

# Price & Farrington's Estate and Tax Planning FastFacts

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Estate, Tax, Business and Wealth Planning for Advisors and Clients

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## How to Re-title Your Inherited IRA + IRA Withdrawals: *Ways to Slice the Pie*

What's the best way to title an IRA account when you inherit it? Are there any income tax risks if the accounts aren't titled properly?

**Example:** Two different inherited IRAs are maintained by the same bank. The bank has transferred the deceased persons' IRAs to the beneficiaries using inherited accounts. The bank insists on titling those accounts as: "**Howard Smith Bene Sally Smith**". The client has read that the best, and

possibly the only proper, way to title an inherited account would be as follows: "**Howard Smith (deceased 1/30/06) Inherited IRA for benefit of Sally Smith, Beneficiary**." The bank has said it won't accept that titling and insists that its method is sufficient under the Internal Revenue Code to enable the beneficiaries to receive required minimum distributions ("RMDs") based on their own life expectancies.

**Question:** Is there any income tax risk if the accounts aren't titled as the client has requested, and instead are titled as the bank has done?

The accounts in this example should be in good shape, although the bank's wording could be clearer (assuming *Bene* is the bank's shorthand for Beneficiary). Having said that, the client is right to handle inherited IRAs with extra care to make sure they are set up correctly.

### *Inheriting from a non-spouse.*

Dealing with an IRA you inherit from your spouse is easy because you can simply roll it into your own individual retirement account. But if you inherit an IRA from anyone else, there are some key rules to follow upfront to squeeze maximum value out of the inheritance. (The rules are spelled out in IRS Publication 590, available at [www.irs.gov/pub/irs-pdf/p590.pdf](http://www.irs.gov/pub/irs-pdf/p590.pdf).)

**The rule.** If you inherit a traditional IRA from anyone other than your spouse, you cannot treat it as your own. You must have the account re-titled. According to IRS Notice 2007-7, **the IRA must be "established in a manner that identifies it as an IRA with respect to a deceased individual and also identifies the deceased individual and the beneficiary, for example, 'Tom Smith as beneficiary of John Smith.'**" In



other words, the name of the deceased IRA owner *must be included* in the title, along with an indication that it is for the benefit of the person who inherited it. The exact form doesn't matter as long as the deceased's name is there and it's clear that it is an inherited account, not the beneficiary's own IRA.

Generally, we recommend this language: "**John Smith, IRA (deceased on May 21, 2007) F/B/O John Smith Jr., beneficiary**".

**Hassle?** Why go to all this trouble? Since the beneficiary of an IRA can stretch out withdrawals from the account across his or her life expectancy, the assets have the potential to continue to grow, with earnings accruing on a *tax-deferred* basis. If an IRA has more than one heir, the heirs may be able to split the inherited IRA account so that each one can use its individual life expectancy to take withdrawals. But in order to do this, *they have to separate the account by the end of the year following the year of the original owner's death*. Otherwise they'll be restricted to using the older heir's age to calculate everyone's with-

### ✦ Law on the Light Side ✦

*When the attorney learned that his colleague of thirty years was dying, he hurried to the hospital. He found his friend struggling through page after page of Holy Scripture. "Looking for solace, my friend?" he asked compassionately. "Nope", the dying man replied, "loopholes".*

**Judge:** *Have you ever stolen?*

**Thief:** *Oh, off and on.*

**Judge:** *What did you steal?*

**Thief:** *Oh, this and that.*

**Judge:** *Officer, take him to his cell.*

**Thief:** *Hey, when do I get out?*

**Judge:** *Oh, sooner or later.*

*In the wee hours of the morning, a lawyer called the governor of his state to inform him that a noted judge had just died and the lawyer wanted to take his place. The irritated governor wickedly assured him, "If it's OK with the funeral parlor, it's OK with me."*

*Under oath....*

**Judge:** *Is your appearance this morning pursuant to a deposition notice, which I sent to your attorney?*

**Defendant:** *No. This is how I always dress when I go to work.*

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drawals. (The specific rules and life expectancy table are also in IRS Publication 590.)

**Roth.** If you inherit a Roth IRA you still have to go through the re-titling process and take distributions on a schedule, but you generally won't owe any tax.

The key: *If you don't title an inherited IRA account properly, or you put the assets in your own IRA, you trigger immediate income taxation on the account's entire value.* This is a no-no - a mistake that cannot be corrected.

A final thought to keep in mind: After you re-title an inherited IRA, name a beneficiary of your own, known as a "successor beneficiary" if the IRA's custodian will let you. If they won't let you, contact your estate planning attorney immediately.

### IRA Withdrawals:

#### Many Ways to Slice a Pie

**Hypo #1.** Suppose you have five IRAs and have to take required minimum withdrawals of \$50,000. Do you have to take an equal amount from each of the five funds or can you pick and choose?

**Hypo #2.** You have to take RMDs from your IRA this year. You have three IRAs: one with CDs in a local bank; one with stocks in a brokerage account; and one with mutual funds in another brokerage account. You'd like to take the total distribution for all three IRAs from the CD account. Can you do this?

The IRS views all your IRAs as a single individual retirement ac-

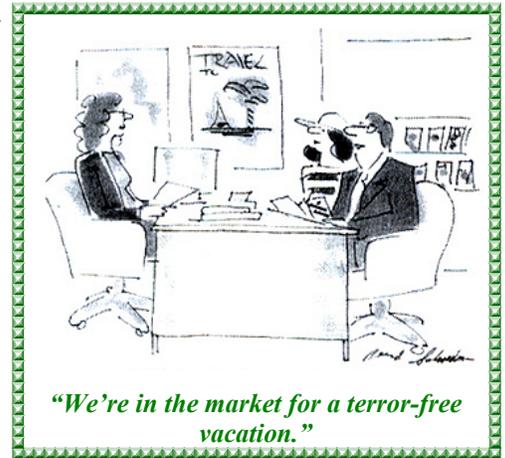
count. That means you have a lot of flexibility in making required withdrawals, taking them from one or more accounts as long as the combined amount meets the government's requirements. By law, IRA custodians have to remind you each year to take your RMDs. You have to include all traditional, SEP and Simple IRA balances, but you don't have to factor in Roth IRAs or defined contribution plans. You're required to take withdrawals from inherited IRAs, but those follow a different schedule, so you don't have to include inherited IRAs in this calculation, either.

**Go figure.** To figure out the minimum amount you have to take out each year, you need to divide the total account balance by the number supplied by your age in the IRS's "Uniform Lifetime Table" (IRS Publication 590 at [www.irs.gov](http://www.irs.gov)). If your spouse is more than ten years younger than you are and is your sole beneficiary for the year of distribution, you would use the divisor supplied by the IRS's "Joint Life and Last Survivor Expectancy Table".

**70 1/2.** Which age do you use for the year in which you turn 70 1/2 and start taking IRA distributions: age 70 or 71? You use the age that you turned on your birthday in the year you turned 70 1/2. So, if you turned 70 1/2 this month (June), your 71st birthday would be in December, so you would use age 71. But if you turn 70 1/2 in August, meaning you celebrated your 70th birthday in February, you would look up the divisor for age 70.

#### The first year's distribution.

There's (at least) one other way to get tripped up: For your first year of taking required distributions, the government gives you a three-month grace period. This means you have until April 1 of the following year to make your first required minimum withdrawal. But you still have to base that withdrawal amount on the account balance as of December 31 of the year before the year in which you turned 70 1/2 — not December 31 of the year before you take the distribution. So, if you turn 70 1/2 this year and wait to



make your withdrawals until next March, you would have to use your account balance as of December 31, 2006 to figure out the minimum size of those withdrawals.

In many cases, it's best not to postpone your first required distribution until the following year so you don't have to take two distributions in the same year. Doing so might increase your income enough to bump you into a higher tax bracket.

**Beware and be wise.** The rules for re-titling inherited IRAs and for taking withdrawals from IRAs can be tricky, resulting in potentially costly mistakes. Whether you are an advisor or a client, we recommend you seek out a knowledgeable estate planning attorney or financial advisor who will work with you to maximize the estate, tax and asset protection planning advantages of these retirement vehicles.

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### Miscellany

Before undergoing a surgical operation, arrange your temporal affairs. You may live.

Ambrose Bierce

Preposition: An enormously versatile part of grammar, as in "What made you pick this book I didn't want to be read to out of up for?"

Winston Churchill

