



## Navigating Inherited IRA Rules for Eligible Designated Beneficiaries

Inheriting an IRA sets you on a new financial voyage, one that requires careful navigation. You have a few possible routes to move before tax amounts strategically through the “tax wall”, and the best course depends on your immediate needs and long-term tax strategy.

Some distribution methods help preserve the account’s tax-advantaged status, while others may steer you into unintended consequences. It’s essential to understand your options, because once you take a distribution, you generally can’t roll it over within 60 days.

Inherited IRA rules can shift like tides. This guide is your compass—designed to help you avoid common pitfalls and sail confidently through the rules.

### Is There Tax on the Horizon?

This question often tops the chart for beneficiaries navigating the waters of Inherited IRAs. Your first navigational marker is identifying whether it’s a Traditional or Roth, as this sets your tax course.

Generally, when you inherit a Traditional IRA, you will need to pay ordinary income tax on distributions. Remember, the distribution is added to your other ordinary income and could put you in a higher tax bracket, so plan your voyage accordingly. However, if there are after tax amounts, the pro-rata rule applies, meaning a portion of the distribution won’t be taxable. Chart this correctly by determining if the deceased IRA owner filed IRS Form 8606; if so, the amount of after tax will be logged on that form. While most Traditional IRAs contain only before tax amounts, it is wise to review the owner’s tax return to be certain.

The waters are often calmer with a Roth IRA. Since Roth IRAs are funded with after tax amounts, only the earnings might be taxed. This is a concern if the Roth IRA was opened less than five years ago.

Once you've sailed past the five years mark, the distributions would be considered qualified, and you can cruise ahead tax free.

And here's a bit of good news to steady your course, regardless of your age, you won't incur the IRS 10% additional tax on early or pre-59½ distributions for any taxable amounts distributed from the IRA you inherited. This is because Inherited IRA distributions are coded as "death" on IRS Form 1099-R, and death is an exception to the 10% additional tax.

## **Charting the Five-Year Course for Roth IRAs**

Let's say a Roth IRA was first opened and funded in 2023, then you inherited it in 2025. The five year holding period starts January 1, 2023, and ends December 31, 2027. Once you reach January 1, 2028, distributions are considered qualified, meaning they are tax-free. This five year clock continues to tick even after the Roth IRA is inherited.

Until that five years trip is complete, you will follow the Roth IRA distribution ordering rules to determine if part of your distribution is taxable:

- First out of the harbor: Contributions, these are always tax-free.
- Next to set sail: Converted amounts are also tax-free.
- Last to leave port: Earnings are taxable if the five year holding period hasn't been met.

Once the five year clock is met, all distributions are qualified, no tax due.

## **Sailing with the Right Crew: Know Your Beneficiary Designation**

Before we hoist the anchor and set sail into the rules, let's chart the map by identifying your beneficiary category. There are three beneficiary categories when the IRA owner dies after 2019: Non-Designated Beneficiary (NDB), Designated Beneficiary (DB) and Eligible Designated Beneficiary (EDB). While a spouse is considered an EDB, we'll focus on non-spouse EDBs.

You're sailing in this category if you meet one of the following criteria:

- Child of the IRA owner, or their QT, who has not surpassed age 21
- Individuals not more than 10 years younger (based on dates of birth), the same age, or older than the IRA owner
- Individuals who are chronically ill/disabled
- Primary beneficiary of a QT who is the surviving spouse or a chronically ill/disabled individual



# Distribution Options: Navigating the Next Coordinates

Now that you've identified your beneficiary category, there are two more critical coordinates to chart before we dive into the distribution options:

## 1. What Is the Required Beginning Date or RBD?

The RBD is the date by which the IRA owner must begin taking Required Minimum Distributions (RMDs). This date is generally April 1 following the year the IRA owner reached their RMD Age.

It's important to note that Roth IRA owners are always considered to have died before RBD because a Roth IRA owner has no RMDs. This simplifies the course for beneficiaries of Roth IRAs.

## 2. What is the IRA Owner's RMD Age?

This depends on their year of birth:

- Age 75 (if born in 1960 or later)
- Age 73 (if born 1951-1959)
- Age 72 (if born July 1, 1949 – December 31, 1950)
- Age 70½ (if born before July 1, 1949)

Individual Beneficiary	Life Expectancy (LX)	10-Year Rule	10-Year Rule with RMDs	Lump-Sum	Disclaim
<b>Eligible Designated Beneficiary</b>					
Child of the IRA owner, or their qualified trust <sup>1,2</sup> , who has not surpassed age 21. After age 21, RMDs are taken over a 10 year term.					
Owner died <b>before</b> RBD	X	X		X	X <sup>2</sup>
Owner died <b>on/after</b> RBD	X		X	X	X <sup>2</sup>
<b>Chronically ill/disabled individuals</b>					
Owner died <b>before</b> RBD	X	X		X	X
Owner died <b>on/after</b> RBD	X		X	X	X
<b>Individuals not more than 10 years younger, the same age, or older than the IRA owner</b>					
Owner died <b>before</b> RBD	X	X		X	X
Owner died <b>on/after</b> RBD	X		X	X	X

1. The duration an Inherited IRA can remain open depends on several factors, including the QT type (accumulation or conduit), the primary beneficiary, and the number of primary beneficiaries. It's essential for the trustee to consult with an attorney to understand the specific trust distribution options available.
2. In some instances an entity may be able to disclaim.

# Journey Through the Distribution Rules

## Port of Potential – Sailing the Stretch Strategy

The Life Expectancy Option is often called the Stretch IRA strategy<sup>3</sup> because beneficiaries are able to chart a long-term course by taking annual RMDs starting the year after the IRA owner's death. It applies to both Inherited Traditional and Roth IRAs.

To navigate this route, the EDB uses:

- A divisor from the Single Life Table (SLT)
- The prior year-end IRA value
- The term certain method, subtracting one from the original divisor each year

Waypoints to Watch:

- The initial divisor is based on the EDB's age as of their birthday in the year following the owner's death.
- If a QT inherited the IRA before 2020, the divisor is anchored to the age of the oldest trust beneficiary.
- If the IRA owner died on or after their RBD, and their remaining LX is longer than the beneficiary's, the owner's divisor is used instead. This is calculated using the owner's age at death, with one subtracted annually.

## Non-Spouse RMD Formulas

### **Non-spouse:**

$$\text{RMD} = \frac{\text{Prior IRA Year-End Value}}{(\text{Beneficiary's SLT divisor in year after owner's death} - 1 \text{ in each following year})}$$

### **Non-spouse older than IRA owner who died on/after RBD:**

$$\text{RMD} = \frac{\text{Prior IRA Year-End Value}}{(\text{Owner's SLT divisor in year of death} - 1 \text{ in each following year})}$$

3. The "stretch" IRA isn't a specific type of IRA, but a strategy to extend an IRA's benefits beyond the IRA owner's lifetime.



## **Young Mariners on Board: RMD Rules for Minor Children**

When a minor child inherits an IRA from a parent, their journey follows a two-phase course:

### *Phase 1: Steady Sailing Until Age 21*

During this first leg of the journey the young mariner sets sail as an EDB and RMDs must be taken. These annual distributions are calculated using the SLT and term certain calculation method.

### *Phase 2: The 10-Year Wind Down*

Once the beneficiary turns age 21, the winds shift, and a new heading is charted. Now treated as a DB they enter the 10-year voyage during which the entire Inherited IRA must be fully distributed, by the time they turn age 31. RMDs remain during this part of the journey.

This two-stage route, starting with the LX method and transitioning to the 10-year rule, is unique route reserved for minor children of the IRA owner. It reflects their hybrid status as EDBs until age 21, after which they sail forward like a DB.

## **Port of Indecision - 10-Year Rule**

While you can use the 10-Year Rule, it's often the least favorable harbor in which to anchor. Under this rule, an Inherited Traditional or Roth IRA must be fully emptied by the end of the 10th year after the original IRA owner's death. This means you must either spread taxable distributions over the decade or risk a tax storm by taking it all in the final year. Carefully weigh this option before docking here.

## **Quick Departure - The Lump-Sum Exit**

Some beneficiaries chose to disembark and not return by emptying the Inherited IRA in a single year. While this quick departure satisfies distribution requirements, it comes with a potential cost: the full taxable amount is included in income for that year, which may bump the beneficiary into a higher tax bracket.

## **Changing Course - The Disclaimer Option**

A beneficiary may choose to change course by disclaiming all or a portion of an IRA they inherited, essentially refusing the inheritance. This decision must generally be made within nine months of the IRA owner's death, but minor beneficiaries have 9 months after age 21. They must also meet specific IRS requirements to be valid.

The beneficiary cannot steer where the disclaimed assets go. Instead, the IRA custodian will follow the path charted by the IRA owner on the beneficiary designation form.

If there are no other named beneficiaries, the IRA custodial agreement's default provisions will be used to determine who inherits.

## Successor Beneficiary of an EDB – The Final Leg of the Journey

A successor beneficiary is the individual or entity who inherits an IRA that was already inherited by someone else. This may be referred to as an Inherited/Inherited or Twice Inherited IRA. Think of it as taking the helm after the first beneficiary's voyage has ended. Current Internal Revenue Code (IRC) rules no longer allows the successor to continue taking distributions over the original beneficiary's LX. Instead, the course they must follow depends on the original beneficiary's category.

### Plotting the Successor's Course – Inheriting from an EDB

When an EDB dies, their successor beneficiary must navigate a different route—one that no longer allows the stretch IRA strategy. Instead, they have 10 years to empty the account.

#### The Successor's Voyage: 10-Year Distribution Rule

The successor beneficiary must empty the Twice Inherited IRA within 10 years of the EDB's death. RMDs continue during this 10-year journey.

These RMDs are calculated using:

- The original IRA owner's date of death
- The prior year-end value of the IRA
- The EDB's SLT divisor
- And the term certain method

If the divisor is less than 10, the account may be emptied sooner than 10 years, shortening the voyage.

#### *Alternate Route: When the Original Owner's Divisor Is Longer*

If the original IRA owner:

- Died on or after their RBD,
- Was younger than the EDB, and
- Had a longer remaining LX than the EDB

Then the successor beneficiary uses the original owner's SLT divisor, determined in the year of death, subtracting one each year thereafter.

Again, if this divisor is less than 10, the IRA may be fully distributed before the 10-year mark.





## Anchors Aweigh: Making Informed Choices Before You Depart

Understandably, inheriting an IRA can feel like navigating choppy waters. You are not only dealing with emotional and personal matters but also making decisions with significant tax and financial implications. Before you hoist the sails and complete any paperwork to claim your inheritance, take time to learn the rules and chart a course that fits your unique situation. Be sure to speak with your trusted crew of financial, tax, and legal professionals before making any final decisions. Their guidance can help you avoid costly tax currents and ensure smooth cruising to the final port.



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