

Avoiding Non-Spouse Beneficiary Mistakes in 5 Easy Steps

How can I avoid making costly mistakes when I inherit an IRA from a person who was not my spouse? Inheriting an IRA can be a financial windfall, but it's important to understand the complex, specific rules that apply to non-spouse IRA beneficiaries to avoid critical errors.

1. At first, don't do anything! Especially, don't take a distribution from the IRA. Doing so without proper planning may forfeit years of potential tax-favored investment returns. Inherited IRA funds are distinct from IRA funds you save for yourself. They can't be commingled with your other IRAs, you can't make contributions to an account that holds them, and they can't be converted to inherited Roth IRAs. Before acting, consult with a qualified advisor to learn the rules and plan how to best use the inherited funds in your personal situation.

2. Set up an inherited IRA. Be sure to set up a properly titled inherited IRA. You can move the funds to a different financial institution if you choose. The transfer between financial institutions must be done by a direct trustee-to-trustee transfer. Non-spouse beneficiaries cannot do a 60-day rollover.

3. If the original IRA has multiple beneficiaries, split it so each obtains a separate inherited IRA. This will ensure that each beneficiary will get the maximum payout period that the rules allow for them.

4. Prepare to take required minimum distributions (RMDs). Both inherited traditional and Roth IRAs are subject to the RMD rules. Most nonspouse beneficiaries under the SECURE Act are subject to a 10-year payout rule and in some cases must take annual RMDs within the 10-year period. A penalty applies to RMDs that are not taken.

5. Heed deadlines and records.

Inherited IRAs must be established and split by December 31 of the year after the year of the owner's death. Also, check the records of the deceased IRA owner to see if an inherited traditional IRA contained non-deductible contributions, which provide tax-free distributions. And be sure to designate beneficiaries of your own to the inherited IRA that you establish.



KELLY RENNER MSF, CFP®

3540 Wheeler Rd Suite 304
706-210-3535
Augusta, GA 30909
info@plan4life.net



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