Planning for Inherited Retirement Accounts

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I. OVERVIEW

Congress permits people to accumulate large amounts of wealth in their tax-sheltered retirement accounts. But eventually those assets must be distributed, or else there will be a 25% penalty.

This article explains in simple terms the complicated rules that govern the required minimum distributions ("RMDs") that a person must receive from their own retirement accounts during their lifetime, and from the retirement accounts that they may inherit. The article also describes several strategies that can be use to reduce the income tax liability from liquidating large inherited accounts, now that most inherited accounts must be liquidated in just ten years,

RMDs must be made from individual retirement accounts ("IRAs") and from qualified employer retirement plans ("QRPs"), which include 401(k) plans, profits sharing plans, and stock bonus plans.

Roth accounts (Roth IRAs, Roth 401(k), Roth 403(b) and Roth 457(b)) qualify for more advantageous RMD rules than traditional taxable accounts. Although contributions to Roth accounts don't qualify for income tax deductions, distributions of the Roth account's investment income will be tax-free if two tests was made: the distribution is made (a) after someone has had a Roth account for at least five years and (b) after age 59 ½ (though there is no age requirement for the accumulated income to be tax-free from an inherited a Roth account).

II. LIFETIME REQUIRED MINIMUM DISTRIBUTIONS

A. Roth Accounts

There are no lifetime RMDs from a person's own Roth account at any age. After an individual's death, the Roth account must generally be liquidated by the end of the tenth year after death.

B. Traditional Taxable Accounts: RMDs Begin at Age 73

RMDs must be made to an IRA owner each year, beginning in the year that the IRA owner attains age 73. Failure to receive an RMD triggers a 25% penalty on the amount that was not distributed. *IRS Section 4974.*

The same rule applies to qualified employer retirement plans, except that RMDs are not required from QRPs during those years that an employee continues working after age 73 (provided that the employee owns less than 5% of the business). Instead, the RMD requirement begins in the year that the employee separates from service. Note that RMDs must still be made from IRAs beginning at age 73, even when a person is working full time. If an individual fails to receive the distribution in this first year, the penalty can be avoided if the distribution is received in the next year at any time before the *required beginning date* (before April 1 of the following year).

If someone has multiple IRAs and QRP accounts, the RMD should be computed separately for each account. The RMD must be distributed separately from each QRP account (including from a 403(b) or a 457(b) account). There is, however, an administrative advantage available with IRAs: the total amount of the RMDs from all IRAs may be distributed from a single IRA. This can be particularly beneficial when some IRAs hold illiquid assets and others have liquid assets.

The amount of each year's RMD is determined by the "Uniform Lifetime Table." The sole exception is that there can be smaller RMDs when an IRA owner is married to someone who is more than ten years younger. When that younger spouse is the sole beneficiary of the account, there are smaller RMDs based on the joint life expectancy of the couple. The computations for such married individuals are available in IRS Publication 590-B.

The percentage of retirement assets that must be distributed from a retirement account gradually increases each year as the IRA owner ages. There are two steps to determine each year's RMD:

Step 1: Determine the value of the investments in the account on the last day of the preceding year (December 31).
Step 2: Multiply the value of those investments by the percentage in the table that is next to the age that the IRA owner will be at the end of the year. This is the minimum amount that must be distributed to avoid the 25% penalty.

> Example: Isabel Ringing had $100,000 in her only IRA on the last day of the preceding year. She will be 80 years old at the end of this year. She must receive at least $4,950 during the year to avoid a 25% penalty (4.95% times $100,000).

--UNIFORM LIFETIME DISTRIBUTION TABLE –

Age	*Payout*	*Age*	*Payout*	*Age*	*Payout*	*Age*	*Payout*
70	-0-%	80	4.95%	90	8.27%	100	15.63%
71	-0-%	81	5.19%	91	8.78%	101	16.95%
72	-0-%	82	5.44%	92	9.26%	102	17.86%
73	3.79%	83	5.69%	93	9.91%	103	19.24%
74	3.93%	84	5.96%	94	10.53%	104	20.41%
75	4.07%	85	6.25%	95	11.24%	105	21.74%
76	4.22%	86	6.58%	96	12.05%	106	23.26%
77	4.39%	87	6.95%	97	12.83%	107	24.39%
78	4.57%	88	7.36%	98	13.70%	108	25.65%
79	4.77%	89	7.76%	99	14.71%	109	27.03%

Percentages computed from Treas. Reg. § 1.401(a)(9)-9(c) ("Uniform Lifetime Table") (rounded)

III. INHERITED ACCOUNTS

Retirement accounts of individuals who died after 2019 must generally be liquidated by the last day of the tenth year that follows the year of death. For example, if an individual died on any day in the year 2025, that person's retirement account musts be empty on December 31, 2035, or else the remaining balance will be subject to a 25% penalty. There are circumstances when amounts may be distributed penalty-free for more than ten years, or that the mandatory distribution period may be even less than ten years. For simplicity, this article will focus only on the planning strategies for the ten-year rule (e.g., when children are the beneficiaries), and the special advantages that are available to a surviving spouse.

A. RMD in the Year of Death

In the year that an IRA owner dies, the RMD continues to be the RMD that was required when the person was alive. Thus, in the example above, if Isabel Ringing died in the year that she was going to turn age 80, at least $4,950 would need to be distributed from the IRA to avoid the 25% penalty. If less than $4,950 had been distributed to Isabel that year, the remaining amount should be distributed to the beneficiary(ies) of the IRA in order to avoid the penalty.

The tax regulations give some leeway if the payment was not made to the beneficiaries in the year of death. As long as the amount is distributed to the beneficiary(ies) before the end of the following year, the 25% penalty can be avoided. This exception can be particularly helpful when someone dies in November or December, and there are much more important things that need to be done than to determine whether that year's RMD had been distributed.

B. A Surviving Spouse Can Do A Rollover

A surviving spouse who is the beneficiary of a retirement account has an important option that no other beneficiary has: the ability to rollover the assets in the deceased spouse's account into their own IRA. Such rollovers are very common, and they usually produce the greatest tax advantages. Since the account is now the spouse's IRA, the surviving spouse will be subject to the lifetime RMD rules described above.

One situation when a surviving spouse might delay a rollover is when she or he is under age 59 ½. Taxable distributions from one's own retirement accounts before that age are subject to a 10% penalty, but distributions from inherited accounts are exempt from that penalty at any age. The spouse can leave some assets in the deceased spouse's account and receive distributions from that account without incurring the 10% penalty. After attaining age 59 ½, the assets can be rolled over to an IRA.

C. Definitions of Terms that Affect Required Distributions from Inherited Accounts

Beneficiary - the person or the entity (e.g., the probate estate or a charity) that will receive the assets in the decedent's retirement account.

Designated Beneficiary ("DB") - a human being who is the beneficiary of a retirement account. A *designated beneficiary* is an *individual* who is entitled to the benefits of an IRA or QRP account upon the death of the employee / participant / IRA owner (hereafter "account owner"). IRC §401(a)(9)(E)(i); Reg. § 1.401(a)(9)-4(b). Neither a charity nor the decedent's estate will qualify as a DB since neither has a life expectancy.

Eligible Designated Beneficiary ("EDB") - An EDB qualifies for an exception to the general ten-year liquidation rule and may receive distributions over more than ten years. An EDB may receive distributions over his or her the remaining life expectancy, based on the EDB's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent (though upon attaining majority age, the ten year rule generally applies), a disabled or a chronically ill person, or someone who is not more than ten years younger than the decedent. IRC § 401(a)(9)(E)(ii).

Required Beginning Date ("RBD")
For IRAs, the RBD is April 1 of the year that follows the year that the person attained (or would have attained) age 73.

The RBD for qualified employer plan accounts (e.g., 401(k)) is generally the same as the RBD for IRAs. However, in the case of individuals who work past age 73 (and who own less than 5% of the employer), the RBD is April 1 of the year after they separate from service.

"**Determination Date**"
The RMDs are determined by the identity of the beneficiaries who are entitled to distributions on September 30 in the year after death (rather than by the beneficiaries who were named as of the date of death). Reg. § 1.401(a)(9)-4(c). A beneficiary who was paid in full before the determination date (e.g., a charity) will not have any impact on the RMD determination. PLR 200740018 (July 12, 2007). If an IRA administrator establishes separate accounts for each beneficiary before the determination date, then the liquidation time period will be ascertained individually for each beneficiary.

D. Maximum Permitted Time Period to Liquidate an Inherited Account: 5 years, 10 years, the Beneficiary's Remaining Life Expectancy, or a "Ghost Life Expectancy"

Retirement accounts of individuals who died after 2019 must generally be liquidated by the last day of the tenth year that follows the year of death. For example, if an individual died on any day in the year 2025, that person's retirement account musts be empty on December 31, 2035, or else the remaining balance will be subject to a 25% penalty. There are circumstances when amounts may be distributed penalty-free for more than ten years, or that the mandatory distribution period may be even less than ten years. For simplicity, this article will focus only on the planning strategies for the ten-year rule (e.g., when children are the beneficiaries), and the special advantages that are available to a surviving spouse.

Failure to liquidate an inherited retirement account within the applicable time period (or failure to receive a required minimum distribution ("RMD") in any given year) triggers a 25% penalty.

There are four possible maximum time periods over which a decedent's account may be liquidated without incurring the 25% penalty. The applicable maximum time period is determined by the types of beneficiaries who are entitled to receive the retirement assets on the "determination date" (which is September 30 of the year after death). If a beneficiary (e.g., a charity) has been paid in full before that date, that person in no longer considered to be a beneficiary. Oversimplified, the time periods are:

(#1) ten years, if only "*designated beneficiaries*" ("DBs") are the beneficiaries of the account.

> * For Roth accounts, there are no RMDs until the last day of the 10th year.
>
> * There may be annual RMDs required from traditional taxable retirement accounts depending on whether the IRA owner/QRP participant died before or after the *"required beginning date"* ("RBD"), *IRC § 401(a)(9)(H)(I)*
>
> **(a)** If death occurred *before* the RBD*,* there is no RMD until the last day of the 10th year.
>
> **(b)** If death occurred *after* the RBD*,* the 2024 final regulations require an RMD in each of the nine years that follow the year of death, and then full liquidation of the account in the 10th year. *Reg. § 1.401(a)(9)-5(d)(1).*

(#2) the remaining life expectancy of an *eligible designated beneficiary* ("EDB"), based on the EBD's age at the end of the year that follows the year of the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent, disabled, chronically ill, or someone who is not more than ten years younger than the decedent. An EDB must receive an RMD every year, beginning in the year after death. *IRC §§ 401(a)(9)(H)(ii), (E)(ii) & B(iii)*

(#3) five years (there is no RMD until the 5th year),if the account owner died before the required beginning date ("RBD") and there was even just one non-DB on the "determination date."
IRC §§401(a)(9)(B)(ii) and (H)(i)("Except in the case of...); Reg. §1.401(a)(9)-3(c)(2).

(#4) the life expectancy of someone who was the account owner's age in the year of death (a/k/a a "ghost life expectancy") if the account owner died after the RBD and there was even just one non-DB on the "determination date." There will be RMDs in each of those years.
IRC §§ 401(a)(9)(B)(i) and (H)(i); Reg. § 1.401(a)(9)-5(d)(1)(iii).

Example of "ghost life expectancy"
Rex D. Carr died at the age of 85 (after his RBD). He had named his probate estate as the beneficiary of half of his IRA, and his niece (Lisa Carr) as the beneficiary of the other half. Since the probate estate is not a DB, the IRA must be fully liquidated in just 8.1 years (the remaining life expectancy of an 85-year-old) rather than over ten years.

Note: there is no "ghost life expectancy" rule for a Roth IRA, Roth 401(k) or Roth 403(b). Instead, a Roth account must be liquidated over five years (not ten years) if there was even just one non-DB (for example, a charity or the probate estate) on the "determination date." There is no RMD until the last day of the 5th year, when the account must be empty.

IV. THE TEN-YEAR TIME LIMIT

A. Inherited Roth Accounts

If a person inherited a Roth account that is subject to the ten-year time limit, there are no RMDs until the last day of the tenth year. Consequently, the best tax-planning strategy for inherited Roth accounts is to avoid receiving any distributions over the ten-year time period to allow the greatest accumulation of tax-free investment income. Of course, a surviving spouse has the option to rollover the deceased spouse's Roth account

B. RMDs from Inherited Taxable Accounts

Even though taxable accounts must be fully liquidated at the end of ten years, in most cases there will also be RMDs in each of the first nine years. Whether or not RMDs are required depends on whether the original account owner died before or after the *required beginning date* (described above). Since most people die after age 73, most inherited taxable retirement accounts will have an annual RMD. The rules are:

1. If the retirement account owner died *before* the required beginning date, **there is no RMD until the last day of the 10th year.**
2. If the retirement account owner died *after* the required beginning date, the 2024 final regulations require an RMD in each of the nine years that follow the IRA owner's death, and then full liquidation of the account in the 10th year. Each year's RMD is computed based on the *beneficiary's* remaining life expectancy in the year after the account owner's death.

C. Calculating the Annual RMD from an Inherited Retirement Account, Beginning in the Year *After* Death

There are two situations when RMDs are required each year from an inherited retirement account:

1. The beneficiary is an "eligible designated beneficiary" who will receive distributions over his or her remaining life expectancy, rather than just over ten years.

2. The IRA or QRP owner died after the required beginning date (i.e., after April 1 of the year *after* the year he or she attained age 73). This is the case even though the account must be fully liquidated by the 10th year after the account owner's death.

In the year of death, the RMD was the amount (if any) that would have been required if the retirement plan account owner had still been alive (please see above). In the first year *after* the account owner's death, the RMD is computed based on the *beneficiary's* remaining life expectancy in that year. In each succeeding year, the RMD is computed by reducing the denominator by 1. *Reg.* § 1.401(a)(9)-5(d)(3).

> Example: In the year following her 95-year-old uncle's death, Isabel Ringing was 71 years old with a remaining life expectancy of 18 years. Her RMD that year was 1/18 (or 5.56%) of the account balance that was in her deceased uncle's account on December 31 of the previous year. In the next year, her RMD increased to 5.88% (to 1/17, since the denominator is reduced by 1 in each subsequent year) of the account balance at the beginning of that year. This process continues subsequent years until the 10th year, in which the inherited account must be fully distributed.

LIFE EXPECTANCIES FOR INHERITED RETIREMENT ACCOUNTS

Age	*Life Expect.*	Age	*Life Expect.*	Age	*Life Expect.*	Age	*Life Expect.*	Age	*Life Expect.*	Age	*Life Expect.*	Age	*Life Expect.*
20	*65.0*	**30**	*55.3*	**40**	*45.7*	**50**	*36.2*	**60**	*27.1*	**70**	*18.8*	**80**	*11.2*
21	*64.1*	**31**	*54.4*	**41**	*44.8*	**51**	*35.3*	**61**	*26.2*	**71**	*18.0*	**81**	*10.5*
22	*63.1*	**32**	*53.4*	**42**	*43.8*	**52**	*34.3*	**62**	*25.4*	**72**	*17.2*	**82**	*9.9*
23	*62.1*	**33**	*52.5*	**43**	*42.9*	**53**	*33.4*	**63**	*24.5*	**73**	*16.4*	**83**	*9.3*
24	*61.1*	**34**	*51.5*	**44**	*41.9*	**54**	*32.5*	**64**	*23.7*	**74**	*15.6*	**84**	*8.7*
25	*60.2*	**35**	*50.5*	**45**	*41.0*	**55**	*31.6*	**65**	*22.9*	**75**	*14.8*	**85**	*8.1*
26	*59.2*	**36**	*49.6*	**46**	*40.0*	**56**	*30.6*	**66**	*22.0*	**76**	*14.1*	**86**	*7.6*
27	*58.2*	**37**	*48.6*	**47**	*39.0*	**57**	*29.8*	**67**	*21.2*	**77**	*13.3*	**87**	*7.1*
28	*57.3*	**38**	*47.7*	**48**	*38.1*	**58**	*28.9*	**68**	*20.4*	**78**	*12.6*	**88**	*6.6*
29	*56.3*	**39**	*46.7*	**49**	*37.1*	**59**	*28.0*	**69**	*19.6*	**79**	*11.9*	**89**	*6.1*

Table 1 to Reg. § 1.401(a)(9)-9 (b) ("Single Life Table")

V. PLANNING FOR LARGE INHERITED TAXABLE ACCOUNTS

If the inherited retirement account holds a small balance, then stretching distributions over ten years shouldn't pose serious income tax problems. But if the retirement account holds millions of dollars, it would be smart to undertake strategies that will reduce the income tax that will be paid upon distributions.

A. Strategies during the Retirement Account Owner's Lifetime

Roth Conversions: With a Roth IRA conversion, a person can move taxable assets in a traditional IRA into tax-free assets in a Roth IRA. The conversion triggers taxable income, but there is no 10% penalty on a Roth conversion when the IRA owner is under age 59 ½. The greatest income tax savings occur if the Roth IRA conversion takes place in a year when a person is in a lower income tax bracket than the tax bracket that would be in place in the year of a future distribution. This can occur if, for example, the account owner lives in a state that does not impose an income tax, but the beneficiaries (e.g., children) live in states that do impose income taxes.

Once the assets are in a Roth IRA, the individual benefits from avoiding lifetime RMDs and by having all withdrawals be exempt from income tax. The beneficiaries will benefit by inheriting a Roth IRA that will have no annual RMDs, thereby permitting the investment income to compound tax-free within the Roth IRA for ten years.

Add More Beneficiaries: For example, a widowed individual might have two children and four grandchildren. Rather than simply naming the two children as beneficiaries, consider naming all six individuals. That way the taxable income from the inherited IRA can be spread over 60 income tax returns over the ten-year period instead of just 20 income tax returns. The "kiddie tax" can apply to income received by dependents under the age of 19, but with a ten-year liquidation span many of them will be past that age at some point. Of course, if the IRA owner is so wealthy that there will likely be a federal estate tax liability, then there are likely better assets to leave to grandchildren when planning for the generation-skipping tax.

After age 59 ½: Lifetime Income Tax Bracket Management: Withdrawals from retirement accounts should generally be avoided before age 59 ½ because they are subject to a 10% penalty. After age 59 ½, individuals can reduce the balances in their accounts by receiving distributions.

Since the distributions generate taxable income, withdrawals should be structured to minimize the income tax cost. From a historical perspective, federal income tax rates are currently "on sale." In 2025, a married couple can have nearly $400,000 of taxable income (nearly $200,000 for a single person) before crossing over from the 24% marginal income tax rate to the much higher 32% tax rate.

Thus, one strategy is to withdraw whatever amounts will get their taxable income up to these thresholds. The maximum federal income tax liability will only be 24%. Then, reinvest the after-tax amounts in a tax-advantageous manner. These investments include:

1. Making Roth IRA conversions (described above) from taxable IRAs.
2. Contributions to Section 529 college savings plans for children and grandchildren (the investment income is tax-free if used for qualified education expenses)
3. Life insurance (especially if the taxpayer will be subject to the federal or a state estate tax; the life insurance policy and proceeds can be excluded from the estate with, for example, an irrevocable life insurance trust ("ILIT"). There are no RMDs from a life insurance policy.

After age 70 ½: Qualified Charitable Distributions (QCDs): After age 70 ½, an IRA owner should make all of their charitable gifts from their IRA. The QCDs are excluded from their taxable income, count toward satisfying the annual RMD requirement, and will also reduce the balance accumulated in large taxable IRAs.

Name a Charity as the Beneficiary of Some or All of the Retirement Assets. The tax savings will be greatest for individuals who are wealthy enough that their estates will be subject to the federal or a state estate tax. The charitable estate tax deduction reduces the estate tax liability, and the tax-exempt charity can apply the entire amount to its charitable purpose without any reduction for income taxes.

When each spouse has sufficient income and assets to last a lifetime, consider naming children as beneficiaries of some or all of the taxable retirement assets, rather than rolling everything over to the surviving spouse.

> **Example:** An elderly married couple where each spouse has $5 million of assets: $2 million in traditional taxable IRAs and $3 million of other assets.
>
> - A common arrangement is that each spouse would name the other spouse as the beneficiary of the IRA. Upon death, the surviving spouse would rollover the deceased spouse's IRA assets to their own IRA.
> - This would produce a single large $4 million IRA. Then when the surviving spouse dies, $4 million must be distributed over ten years.
> - If, instead, each spouse names children as beneficiaries, and they die years apart, then the $4 million total could be distributed over more than ten years, thereby reducing the amount of taxable income the children recognize each year.

This result could also be achieved with a disclaimer by a surviving spouse who is listed as the primary beneficiary of the retirement account (when the children are named as contingent beneficiaries)

B. Strategies for Non-spouse Beneficiaries Who Inherit Large Retirement Accounts

Before the SECURE Act shortened the withdrawal period to ten years, people who inherited an IRA could easily stretch distributions over their life expectancy (a "stretch IRA"). The inherited IRA could continue to defer income taxes until the *beneficiary* attained age 83 (at least). The strategy then was: "defer, defer, defer!" Today, only a few beneficiaries qualify for such stretch treatment.

Instead, current planning strategies for large inherited accounts focus on income-tax planning for large amounts of taxable income that will be received over a ten-year period. Deferring a massive amount of taxable income to the tenth year will subject most of that income to the highest income tax rate. Instead, beneficiaries should consider withdrawing large amounts each year (e.g., 10% of the account balance) to reduce the accumulation in the retirement account that will get hit with the highest income tax rate in the tenth year.

Consequently, for large retirement balances, consider these strategies:

1. **Plan to use taxable distributions from inherited retirement accounts for living expenses over the ten-year period, thereby permitting other inherited assets to be invested for long-term growth.**

2. **Increase 401(k) contributions at work.** If the beneficiary hadn't contributed the maximum amount to a retirement account at work ($23,500 to a 401(k) in 2025 ($31,000 if over age 49; $34,750 if between ages 60 and 63)), then take full advantage of that opportunity and increase withdrawals from the inherited IRA to cover the larger contributions. Consider making after-tax contributions to a Roth 401(k), which effectively puts more dollars into a tax-sheltered and tax-free environment.

   But beginning in 2026, if compensation in previous year had been over $145,000, the extra catch-up contributions (up to $7,500 if over age 49, and up to $11,250 between ages 60 and 63) must be made to nondeductible Roth accounts.

3. **Use the same income-tax management strategies described above for IRA owners.** Beneficiaries can use these strategies at any age, since distributions from inherited retirement accounts are not subject to the 10% penalty.

   a. Roth IRA conversions of inherited QRP accounts (inherited taxable IRAs don't qualify for a Roth conversion, but inherited QRPs do)

   b. Roth IRA conversions of the beneficiary's own IRAs

   c. Contributions to Section 529 college savings accounts; life insurance; etc.