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## YOUR IRA: BENEFICIARY STRATEGIES AND KEY CONSIDERATIONS

One of the key components of Employee Retirement Income Act of 1974, Individual Retirement Accounts, or IRAs, were created as a means to help individuals save for retirement in a tax advantaged way. Originally restricted to individuals who were not covered by an employer sponsored retirement plan, in the years since their inception, legislation has eased the restrictions on IRA eligibility, and “traditional IRAs” as they are now known, are currently available as a retirement savings vehicle for most all taxpayers age 70½ or under. While contributions were originally limited to \$1,500 per year, the limits have increased through the years such that in 2016, individuals may contribute up to \$5,500, with an additional \$1,000 catch-up contribution

eligible for those age 50 or older.<sup>1</sup> It’s important to bear in mind, however that while almost everyone who meets the age requirement is able to make an IRA contribution, its deductibility may be limited based on one’s income level, and whether the individual (or his or her spouse) participates in an employer sponsored retirement plan.

While we believe it’s important for IRA owners to have a basic understanding of concepts such as contribution limits and their deductibility, equally important, we believe, is an understanding of some basic considerations as they relate to IRA beneficiaries. While IRAs offer the owner the convenience of naming a beneficiary(s), whom one names, as well as how the beneficiary chooses to take distributions from the deceased’s account, may have a significant and lasting impact.

Perhaps the most basic consideration regarding beneficiaries is the naming of a primary and contingent beneficiary. Very simply, the primary beneficiary(s) is the first in line to receive the IRA assets upon the account owner’s death, while the contingent beneficiary is second in line. Frequently, married individuals will name their spouse as the primary beneficiary, with any children named as contingents. In doing so, if the owner were to pass away, the assets would go to the spouse. If, however, the spouse were to pre-decease the owner, the assets would go to the children.

Once chosen, it’s important for account owners to review their beneficiary designations periodically to ensure they remain up-to-date and current. For a variety of reasons, one may wish to change the beneficiary on his or her account, but unless the change has been made in writing, the original beneficiary will be entitled to the assets if the account owner were to pass.

For example, if a divorced individual re-married, but never updated his designation to reflect his new wife as his beneficiary, if he were to die, the ex-wife still named as the beneficiary would be fully entitled to the proceeds of her ex-husband’s IRA, and unfortunately, the new wife would likely receive nothing.

While most tend to name family or friends as beneficiaries, there are instances where the owner may wish to name one’s estate, or a trust. Given that choosing one of these entities could create some complicated tax or probate issues, however, we suggest that you speak with a qualified estate planning attorney prior to making these designations. When working with an attorney, we believe you’ll be better positioned to achieve your estate planning goals while minimizing the chances of unforeseen or negative outcomes.

While IRA owners have important decisions to make with respect to whom they will name as beneficiaries, the beneficiaries have similarly important decisions regarding the distribution of the assets if the account owner were to die. While there are different distribution strategies to consider, the options vary somewhat depending on whether or not the beneficiary is a surviving spouse.

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In spousal situations, the beneficiary has the option of taking a lump sum and paying the applicable income taxes, assuming the IRA as one's own, or transferring the IRA to an inherited IRA.

While some may be tempted to take a lump sum, we believe it's important to consider the tax implications of such a strategy as they may be significant. For example, not only will the beneficiary be required to pay taxes on the entire amount withdrawn, but he or she may also end up being pushed into a higher tax bracket, thereby causing his or her employment income to be taxed at a higher rate.

If the beneficiary assumes the account as his own, however, the assets can be transferred to an existing IRA, or a new one can be established. Additionally, as the new owner, he's eligible to designate a new beneficiary to receive the assets if he passes. With respect to accessing the funds, taxable distributions may be taken at any time, but early withdrawal penalties may apply to distributions taken prior to the individual reaching age 59½. Once the account owner reaches age 70½, however, he must begin taking required minimum distributions (RMDs) each year based on his life expectancy.<sup>2</sup> The balance can remain invested, however, thereby providing the potential for greater future wealth, and perhaps subsequently, a larger inheritance for his beneficiaries.

If, however, a surviving spouse chooses to transfer the deceased's IRA to an inherited IRA, the assets can continue to grow tax deferred, while taxable withdrawals can be taken at any time free of the early withdrawal penalty.<sup>3</sup> Given this provision, an inherited IRA may be an advantageous strategy for a beneficiary who may need to access the funds before reaching age 59½.

While penalty free withdrawals are available at any time from an inherited IRA, RMDs based on the beneficiary's life expectancy apply. Given there are some variables with respect to the RMDs, including whether the original account owner had reached age 70½, we suggest you contact us so that we can discuss a distribution strategy that may be best for you.

In cases where the beneficiary is someone other than a spouse, the beneficiary has two options: either take a lump sum, or transfer the assets to an inherited IRA.

While distributions can be taken penalty free whether one chooses to take a lump sum or transfer the assets to an inherited IRA, the inherited IRA may be a better option. With an inherited IRA, not only will the beneficiary avoid the potentially significant tax consequences of taking a lump sum, but by leaving the assets invested, the account has the opportunity to continue growing tax deferred. Furthermore, if managed appropriately, the beneficiary can potentially "stretch" the IRA, thereby providing him or herself with a source of lifetime income, while any remaining assets can be passed on to his or her children, or any other named beneficiary.

While the concept of an IRA as a retirement savings vehicle is fairly straightforward, there are many facets of the accounts that go beyond this brief discussion. Please contact us if you would like additional information, or if you have questions as to ways that you may be able to maximize the value and efficacy of your of IRA for yourself, and your beneficiaries, while also controlling taxes to the extent possible

Source: <https://www.schwab.com/cms/P-1625576>

<sup>1, 2, 3</sup> [www.irs.gov](http://www.irs.gov)

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