Financial Planning Topic of the Month

If you have ever inherited an IRA or other tax-deferred retirement account, you may be familiar with the 10-Year RMD rule. If you are a beneficiary but have yet to inherit a tax-deferred retirement account, then it is essential that you familiarize yourself with this rule. Your relationship to the original account owner will impact the distribution rules you are subject to. Spouses who inherit an IRA have more flexibility than non-spouse beneficiaries regarding when withdrawals must be taken.

If you are a spouse beneficiary, You can treat the IRA as your own and designate yourself as the account owner. The spouse can also roll it over into their own pre-existing IRA. If you are a non-spouse beneficiary, all the money from the account must be withdrawn by December 31st of, the 10th year after the original owner's death. Since withdrawals are required, you won't pay the 10% penalty if you're under 59 ½. But you must pay income taxes on the distributions and eventually empty the account.

Some beneficiaries are exempted from the 10-year rule. This exemption includes the following:

- A surviving spouse.
- A disabled or chronically ill person.
- A child who hasn't reached the age of majority.
- A person not more than 10 years younger than the IRA account owner.

It is also important to note that the 10-year rule only applies to accounts inherited after 2019. If a non-spouse beneficiary inherited the account in 2019 or prior, there is more flexibility. The non-spouse beneficiary would be allowed to take withdrawals over their lifetime expectancy instead of depleting the account within 10 years. If the account owner died in 2020 or later, this is when the 10-year rule applies to non-spouse beneficiaries.

We typically recommend taking 1/10th of the account balance every year until you reach that 10-year mark. If you were to deplete the entire account balance in the first year, you would have a large tax bill. By breaking up the tax liability over a 10-year period, you are minimizing the taxes you must pay. If you don't need this withdrawal for income every year, you can even reinvest it into an after-tax account. Even though you are required to deplete the account, you can keep that money invested for your own retirement.

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If you inherit a Roth IRA, it is completely tax-free if the Roth IRA was held for at least five years, starting January 1st of the tax year for which, the first Roth IRA contribution was made. If you receive distributions from the Roth IRA before the end of the five-year holding period, they are tax-free to the extent of the owner's contributions. However, any earnings or interest on the contribution amount is taxable.

Overall, it is important to keep this 10-year RMD rule in mind when planning for retirement if you expect to inherit a tax-deferred retirement account. The SECURE Act requires the entire balance of the participant's inherited IRA account to be distributed within 10 years of the death of the original owner. Waiting until the end of year 10 to withdraw the entire balance could bump you up tax brackets and cause you to pay more than you would have if you depleted the account over 10 years.

10-Year RMD Rule for Inherited IRAs

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