

Spousal Rollovers- No Do-Overs

Quick-Take: A spousal rollover of an inherited IRA brings with it the risk of the 10% early distribution penalty.

Background: A *spousal rollover* is when the surviving spouse, named as the designated beneficiary of his/her deceased spouse, can move the deceased spouse's traditional IRA funds into his/her own traditional IRA. This is a common planning step taken by many surviving spouses. They can then control the investments, name their own designated beneficiary of the account, and decide when and how to take distributions from *their* traditional IRA. The inherited funds become the surviving spouse's retirement funds in every way. But that means that all IRA distribution rules, and penalties, will apply to the surviving spouse and his/her rollover IRA. The flexibility, and the exposure to penalties, have been covered in past missives. Particularly a surviving spouse's need to access the funds in the rollover IRA to pay expenses when the survivor is under the age 59 ½. Normally the 10% early distribution penalty does not apply to an inherited IRA, regardless of the age of the inheritor. But if the surviving spouse rolls the inherited IRA funds into his/her own IRA, then they are the owner and thus exposed to the early distribution penalty.

Key Point: A spousal rollover, once completed, cannot be undone.

Example: In *Charlotte Gee v. Commissioner*, 127 Tax Court 1, No 875505 (July 24, 2006) Mrs. Gee inherited \$2,646,798 from her husband. She rolled that entire amount of her late husband's IRA to her own IRA. When Mrs. Gee was still under the age of 59 ½, she took \$977,888 from *her* IRA as a taxable distribution. The IRS assessed a 10% penalty on the \$977,888 distribution, or \$97,788, since Mrs. Gee was not yet 59 ½ years old when she took the distribution. Mrs. Gee objected to the imposition of the early distribution penalty. She claimed that she had inherited the funds and was a *beneficiary* of her late husband's traditional IRA. The court disagreed with her analysis, and it pointed out that by rolling *his* IRA funds to *her* IRA she became the sole owner of those retirement assets and was thus subject to the early distribution penalty.

Planning Decisions: Had Mrs. Gee retained a portion of her late husband's IRA as an inherited IRA and not rolled over the entire amount to her own IRA, then the 10% early

distribution penalty could have been avoided by her. Distributions could then have been taken by her from the 'continuing' inherited IRA without any penalty (just income taxes withheld), while the other funds transferred to her spousal rollover IRA could have been retained intact until she reached age 59 ½, after which no penalty would be assessed on distributions.

EDB: Recall that under the SECURE Act, while Mrs. Gee as an *eligible designated beneficiary* (EDB) would be required to take annual required minimum distributions (RMDs) from the inherited IRA, but those mandatory annual distributions would be taken over her life expectancy, not the 'regular' 10-year distribution period imposed by the SECURE Act.

SECURE 2.0 Act Election: If Mrs. Gee had made the *election* created under the SECURE 2.0 Act (available only to surviving spouses) the more favorable Uniform Lifetime Table could be used by her to calculate her RMDs, which would be lower than the Single Lifetime Table that all other eligible designated beneficiaries must use to calculate their RMDs.

Later Rollover: Finally, if Mrs. Gee had maintained an inherited IRA until she was older than age 59 ½, she could then rollover the balance of the inherited IRA into her own IRA at that later date and add her own designated beneficiaries to that IRA and no longer be subject to annual RMDs until she attained age 73.

Conclusion: Spousal rollovers are frequently used by surviving spouses to simplify their lives and to avoid having to take RMDs until age 73. That said, a spousal rollover cannot be reversed, once done, so it is important for the survivor to consider his/her needs in the future to access the inherited retirement funds, and if the need exists, it would be wise to maintain an inherited IRA for a period of time, or at least until the survivor is age 59 ½ or older.

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