Rethinking Inherited IRAs

As you build your estate plan and consider how to provide for your adult children, keep in mind that naming children as the beneficiary of an IRA or other qualified plan probably is not something that should be automatic.

For starters, if you are charitably-minded and have other assets, such as highly-appreciated stock, to leave your children, those assets should come first. This is because your children will inherit the stock at a "stepped up" basis, meaning their capital gains tax hit upon sale will be far less. Plus, if you name a charitable organization, such as the Community Foundation, as the beneficiary of your IRA, the IRA proceeds won't be depleted by either income tax or estate tax. Your kids, on the other hand, will have to pay income tax on the proceeds of an inherited IRA.

This dynamic became even more important to consider when the law changed a few years ago, such that a child who was named as the beneficiary of a parent's IRA, for example, could no longer count on a relatively straightforward and tax-savvy method of withdrawals called the "stretch IRA." With the passage of the SECURE Act, that changed for many children who inherited an IRA after December 31, 2019. Instead of taking distributions over their lifetimes, affected children now need to withdraw the entire inherited IRA account within a 10-year period as calculated under the law.

If you're evaluating options for how to handle an IRA in your estate plan, talk with your advisors and the Community Foundation about leaving an IRA to your to the fund of your choice at the Foundation, or other charity, via a beneficiary designation. Or, if you'd still like to provide an income stream to your children following your death, in some circumstances it might be worth considering establishing a charitable remainder trust to name as the IRA beneficiary (assuming the stars align vis-a-vis children's health, their tax brackets, projected returns, and other factors).

Importantly, if you are a child of parents who own IRAs, they will appreciate you bringing this opportunity to their attention! Your parents might not realize that their good intentions to leave their IRAs to their children could be saddled with tax burdens down the road. Encourage your parents to talk with their advisors and give the Community Foundation a call. We are here to help make IRAs a win for everyone–your parents, their favorite charities, and you!

Let's connect.

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