Protecting an Inherited 401(k) from taxation

In this instance the proceeds should be transferred to an inherited IRA which can be emptied over the life expectancy of the beneficiary. The person inheriting the proceeds will pay taxes on the required minimum distributions every year. The account balance will continue to grow on a tax deferred basis.

The money must be transferred correctly to preserve its tax deferred status. The 401K Plan should be asked to move the money directly to the inherited IRA in a tax-free trustee to trustee transfer.

The inherited IRA should be titled "John Doe IRA" (deceased date of death) for the benefit of "Mary Doe". Finally Mary Doe must begin taking taxable annual minimum distributions no later than December 31 of the year after the original owner's death. She can of course withdraw more if she wishes. Withdrawing less than the required minimum distribution (RMD), she will incur a penalty equal to 50 percent of the amount that she should have taken but never did.

Websites with more information: Lusa.gov/14pcjod & bit.ly/115C94C