracts specify that the remaining balance is payable to the primary beneficiary's estate. Still other IRA contracts (or the IRA owner, with properly drafted language) may grant the primary beneficiary the right to determine the successor beneficiary.

Qualifying successor beneficiaries

Examples of language specifying one or more successor beneficiaries that will qualify as a "designated beneficiary" are provided below:

Example: Dan has decided to name his three children as primary beneficiaries of his IRA. If any one of his children does not survive him, he wants his deceased child's descendants to receive the deceased child's share of the IRA. To accomplish this, Dan would use the following language:

Primary beneficiary: My three children, Jack Jones, Jill Smith and Deb Potter, in equal shares.

Successor beneficiary: If any of my three children should predecease me, or if any of my three children should die before receiving his/her share of this IRA in full, the deceased child's share shall be distributed to the deceased child's descendants, by right of representation.

The description of a class as "deceased child's descendants," is an acceptable designation because the youngest member of the class can be identified. "By right of representation" is a legal term that passes a deceased child's share to the deceased child's descendants.

Example: Joan has decided to name her husband, Steve, as primary beneficiary of her IRA. If Steve should predecease her, or if he should die before receiving the IRA in full, Joan wants their children to be the successor beneficiaries and receive the balance in the IRA in equal shares. If a child should die before Joan or before receiving his/her share in full, Joan wants their deceased child's children, if any, to receive the deceased child's share. To accomplish this, Joan would use the following language:

Primary beneficiary: My husband, Steve Young.

Secondary beneficiary: In equal shares to our two children, Jennifer Anderson and Richard Young, and if either of them should die before receiving his/her share of this IRA in full, the deceased child's share shall be distributed to the deceased child's descendants, by right of representation.

If Steve, the primary beneficiary, elects to roll over Joan's IRA into his own, and this is accomplished before his subsequent death, the determination of the beneficiaries for Steve's IRA (including the amounts he has rolled over from Joan's IRA to his IRA) will be his decision, not Joan's.

Example: If Steve remarries, he could add his new wife as the beneficiary of his IRA (including any amounts rolled over from Joan's IRA). In this case, Steve and Joan's children would not be entitled to the IRA that was formerly their mother's unless Steve also names them as beneficiaries of his IRA.

If you are uncertain how to word the designation of your beneficiaries to accomplish your intent, seek the advice of an attorney or qualified financial advisor.

Spousal roll-overs

If an IRA owner has designated a spouse as the primary beneficiary, and the surviving spouse rolls the deceased spouse's IRA into his/her own IRA before death, the deceased spouse's age at death is no longer used to calculate the surviving spouse's required minimum distributions (RMD) from his/her own IRA. (RMD are the minimum amounts that an IRA owner must withdraw from his/her IRA account annually.) Instead, the ages of the surviving spouse and his/her designated beneficiaries become the determining factors.

For example, if the surviving spouse is 55, and he/she rolls over the deceased spouse's IRA into his/her own IRA, the surviving spouse is not required to begin RMD until his/her required beginning distribution date (April 1 of the year after the surviving spouse reaches age 70½.)

Once a surviving spouse begins taking RMD, the Uniform Lifetime Table (**Table 1**) is used. The table incorporates the surviving spouse's age and a hypothetical beneficiary 10 years younger than the surviving spouse. If the surviving spouse has remarried a person more than 10 years younger than the surviving spouse, the Joint Life and Last Survivor Table (**Table 2**) in this MontGuide is used.

Upon the death of the surviving spouse, the surviving spouse's IRA (including any amounts rolled over from the first spouse's IRA) will be subject to the rules discussed in this MontGuide, using the surviving spouse's designated beneficiaries.

Table 1: Uniform Lifetime Table

Age	Distribution Period (years)	Age	Distribution Period (years)
70	27.4	86	14.1
71	26.5	87	13.4
72	25.6	88	12.7
73	24.7	89	12.0
74	23.8	90	11.4
75	22.9	91	10.8
76	22.0	92	10.2
77	21.2	93	9.6
78	20.3	94	9.1
79	19.5	95	8.6
80	18.7	96	8.1
81	17.9	97	7.6
82	17.1	98	7.1
83	16.3	99	6.7
84	15.5	100	6.3
85	14.8	101	5.9

Example: Florence has designated her husband, Harry, as the primary beneficiary of her IRA. If Harry dies before Florence, or before receiving the IRA in full, Florence's church is designated as the successor beneficiary. If Harry survives Florence and rolls over her IRA into his own IRA, upon Harry's death any remaining balance of the IRA will not be distributed to Florence's church. Instead, the remaining balance will be distributed to the beneficiary designated by Harry in his IRA contract.

Table 2: Joint Life and Last Survivor Table*

Owner's Age	Beneficiary's Age									
	65	66	67	68	69	70	71	72	73	74
70	24.3	23.7	23.2	22.7	22.2	21.8	21.3	20.9	20.6	20.2
71	23.9	23.4	22.8	22.3	21.8	21.3	20.9	20.5	20.1	19.7
72	23.7	23.1	22.5	22.0	21.4	20.9	20.5	20.0	19.6	19.3
73	23.4	22.8	22.2	21.6	21.1	20.6	20.1	19.6	19.2	18.8
74	23.1	22.5	21.9	21.3	20.8	20.2	19.7	19.3	18.8	18.4
75	22.9	22.3	21.6	21.0	20.5	19.9	19.4	18.9	18.4	18.0
76	22.7	22.0	21.4	20.8	20.2	19.6	19.1	18.6	18.1	17.6
77	22.5	21.8	21.2	20.6	19.9	19.4	18.8	18.3	17.8	17.3
78	22.4	21.7	21.0	20.3	19.7	19.1	18.5	18.0	17.5	17.0
79	22.2	21.5	20.8	20.1	19.5	18.9	18.3	17.7	17.2	16.7
80	22.1	21.3	20.6	20.0	19.3	18.7	18.1	17.5	16.9	16.4

***Complete tables for owners ages 35 to 115 and beneficiaries' ages can be found in IRS publication 590 "Individual Retirement Arrangements." For ages under 35, see IRS Publication 939. Both can be ordered from the IRS at 1-800-829-3676. Or, download from the web at http://www.irs.ustreas.gov.**

Death of primary beneficiary in situations not governed by spousal roll-over rules.

If an IRA owner dies and has designated a beneficiary other than a surviving spouse (or has designated a surviving spouse, but the surviving spouse has not rolled over the deceased spouse's IRA into his/her own IRA), the following rules apply:

If the primary beneficiary dies before the IRA owner's death, the primary beneficiary is disregarded in determining RMD after the IRA owner's death. Instead, the successor beneficiary or beneficiaries are used in determining the amount of RMD payable after the owner's death.

Example: Paul designated his wife as primary beneficiary and his two daughters as successor beneficiaries. Paul's wife dies before he does; Paul subsequently dies after beginning his RMD. Because Paul's wife died before him, she is disregarded in determining what rules apply in calculating the RMD payable after Paul's death. Instead, the life expectancy of the oldest daughter (under the Single Life Table, Table 3 in this MontGuide) will determine the RMD.

If the IRA is divided into separate accounts, one for each daughter, by Sept. 30 of the year following Paul's death, each daughter can use her own life expectancy (Single Life Table, **Table 3**) in determining the RMD payable from her separate account.

If the primary beneficiary survives the IRA owner, but dies before receiving the entire account balance, the primary beneficiary's remaining life expectancy (and not the life expectancy of the successor beneficiary) continues to be used to determine the RMD payable to the successor beneficiary.

Example: Nancy designated her son, Kyle, as the primary beneficiary of her IRA and designated her grandson, Connor, as the successor beneficiary.

Nancy dies in July 2006 at the age of 78. Kyle receives the RMD otherwise payable to Nancy in the year of death, which was determined as if Nancy had not died. For 2007, Kyle receives an RMD, based upon his life expectancy as of his birthday in 2007 (age 50), using the Single Life Expectancy Table (Table 3), which is 34.2. In 2008, the factor is reduced by 1.0 to 33.2, and in 2009, the factor is reduced by 1.0 to 32.2.

Kyle dies in 2010, when his son, Connor, is age 36. Connor does not use his age to redetermine his RMD; he continues to receive RMD based upon the original pay-out term that was determined using the primary beneficiary's (his dad's) life expectancy. In 2010, Connor will receive an RMD based upon 31.2 (the factor established initially for Kyle), which will continue to be reduced by 1.0 for each subsequent year until the account balance has been fully distributed.

Table 3: Single Life Table

(For Use by Beneficiaries)

Age	Life Expectancy	Age	Life Expectancy
35	48.5	75	13.4
36	47.5	76	12.7
37	46.5	77	12.1
38	45.6	78	11.4
39	44.6	79	10.8
40	43.6	80	10.2
41	42.7	81	9.7
42	41.7	82	9.1
43	40.7	83	8.6
44	39.8	84	8.1
45	38.8	85	7.6
46	37.9	86	7.1
47	37.0	87	6.7
48	36.0	88	6.3
49	35.1	89	5.9
50	34.2	90	5.5
51	33.3	91	5.2
52	32.3	92	4.9
53	31.4	93	4.6
54	30.5	94	4.3
55	29.6	95	4.1
56	28.7	96	3.8
57	27.9	97	3.6
58	27.0	98	3.4
59	26.1	99	3.1
60	25.2	100	2.9
61	24.4	101	2.7
62	23.5	102	2.5
63	22.7	103	2.3
64	21.8	104	2.1
65	21.0	105	1.9
66	20.2	106	1.7
67	19.4	107	1.5
68	18.6	108	1.4
69	17.8	109	1.2
70	17.0	110	1.1
71	16.3	111+	1.0
72	15.5		
73	14.8		
74	14.1		

Conclusion

The rules for withdrawing funds from an inherited IRA remain complicated even under the Economic Growth and Tax Relief Reconciliation Act of 2001. Readers who have other types of retirement plans may find that the terms of their plan further restrict the rules discussed in this MontGuide. One option is to roll over their plan into an IRA.

IRA owners and IRS qualified retirement plan participants should seek the assistance of a specialist, such as a Certified Public Accountant (CPA), Certified Financial Planner (CFP®), or an attorney who specializes in taxes to ensure they are following rules established by the Internal Revenue Service.

Further information from MSU Extension

Additional MontGuides on Individual Retirement Accounts are available from the MSU Extension Service.

- Types of IRAs and changes resulting from the Economic Growth and Tax Relief Reconciliation Act of 2001: MT 199807 HR Individual Retirement Accounts.
- Features to consider when Shopping for an IRA: MT 200207 HR.
- Withdrawals from IRAs when the owner is under age 59½: MT 200308 HR.
- Withdrawals from IRAs when the owner is between ages 59½ and 70½, and when owner turns 70½: MT 200309 HR.
- Inheriting an IRA: Planning techniques for primary beneficiaries MT 200310 HR.

All five MontGuides are available free from your local MSU Extension Office. Or, send $1 for handling to: MSU Extension Publications, PO Box 172040, MSU-Bozeman, 59717.

The publications can also be downloaded without charge from the Web under retirement planning at http://www.montana.edu/extensionecon/publications/confinpub.html or under "Family Financial Management" at www.montana.edu/publications

Further information from the Internal Revenue Service

"Individual Retirement Arrangements" (Publication 590) is available from the Internal Revenue Service. For delivery via US Postal Service call 1-800-TAX-FORM (1-800-829-3676).

The publication can be downloaded at: http://www.irs.gov. Under Search Forms and Publications, type 590 and click GO.

Acknowledgment

Representatives from the following have reviewed this MontGuide and recommend its reading by all Montanans.

- Montana Credit Union Network
- Montana Society of Certified Public Accountants

Disclaimer

This publication is based on laws in effect as of April 2006. It is designed to provide educational information on IRAs, not to render legal, accounting or other professional advice. If legal advice or tax assistance is required, seek the services of a competent professional.

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