



## Navigating Inherited IRA Rules

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, unless you are the surviving spouse.

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 the type of IRA you’ve inherited, either a Traditional or Roth, as this sets your course for understanding potential tax obligations.

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).



# Beneficiary Designation Types

Non-Designated Beneficiary (NDB)	Designated Beneficiary (DB)	Eligible Designated Beneficiary (EDB)
<ul style="list-style-type: none"><li>• Charity</li><li>• Estate</li><li>• Non-qualified trust</li></ul>	<ul style="list-style-type: none"><li>• Child of the IRA owner who has surpassed age 21</li><li>• Individuals who are more than 10 years younger than the IRA owner (based on date of birth)</li><li>• Individuals not chronically ill/disabled</li><li>• Primary beneficiary of a qualified trust (QT) who is not the spouse or chronically ill/disabled</li></ul>	<ul style="list-style-type: none"><li>• Child of the IRA owner, or their QT, who has not surpassed age 21</li><li>• Individuals not more than 10 years younger, the same age, or older than the IRA owner</li><li>• Individuals who are chronically ill/disabled</li><li>• Primary beneficiary of a QT who is the surviving spouse or a chronically ill/disabled individual</li><li>• Surviving spouse (S/S)</li></ul>

## 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.

### 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 72 (if born July 1, 1949 – December 31, 1950)
- Age 73 (if born 1951-1959)
- Age 70½ (if born before July 1, 1949)

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.

Beneficiary	Life Expectancy (LX)	5-Year Rule	10-Year Rule	10-Year Rule with RMDs	Lump-Sum	Disclaim
<b>Eligible Designated Beneficiary</b>						
S/S, or individuals not more than 10 years younger, or chronically ill/disabled, or QT <sup>1</sup> primary beneficiary is the spouse or chronically ill/disabled.						
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>
QT <sup>1</sup> primary beneficiary is the child of the IRA owner 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>Designated Beneficiary</b>						
Individual more than 10 years younger, not chronically ill/disabled, or a minor who is not the IRA owner's child.						
Owner died <b>before</b> RBD			X		X	X
Owner died <b>on/after</b> RBD				X	X	X
QT <sup>1</sup> primary beneficiary is not the spouse or chronically ill/disabled.						
Owner died <b>before</b> RBD			X		X	X
Owner died <b>on/after</b> RBD				X	X	X
<b>Non-Designated Beneficiary</b>						
Charity, estate, non-qualified trust						
Owner died <b>before</b> RBD		X			X	X <sup>2</sup>
Owner died <b>on/after</b> RBD	X <sup>3</sup>				X	X <sup>2</sup>

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.
3. RMDs are based on the IRA owner's age as of their birthday in the year of death. The divisor is reduced by one in each subsequent year.



# Journey Through the Distribution Rules

## First Port of Call - 10-Year Rule

When it comes to Inherited IRAs, beneficiaries must chart a clear course—especially under the 10-Year Rule.

- **Set Your Compass:** An Inherited Traditional or Roth IRA must be fully emptied by the end of the 10th year following the year the original IRA owner died.

### **Example:**

The IRA owner died in 2024; year one is 2025. The beneficiary must fully distribute the Inherited IRA by the end of 2034. A common mistake is assuming the 10-year term ends in 2035 ( $2025 + 10$ ). However, 2025 is year 1 and  $2025 + 9$  more years = 2034.

RMDs:

- If the IRA owner died on or after their RBD, RMDs are necessary for years 1-9.
- These RMDs are calculated using a divisor based on the beneficiary's age, as of their birthday, in the year following the death of the owner, using the term certain calculation method.
- This method subtracts one from the original divisor in each subsequent year.
- However, in year 10, the entire account balance must be distributed, no exception. That final year is a tidal wave, not a ripple.
- If the IRA owner died before their RBD, there are no RMDs during the 10 years.

**Reminder:** Roth IRA owners are always treated as having died before their RBD, so Roth beneficiaries enjoy smoother sailing—no RMDs, just the 10-year deadline.

## Watch Those Tax Currents:

The bigger storm to sail through is how to manage taxes. Even a modest IRA has the potential to increase substantially over the 10 years. If the beneficiary chooses the IRS strategy of delaying distributions, or only takes the RMD, they could face a tax surge that year and could push them into a higher tax bracket. A more strategic approach is Break Analytics Distribution Smoothing™\* over the 10 years, avoiding a tsunami of taxable income. Meet Natasha, a hypothetical DB who is 50 the year after the IRA owner's death and inherits \$100,000. Her case illustrates how she fares under the three different distribution strategies.

**IRS Strategy #1 – Wait until year 10** - In this hypothetical scenario, Natasha doesn't take any distributions for 10 years because the IRA owner died before their RBD. \$100,000 grows at an annual rate of 8% and by year 10, the Inherited IRA's has grown to \$215,892.

Now, here's where taxes surface. If Natasha has no other income, she will be in the 32% tax bracket if filing single and 24% tax bracket if filing joint. That's a big tax wave to ride all at once.

Year	Age	ROI	Earnings	LX	RMD	Account Balance
2025	50	8%	\$8,000			\$108,000
2026	51	8%	\$8,640			\$116,640
2027	52	8%	\$9,331			\$125,971
2028	53	8%	\$10,078			\$136,049
2029	54	8%	\$10,884			\$146,933
2030	55	8%	\$11,755			\$158,687
2031	56	8%	\$12,695			\$171,382
2032	57	8%	\$13,711			\$185,093
2033	58	8%	\$14,807			\$199,900
2034	59	8%	\$15,992	1.0	\$215,892	\$0

**IRS Strategy #2 – Taking RMDs** - In this version of Natasha's journey, she takes RMDs each year. Meanwhile, the account continues to grow at an 8% annual rate. By year 10, the Inherited IRA's has grown to \$165,736.

Because she's spreading distributions over time, the tax wave is a bit calmer. If Natasha has no other income, she will be in the 24% tax bracket if filing single and 22% tax bracket if filing joint. This appears to be calmer waters compared to the lump-sum, but is it really? Even with RMDs, the final distribution can still trigger a significant tax bill; especially when combined with other income sources such as wages or Social Security.

So, what's the better answer?



Year	Age	ROI	Earnings	LX	RMD	Account Balance
2025	50	8%	\$8,000	36.2	\$2,763	\$105,237
2026	51	8%	\$8,419	35.2	\$2,990	\$110,666
2027	52	8%	\$8,853	34.2	\$3,236	\$116,283
2028	53	8%	\$9,303	33.2	\$3,503	\$122,082
2029	54	8%	\$9,767	32.2	\$3,792	\$128,057
2030	55	8%	\$10,245	31.2	\$4,105	\$134,197
2031	56	8%	\$10,736	30.2	\$4,444	\$140,489
2032	57	8%	\$11,239	29.2	\$4,812	\$146,916
2033	58	8%	\$11,753	28.2	\$5,210	\$153,459
2034	59	8%	\$12,277	1.0	\$165,736	\$0

**Enter Break Analytics' Strategy - Distribution Smoothing™** - Now let's chart a smarter, more proactive course for Natasha with Distribution Smoothing™ a proprietary strategy from Break Analytics. Unlike the IRS strategies, this method isn't anchored to the owner's RBD because Natasha takes an amount greater than the RMD annually. This allows her to take the helm of her Inherited IRA and plot her own path through the tax wall.

Natasha takes amortized distributions each year based on an 8% rate of return. By year 10, the Inherited IRA's remaining balance is \$26,512. But here's the real treasure: by spreading the income over the 10 years, Natasha avoids the stormy tax seas. If she has no other income, she will be in the 12% tax bracket if filing either single or joint.

Year	Age	ROI	Earnings	LX	RMD	Account Balance
2025	50	8%	\$8,000	10.0	\$10,000	\$98,000
2026	51	8%	\$7,840	9.0	\$10,889	\$94,950
2027	52	8%	\$7,596	8.0	\$11,869	\$90,677
2028	53	8%	\$7,254	7.0	\$12,954	\$84,977
2029	54	8%	\$6,798	6.0	\$14,163	\$77,612
2030	55	8%	\$6,209	5.0	\$15,523	\$68,298
2031	56	8%	\$5,464	4.0	\$17,075	\$56,687
2032	57	8%	\$4,535	3.0	\$18,896	\$42,326
2033	58	8%	\$3,386	2.0	\$21,163	\$24,548
2034	59	8%	\$1,964	1.0	\$26,512	\$0

## Second Port of Call – Sailing the Stretch Strategy

The Life Expectancy Option is often called the Stretch IRA strategy<sup>5</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:

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

5. 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.



### **Third Port of Call – Spousal Waters**

When navigating the inheritance seas, a Surviving Spouse (S/S) has two primary routes available:

- Establish an Inherited IRA, or
- Roll or transfer the assets into their own IRA

Choosing the right vessel for the journey requires careful charting. Inherited IRAs may offer flexibility for spouses, while rolling into one's own IRA can simplify future RMDs and consolidate retirement assets.

#### *Entering the Harbor: Establish an Inherited IRA*

This maneuver may be a smart route, especially for a S/S under age 59½. Distributions from an Inherited IRA avoid the 10% additional tax, unlike distributions from the S/S's own IRA, which could incur the additional tax if taken before age 59½.

Importantly, the S/S retains flexibility: they can always move the assets to their own IRA at any time, adjusting their course as circumstances change.

This port also offers strategic shelter for spouses who've reached RMD Age, while their deceased spouse had not. In such cases, RMDs can be delayed until the year the deceased spouse would have reached RMD Age, giving the S/S more time to navigate the tax planning waters.

#### *Recalculation Method: A New Course Each Year*

When RMDs are needed the S/S generally uses the recalculation method, meaning they chart a fresh course annually with a new divisor.

If the deceased spouse reached RMD Age\* before 2024, S/S uses the SLT. If they reached RMD Age in 2024 or later, the Uniform Life Table applies.

#### *When the Waters Get Complex: Term Certain Method*

The term-certain method is used if the deceased spouse, died on or after their RMD Age, was younger than the S/S, and the deceased spouse's divisor is longer. The divisor is based on the deceased spouse's age in the year of death, and one is subtracted from the divisor each year thereafter.

#### *When RMDs Must Begin: Timing the Voyage*

The last rule to understand is when RMDs must begin for the S/S. RMDs are taken from the Inherited Traditional or Roth IRA in the year the deceased spouse would have reached RMD Age or in the year after the deceased spouse died, if they had already reached RMD Age.

# Spouse RMD Formula

$$\text{RMD} = \frac{\text{Prior IRA Year-End Value}}{\text{Single or Uniform Life Table Divisor}}$$

## **Crossing the Channel: Rollover or Transfer to the S/S's Own IRA**

Only a S/S has the option to roll over or transfer inherited IRA assets into their own IRA, a unique harbor not available to other beneficiaries. Once the assets are docked in the S/S's own IRA, they take the helm as the account owner. From that point forward, standard distribution rules for IRA owners apply, including RMDs based on their age and applicable LX table.

## **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 a 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.

## **Final Port of Call: The 5-Year Rule**

The journey is short and direct for NDBs.

- An Inherited Traditional or Roth IRA must be fully emptied by the end of the 5th year following the year the IRA owner died.

This rule is a straight sail to sunset, no annual RMDs required, but the account must be cleared before the final buoy.



### **5-Year Rule Example:**

The IRA owner died in 2024; year one is 2025. The EDB must fully distribute the Inherited IRA by the end of 2029. A common mistake is assuming the 5 year term ends in 2030 (2025 + 5). However, 2025 is year 1 and 2025 + 4 more years = 2029.

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

Some beneficiaries choose 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.

### **Successor Beneficiary of a DB - 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 life expectancy. Instead, the course they must follow depends on the original beneficiary's category.

### **Plotting the Successor's Course - Inheriting from a DB**

- A DB follows the 10 year rule. If they die before the end of the 10 years, the successor must finish the journey by emptying the Twice Inherited IRA within the remaining years of that original 10-year term.
- RMDs are necessary if the IRA owner died on/after their RBD.

These RMDs are calculated using:

- The original owner's date of death
- The DB's SLT divisor, obtained the year following the owner's death
- And the term certain calculation method.
- The account is emptied in year 10.

If the DB's divisor is less than 10, the successor may need to dock earlier and empty the account sooner.

### **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 EDB's SLT divisor
- The prior year-end value of the IRA
- 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.



Author:

**Cathleen Davis-Whitmore**

Chief Marketing Officer & IRA SME

Fin CW's "IRA Oracle"

 [fincw.com](https://fincw.com)

 1.800.766.7327

 [sails@fincw.com](mailto:sails@fincw.com)

