

You Have Inherited My Traditional IRA

As you children may have learned by now, you have inherited my Traditional IRA in equal shares. The IRA you have inherited is a perfectly legal tax shelter that can be kept going for many years to come.

First, I am going to tell you the golden rule of maximizing the value of your inherited IRA and how you are required to take it out.

Then I am going to tell you what you must do now.

THE GOLDEN RULE

The golden rule of maximizing the value of your inherited IRA is:

Every year, take out only that you are required to, and no more!

Here's why:

You produce the greatest possible tax-sheltered earnings and growth on the IRA by leaving the most money inside of your inherited IRA for the longest time possible. Leaving as much money as possible inside of the IRA is therefore the only course of action likely to produce the greatest value to you.

If you invest wisely and leave your investments in the IRA long enough, you might even out-earn the taxes you have to pay by withdrawing the entire IRA now. On the other hand, each dollar you withdraw will cost you income taxes. The more you take out, the higher the income taxes you will pay at rates that increase as your taxable income rises. So, when you make an IRA withdrawal that you don't have to, you voluntarily end your tax-sheltered investing opportunities too soon and you pay more income taxes than you otherwise were going to have to pay. That enriches Uncle Sam – at your expense. And every dollar taken out of your inherited IRA can never be put back in – even if taken out by mistake.

WHAT YOU ARE REQUIRED TO TAKE OUT

Tax laws impose annual “required minimum distributions” (RMD's) IRA owners generally must take them during their lifetime, and you must take them after you inherit the IRA. RMD's are determined by dividing the account balance by life expectancy. A hefty federal tax penalty applies to failures to withdraw required minimum distributions – 50% of the amount that should have been withdrawn. The penalty applies *in addition* to applicable income taxes!

It might be that I had not yet taken the distribution required during the year of my death. In that case, you must take that distribution by December 31 of the year of my death and pay any income taxes due on that distribution. Starting with the year after my death, distributions are based on your life expectancy, but only if you divide up the account on time and set up an inherited IRA for each of you. On the other hand, if you fail to divide up the account by 12/31 of the year AFTER my death then all of you must use the shortest (oldest child's) life expectancy.

The rules that permit division of the account by 12/31 of the year AFTER the IRA owner's death are provided in the income tax regulations.

WHAT YOU MUST DO NOW

First, don't do ANYTHING or TAKE ANY MONEY until you've discussed your proposed actions with _____. He, She or I understand these rules – and a mistake can be very costly!

Right now, the IRA is held in my name. You must each set up an inherited IRA for your share of my IRA. Your inherited IRA account must be titled in my name as the deceased IRA owner and held in your benefit as beneficiary. You may set up your inherited IRA with the IRA custodian that I used, or you may use any other qualified IRA custodian.

However, if you decide to use a different custodian, make sure the account is moved in a DIRECT TRANSFER, trustee-to-trustee, since you are NOT permitted to make a rollover. Here's how to divide up the account. It would be preferable to divide up the account by December 31 of the year of my death. But, as I stated earlier, it can be done by 12/31 of the year after my death, you will have to use a life expectancy based on the age I myself would have attained in the year after my death. That means larger required minimum distributions ending the IRA sooner. But, if you act in time, you can use your *own* life expectancies based on your age attained in the year of my death.

After establishing the inherited account for each of you, my IRA can be divided and transferred to each of those accounts.

Ask – IN WRITING – for a direct transfer. Do not ask for a rollover because a person who inherits an IRA may never make a rollover (except for a spouse).

These rules are complex; so again, please check with _____ before you make any decisions.

Your Loving Father/Mother