Obama Budget Proposes Major Changes to Non-Spouse Inherited IRAs

There has been much discussion in the press about President Obama's budget proposal to cap the amount an individual can accumulate in IRAs and other tax-favored retirement investments.

Less noticed is a proposal that could dramatically affect individuals who inherit IRAs from persons other than their spouse. Unlike the proposed cap on total accumulation, which affects millionaires only, this proposal affects IRAs of all size, whether the inherited IRA is worth $10,000 or $1 million. Accordingly, if enacted into law, this provision would impact estate planning for many middle-class Americans.

Under current rules, a non-spouse beneficiaries who inherits an IRA is generally able to extend the tax deferred benefits by taking required minimum distributions (RMD's) over the course of his or her life expectancy. Under Obama's budget proposal, the non-spouse beneficiary would be required to take distributions of the entire value of the inherited IRA within five years. This significantly reduces the tax-deferral benefits of inherited IRAs for most non-spouse beneficiaries.

The proposal would apply to non-spouse beneficiaries when the IRA owner dies after December 31, 2013. The proposal would also require distribution within 5 years, regardless of when the original IRA owner dies, if the non-spouse beneficiary of the inherited IRA dies after December 31, 2013.

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