The Biggest Tax Mistakes with Inherited IRAs

Inheriting an IRA can create significant tax complications if not handled correctly. Here are the most common and costly tax mistakes that people make with inherited IRAs:

Misunderstanding the 10-Year Rule
Since the SECURE Act of 2019, most non-spouse beneficiaries must withdraw all funds within 10 years of inheriting an IRA. Many beneficiaries mistakenly:

1. Wait until year 10 to take all distributions, potentially creating a massive tax hit in a single year.
2. Don't realize that, for inherited IRAs where the original owner was taking RMDs, annual distributions are still required during the 10-year period.

Failing to Identify Eligible Designated Beneficiary Status
Some beneficiaries qualify for exemptions from the 10-year rule, including:

1. Surviving spouses.
2. Minor children of the account owner (until reaching majority).
3. Disabled or chronically ill individuals.
4. Beneficiaries who are not more than 10 years younger than the decedent.

Not identifying your status could mean missing more favorable distribution options.

Incorrect Titling of the Inherited Account
Improper account titling can trigger immediate taxation. The correct format is generally: "[Original Owner Name] (deceased [date of death]) IRA FBO [Beneficiary Name]"

Rolling an Inherited IRA into Your Own IRA (Non-Spouse)
Only spouses can roll inherited IRAs into their own IRAs. *Non-spouse beneficiaries who attempt this trigger full taxation of the account.*

Missing the Required Beginning Date for RMDs
If the original owner died after their required beginning date for RMDs, beneficiaries may need to take an RMD in the year of death if the owner hasn't already done so.

Overlooking State Tax Implications
Some states treat inherited retirement accounts differently than federal tax law.

Not Considering Roth Conversions Before Death
For original IRA owners, not considering strategic Roth conversions during your lifetime can leave their heirs with significant tax burdens.

Consulting with a tax and financial professionals who specialize in retirement accounts is strongly recommended when dealing with inherited IRAs to avoid these costly mistakes.