Inherited Individual Retirement Annuities

When your client inherits an Individual Retirement Annuity (IRA), they become a beneficiary. A beneficiary can be any person or entity the owner chooses to receive the benefits of the IRA after she or he dies. A beneficiary of a Traditional IRA must include any distributions in their gross income as received. Understanding the options as a beneficiary is extremely important as this can impact how much your client can receive and the tax consequences of the decisions they make. Consider contacting a professional tax advisor to provide advice on the options.

Inherited From Spouse

Following are the options your client can choose if they are the surviving spouse inheriting an IRA:

- Treat the Inherited IRA as their own by designating themselves as the annuity owner
- Treat the Inherited IRA as their own by rolling it over into their own Traditional IRA or into an eligible qualified plan
- Treat themselves as the beneficiary rather than treating the IRA as their own IRA
- Take lifetime payments or
- Take as a lump sum or over five years

Under any option, they have an unlimited right to take withdrawals subject to tax penalties. For instance, if they choose to have the IRA treated as their own, then any distributions that they take from it before age 59 ½ will be subject to the IRS 10% early distribution penalty. However, if they treat themselves as the beneficiary, they are able to take distributions prior to age 59 1/2 without penalty. Please have your client consult their tax advisor as these options can have significant impacts on taxable income.

Your client will only be considered to have chosen the "treat as their own" method if they are the sole beneficiary of the IRA or the IRA has been placed in a separate annuity for each beneficiary and them in their capacity have an unlimited right to withdraw amounts from their separate annuity.

Inherited From a Non-Spouse

If they inherit an IRA from someone other than their spouse, they cannot treat the Inherited IRA as their own. Your client cannot make contributions to the IRA or rollover the Inherited IRA into their own IRA.

Your client may want to have the funds in the Inherited IRA grow tax deferred for as long as possible or they may have a need for the money now and may want to take a lump sum. Understanding the tax ramifications of each option prior to making a decision is very important. Whatever choice they make will be irrevocable.

Your client must take a Minimum Required Distribution (MRD) each year when they inherit an IRA to avoid paying a 50% tax penalty on the amount of the MRD that should have been taken. How they take MRD depends on whether the annuity owner died before or after his or her Required Beginning Date (RBD), as described below.

- If the IRA owner died before the RBD, your client may choose the Life Expectancy Method, the Five Year Method, or a lump sum.
- If the IRA owner died on or after the RBD, your client may use the Life Expectancy Method or take a lump sum.

Life Expectancy Method
To avoid tax penalties, the Life Expectancy Method requires that your client withdraw minimum amounts each year according to calculations specified by the IRS paid over an expected lifetime. A distribution period is established based upon the designated beneficiary's single life expectancy in the year after the owner's death. They are always able to withdraw more but must withdraw all funds by the end of the distribution period.

Five Year Method
To avoid tax penalties, the Five Year Method requires that they distribute the entire value no later than the end of the fifth year following the owner's year of death.

Required Beginning Date (RBD)
The Required Beginning Date for a Traditional IRA is April 1 of the calendar year following the year in which the owner attains the age of 70 ½.

Minimum Required Distributions (MRD) for Inherited IRAs
The MRD amount is set through IRS tables for Inherited IRAs. It is based upon the beneficiary's age and resulting life expectancy. So, for example, if under the single life expectancy table someone has a 30 year life expectancy, the first year after the year of death they would be required to remove 1/30th of the prior year-end balance from the Inherited IRA. The following year they would subtract one and need to withdraw 1/29th and the following year 1/28th and so on each year until the beneficiary dies or the money in the IRA is exhausted. If a beneficiary dies prior to removing all funds, they may name a beneficiary to finish out the distributions at least as rapidly as the original Inherited IRA beneficiary.

If there are multiple beneficiaries named by the original IRA Owner and they do not establish separate annuities prior to December 31 of the year following death, the expected lifetime of the oldest beneficiary is used to compute all beneficiaries' Minimum Required Distribution.

60 Day Rule
Keep in mind that with an Inherited IRA, the 60 day rule does not apply. Any transfer must be a Trustee to Trustee transfer. The 60 day rule whereby an annuity holder may take the money out of the IRA and redeposit it in another IRA within 60 days applies only to Traditional IRAs and does not apply to Inherited IRAs.

If the original IRA owner dies on or after their Required Beginning Date, those who inherit the IRA must take the original IRA owner's Minimum Required Distribution in the year of the original IRA owner's death. The Minimum Required Distribution is not paid to the estate unless the estate is the beneficiary of the IRA. If, however, the original IRA owner dies prior to their Required Beginning Date, no distributions are required in the year of death.

American National Products and Inherited IRAs

Choosing an annuity to use in an inherited IRA situation must be done carefully to avoid the 50% penalty for not distributing the minimum distribution amount or distributing money after the end of the distribution period.

As stated above, unlike a Traditional IRA, a different table is used for Inherited IRAs (Single Life Expectancy Table found in IRS Publication 590) than is used for Traditional IRAs. The table computes the life expectancy of the beneficiary (oldest beneficiary if multiple beneficiaries) and then subtracts one each year until the entire distribution must be distributed. If someone inherits an IRA and has a 20 year life expectancy, the first year 1/20th must be distributed and the next year 1/19th and so on until in the 20th year the entire annuity would be distributed.

If a Palladium® Single Premium Immediate Annuity (SPIA) for life was chosen as the funding vehicle, in the later years of the 20 year distribution period used in the example above, the distribution would be less than that required by law and a 50% penalty would apply. If the inherited IRA beneficiary lived beyond their 20 year life expectancy and continued to receive payments the 50% penalty would also apply.

If an ANICO Strategy Indexed Annuity PLUS (ASIA PLUS) with the Lifetime Income Riders were chosen, the same issue would apply as with the SPIA. Eventually the payments under the Lifetime Income Rider would not meet the Minimum Required Distribution and would result in penalty taxes applying. In addition, if the beneficiary lived beyond their life expectancy and continued to receive Rider payments, the penalty taxes would again apply.

In the case of an Inherited IRA where the payment is not recalculated annually but is set up on a schedule where payments must be made according to such schedule, a Lifetime SPIA or a product with a Lifetime Income Rider would not work.

American National products that would work with an inherited IRA include:

- ANICO Strategy Indexed Annuity PLUS 7 & 10 without the Lifetime Income Rider.
- Palladium® Multi Year Guarantee Annuity
- WealthQuest® Citadel Five and Seven Diamond Series

Inheriting an IRA requires your client to make complex decisions based upon their specific fact situation. Every alternative cannot be covered here. American National does not provide legal or tax advice. Have your client consult their tax and legal advisors to determine what their options are and which method of distribution best meets their needs.

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When a person buys the ANICO Strategy Indexed Annuity PLUS, the person is not buying an ownership interest in any stock or index. Interest earnings are paid at a rate that is related to the performance of an index. The index does not reflect dividends paid on stocks underlying the index. Past performance of the index is no guarantee of future results. **Neither American National Insurance Company nor its agents offer tax or legal advice. Clients should consult their own tax and legal advisors.** Contract Form Series IA13; LIR14; NSPA; MYGNQ; MYGPQ, GMYGNQ-C; GMYGPQ-C; WQ512; WQ712 (Forms may vary by state)