

# Episode 229: How To Leave More Wealth to Your Children After Taxes

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## SUMMARY KEYWORDS

Retirement planning, tax-efficient estate planning, gifting strategies, inherited IRAs, step-up in basis, Roth IRA, estate taxes, lifetime stretch, Secure Act, required minimum distributions, irrevocable trusts, life insurance, financial personality, legacy considerations, marginal tax rate.

## SPEAKERS

Alex Murguia, Speaker 1, Wade Pfau, Briana Corbin

### **Briana Corbin** 00:00

The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to [retirewithstyle.com/style](https://retirewithstyle.com/style) and sign up to take the industry's first financial personality tool for retirement planning this week on Retire with Style, Wade and Alex prove that nothing says I love you quite like tax-efficient estate planning. They're covering gifting strategies, inherited IRAs, and how to explain to your children that giving them unequal amounts of money is actually a sign of affection.

### **Wade Pfau** 01:01

Hey everyone, welcome to Retire with Style. I'm Wade, and I'm here with my trusty co-host, Alex. And we're continuing our.. hey, Alex. Hello, trying to get a word in edgewise.

### **Alex Murguia** 01:12

No, no, no.

### **Wade Pfau** 01:14

Our series on the retirement planning guidebook, the third edition that came out in January, fully updated for 2026 and also a lot more reader friendly than past editions. So, if you're looking for a resource for retirement income, it's a good resource to check out. And we're continuing this week with the second half of chapter 11, talking about what the book covers, what you need to know for retirement, and the second half of chapter 11, Alex is about tax planning with legacy and estate considerations.

### **Alex Murguia** 01:45

Wow, but I do have a question beforehand.

### **Wade Pfau** 01:47

Okay,

**Alex Murguia 01:48**

why were you so reader unfriendly in your previous edition? Why did you decide to make this one friendly? I thought all of you, I thought all the Wade versions were friendly.

**Wade Pfau 01:59**

Yeah, it's a good question. I guess. When I was first making the book, I was thinking it would be more like a textbook for retirement income planning, and the longer the better in that regard. But with reviews that came in, they didn't always appreciate the longer the better philosophy, or the textbook philosophy. So, without really taking away any substantive content, I was able to cut out about 100 pages just by really focusing on what you need to know and trying to explain it more clearly and accessibly. So, I guess just maturing and growing using that in making the book something that's.. it's still.. if you're a very beginner, and in that case, you're probably not listening to the podcast, anyway, that the book could still be complicated, but I think it's a lot more accessible than past editions.

**Alex Murguia 02:49**

Look at you, always growing. I aspire to have that kind of

**Wade Pfau 02:54**

book as a living document.

**Alex Murguia 02:56**

There you go, there you go. That was nice. So it's not the director's cut anymore. It's like straight, just things you need to know. Oh, that's awesome. No, no, I agree, Wade. I think it's a, I think it's a better edition than the previous ones. It's like that Mark Twain thing. I would have wrote a shorter book if I had more time, you know, something like that.

**Wade Pfau 03:19**

Gravity is the soul of wit.

**Alex Murguia 03:20**

Oh, wow, look at this Shakespeare over here. Use that

**Wade Pfau 03:24**

quote before, though. But yeah, the third edition is well, the full length, including the index, it gets up to 377 pages. But the second, the 2025 update of the second edition, I think was 507 pages.

**Alex Murguia 03:38**

There we go.

**Wade Pfau 03:38**

So I was editing.

**Alex Murguia 03:41**

I can't wait to read the Twitter edition. All right, so we're on the tax planning chapter here, the second half of it. And in the previous episode, if you haven't heard it, check it out. We talk about the basics, we're sort of laying the groundwork for estate planning 101 not to roll up our sleeves

a little bit. Wade, get right into it. How does tax planning change when preparing to leave an estate?

**Wade Pfau 04:13**

So, in chapter 10, when we talk about tax planning, it was about getting the most after-tax spending and legacy from your assets, but legacy wasn't a specific consideration, or otherwise legacy was more of a background consideration. There's three important points to consider when it is becoming more clear that there will be a legacy, and/or you're otherwise planning for a legacy, if you're not planning for a legacy specifically, the the Chapter 10 tax planning advice is you really do spend down taxable accounts first. Now you're blending that with tax deferred distributions, but you are on a track towards eventually the account that you spend down first is. To be the taxable brokerage account now. When there's a legacy consideration in mind, you might slow down the distribution of the taxable account because there's the step up in basis rules that taxable assets receive a step up in basis at death, so if you are able to leave taxable assets as an inheritance, any embedded capital gains go away. The if you have a low cost basis, if you distribute now for retirement expenses, you have to pay the capital gains tax. If you leave it for beneficiaries, they get a reset.

**Alex Murguia 05:33**

So, so let me just make it clear for folks listening who may not be as well versed in just the terms we're throwing out, so if I buy a stock right now, and I buy it for \$10 you know, I put, you know, whatever, I put \$100,000 into it at a \$10 you know, average price \$10 and then effectively 15 years later I die, and you know, the 100,000 is not worth a million dollars. I've effectively made \$900,000 on it, but not made, obviously. I passed away with that account being worth \$900,000 of it. It goes to, it goes 100% to one of my kids. They don't pay any of that \$900,000 in capital gains, is what

**Wade Pfau 06:20**

you say

**Alex Murguia 06:22**

they get the basis at the time of my death,

**Wade Pfau 06:25**

right? That step up in basis means they're the cost basis. I think your example, when you bought it, it was 100,000 but now it's worth a million, so it resets their cost basis to a million. Now, if they continue to hold on to it and it grows to 1.1 million, they'll have \$100,000 of capital gains in there from the growth since death, but that \$900,000 of capital gains that was embedded, and that you would have to pay the capital gains tax on had you sold it during your lifetime goes away,

**Alex Murguia 06:55**

and so this is where you're getting at that if you see yourself being able to not fum out assets, and you're realizing I'm going to have a lot left over, because I don't want to spend what I have, I can't spend what I have, you know, it just doesn't feel right. What you're saying is the philosophy could begin to switch, because now that you're going to leave a legacy behind, and legacy is just right now a nice way of saying you're going to leave money behind, effectively you want to make sure that maybe you take advantage of the, the call it the carryover in cost basis.

**Wade Pfau 07:30**

Yeah, the traditional advice is you continue to aggressively spend down the taxable account, but to preserve that ability to get the step up in basis, you might well, you still every year the account is going to be kicking off income, the dividends and interest, and so forth. You spend that, but you might not want to sell shares and realize capital gains, maybe instead cover those additional distribution needs from from the Roth IRA, or you're more mindful of it's not necessarily a good idea to aggressively spend down that taxable account just because of the tax considerations and the benefits of the step up in basis,

**Alex Murguia 08:09**

and the flip side to this is I know you want to deal with this towards the end of the episode, so that's fine, because if you don't, and if you just leave, if you will, a Roth IRA at the end, because you spent on all your taxable assets, your inheritors are going to get a different tax sort of dynamic than than if it was a taxable account.

**Wade Pfau 08:33**

Well, an inherited Roth IRA is also a great thing to inherit.

**Alex Murguia 08:38**

Yeah, but the tax, there's gone

**Wade Pfau 08:41**

well, there's no, yeah. Well, we'll talk about that more at the end, but there's not.. they'll, they'll still have to distribute out of the Roth IRA and reinvest in a taxable brokerage account, but they won't have to pay any taxes on the distributions from the Roth IRA, so it.. it behaves pretty similarly to, like, a taxable

**Alex Murguia 08:58**

limit. Yeah, I was just.. I was just referring to the 10 year limit, kind of thing.

**Wade Pfau 09:02**

Yeah, so it actually, you get to distribute it out over 10 years to reset the, so you get there is a little bit more tax benefit in that regard, but that's compared to getting a taxable account with the the account equal to its cost basis. The fact that you can wipe out all the embedded capital gains in that taxable account is a huge benefit, which means you'd rather let your beneficiaries get those capital gains wiped out. It's okay to spend from the Roth IRA, even though the Roth IRA also has some really great tax advantages too.

**Alex Murguia 09:40**

Okay.

**Wade Pfau 09:41**

Yeah, yeah, so then other considerations are when you're thinking about the effective marginal tax rate management of I'm I want to make a Roth conversion, for instance, when I can pay at a relatively low effective marginal tax rate, when legacy is a consideration. And you're comparing the tax rates you would pay by doing the Roth conversion versus the tax rates that your beneficiaries would pay if they instead inherited that as an inherited IRA, and that starts to get

into the issues of if your adult children are inheriting an IRA in their 50s, they may be in their peak earnings years with really high effective marginal tax rates, and so from the perspective of creating the biggest after-tax legacy, you as a retiree might want to do the Roth conversions, so that they would inherit a an inherited Roth IRA instead of an inherited IRA, so that they then have a 10 year window to distribute the account, and they might be doing that at quite high tax rates. It's effective marginal tax rate management becomes comparing not just like how much would I pay now versus in the future, but how much would I pay now versus my beneficiaries, what they would pay in the future, and then

**Alex Murguia** 11:01

that's what you said more eloquently than I did at the beginning. That's kind of what I was getting at.

**Wade Pfau** 11:05

Yeah, and the third consideration is, if you have multiple beneficiaries who will face different tax rates, that can impact how you want to distribute the assets. That just dividing everything up equally could be a lot less tax efficient than like the idea is, maybe I've got two children, one of them is a really high-paid professional who's facing the 37% income tax bracket, another child has a lower paying job and might be able to manage distributions in the 12% income tax bracket, in that case you might create unequal pretax distributions that will translate into equal after-tax distributions and much greater after-tax spending, the idea being you give more Roth assets, more like Roth type assets to the person in the higher tax bracket, more the traditional IRA assets to the person in the lower tax bracket, but then you also give them a little extra to pay the tax bills, so that after the tax bills are paid on those IRA assets, they receive more equalized after-tax legacies, they're not equal pre-tax legacies, but they're equal post-tax legacies that might require some explanation and concerns about it not being fair, but if you explain how this could lead to much larger after-tax legacies for each individual, they might be willing to go along with that.

**Alex Murguia** 12:36

Could you imagine? Hey guys, I got an idea, but listen to the whole thing first before you say anything, let me get to the end. Before you say anything, it's gonna work out. Trust me.

**Wade Pfau** 12:47

Here's the idea: child A gets more than child B,

**Speaker 1** 12:50

but trust me, it'll be fine. I knew it, I knew it, I knew he was your favorite.

**Wade Pfau** 13:03

It, no, you're right, because I ultimately, it's what you keep, and so it's, it's a way to harmonize it on a level of complexity. What are you talking about here, from one to 10? Well, I give an example in the book, and, of course, part of it is, it may be difficult to predict what tax rates each adult child would face, because their financial situations could change, but, like, I create a simple example where it's there's \$100,000 in an IRA and \$100,000 in a Roth IRA. If you divided both of those counts equally between each child, the final after-tax legacy is a lot less than what you do, is you give \$94,000 from the Roth IRA to the person in the higher bracket, you give the other \$6,000 in the Roth IRA and all \$100,000 in the IRA to the child in the lower

tax bracket, that the child in the lower tax bracket pays \$12,000 in taxes from the IRA, and then they're both left with \$94,000 after tax, and that's a lot more than they'd end up with if those accounts were split more well. The on a on an after-tax basis, the person in the higher tax bracket would be hurt a lot worse than the child in the lower tax bracket, but they can both be made better off by thinking through this process.

**Alex Murguia** 14:30

No, I think it's great. I don't think it's that complicated, but I just didn't want to have folks, when you were kind of doing the initial explanation, thinking that's that's too much. I can't keep track of that on my Hewlett Packard, you know, HP 12 C, whatever, yeah, that kind of thing, but it's, it's not, if you conceptually understand it, I, I think directionally it's fairly simple to pull off,

**Wade Pfau** 14:53

and even if you are kind of forced into a constraint of providing equal pre tax, and here. Patience is because the kids just can't wrap their heads around it. You still, it makes sense to give more of the Roth to the child in the higher tax brackets, although if they figure out after the fact that the child in the lower tax bracket got stuck with a bigger tax bill, they might still be unhappy, but more the IRA goes to the child in the lower tax bracket.

**Alex Murguia** 15:22

What happened to the days of just thank you. Thank you for anything.

**Wade Pfau** 15:25

Yeah, those days are gone.

**Briana Corbin** 15:31

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**Alex Murguia** 15:56

All right, now in terms of estate planning, we talked anything more about efficient distributions with inheritance.

**Wade Pfau** 16:05

Now that's the idea, because that's not yet into the estate taxes. Now we're ready to propose estate taxes.

**Alex Murguia** 16:11

Okay, so right off the bat, what are the numbers here?

**Wade Pfau** 16:15

Well, in 2026 it's pretty simple. You have an exemption of \$15 million per person, so you do this properly within a couple, potentially \$30 million for a couple eggs exempt from estate taxes, and then beyond those limits you quickly go from after another million dollars you up to a 40% estate tax rate at the federal level, so state taxes have a pretty high tax rate, and these, these limits

can change over time. They, in the past, they have been a lot lower, but at least right now, like most households are not going to have to worry about estate taxes, but the change in the future,

**Alex Murguia 16:56**

and just because we've been talking about taxes, and you know, the term waterfall versus non-waterfall, whatever, let's say you're single and you die with \$15 million \$15,000,100 What gets taxed at 40% The \$100 that's over the 15 million or the whole thing.

**Wade Pfau 17:15**

Well, it would just be that \$100 over 15 million. It's just like tax brackets in that regard, but you don't immediately go into the 40% rate, it starts at 18% I think. So, there might be an \$18 estate tax bill in that scenario. You just

**Alex Murguia 17:29**

print out, okay? The the other piece is, where does it stand, the 15 and 30 relative to historical numbers, just to put things in perspective. And, and how crystallized do you feel this number is in the foreseeable future, and granted things change, but just curious,

**Wade Pfau 17:46**

as far as I know, these are as high as they've ever been. I don't know if there was any minor historical period where they were higher, but yeah, these are pretty high limits right now relative to history, and that they're permanent right now in terms of they'll adjust for inflation each year, but it would require new legislation to change them, so that new legislation could come at any point in the future, but that's hard to predict, and that's just where we are right now, 15 million and 30 million for a couple.

**Alex Murguia 18:20**

Okay,

**Wade Pfau 18:21**

now some states do have their own estate tax as well. There's not that many. The states with an estate tax are Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, Washington, and the District of Columbia. And there's also an inheritance tax in a few states, which is more to when you receive the inheritance versus the estate paying the tax in Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania, and Maryland special because it has both an estate and an inheritance tax, the only state with that, but those could match federal limits, or they could be much lower limits as well, so if you're in one of those states, state estate tax is also a consideration alongside the federal, so even if you're not going to hit the federal limits, you might still be hitting some state limits.

**Alex Murguia 19:15**

What's going on with Maryland? So I'm part of the DMV. What's happening here?

**Wade Pfau 19:23**

Right,

**Alex Murguia 19:23**

me too. The district as well.

**Wade Pfau** 19:26

Yeah, and Virginia was not on the list. You're good.

**Alex Murguia** 19:33

Yes, yes. Northern Virginia exempt. All right. And so, so those, the limits on the estate. What are the gifting limits?

**Wade Pfau** 19:46

Yeah, so then gifting gets into each year an individual can give to another individual up to \$19,000 as a gift that does not um. To work against the estate, any gifts in excess of \$19,000 you then have to start keeping track of, because that goes against your estate tax limits. You can't just gift if you had a \$15 million account, you can't just gift it right now and then avoid estate taxes on it. The first \$19,000 would be free of consideration, but the rest of the gift goes against your estate tax limits, and then at the end would be part of the calculation of the estate tax,

**Alex Murguia** 20:31

and again, this is where the first 19,000 is no consideration, and then any dollar over that, that's when you start, it's not, it's not a waterfall, I just want to make sure again for those folks, it's just the amount over 19 now,

**Wade Pfau** 20:45

so then people might also start gifting right now to take advantage of the limits from now, because if those limits were lowered in the future, they'd be protected on the gifts they made while the limits were higher,

**Alex Murguia** 20:57

100% and now of that 19,000 what happened, there's two things that happen, right? You start, you need to keep track of it. Is there a tax involved, and for who? For the amount over 19,000

**Wade Pfau** 21:09

Well, on gifts of over 19,000 the the additional amount over the 19,000 you do need to keep track of that. The there's no tax due now, but it will be counted against your estate tax limits. So, if you had made gifts of a couple million dollars, you'll ultimately be fine, because that's still under the \$15 million limit. But you might do this strategically now to take advantage of that limit while it's higher, just in case those limits drop in the future, it's going to count against the limits, and as long as you don't ultimately exceed the limits, you're fine, but you do have to keep track of gifts for the amounts over the \$19,000 exempt amount each year, but that's per person and from each person, so a couple, they could each gift a child \$19,000 so that that's \$38,000 and then if you have five kids, you could do that \$38,000 for each of the five kids, and

**Alex Murguia** 22:11

but that doesn't go towards the limit either,

**Wade Pfau** 22:13

right?

**Alex Murguia 22:13**

That's all,

**Wade Pfau 22:15**

not you don't have to keep track of that, and there's also a special rule with the five to nine plans that someone often like a grandparent in this situation could make up to five years worth of those gifts all at once, so the 19,000 times five could all \$95,000 donated in one calendar year, not donated but going to the five to nine plan and that also avoids that's within the rules of an exempt gift

**Alex Murguia 22:50**

and what is what when you hear the terms yearly gifting and lifetime limit, how does that work?

**Wade Pfau 23:00**

Well, if you just start getting in the habit of like gifting people \$19,000 and these go up every year for inflation, but like \$19,000 a year, that's a way to start getting money out of the estate without any sort of estate tax considerations.

**Alex Murguia 23:14**

When you hear lifetime limit, it's referring to the estate ceiling,

**Wade Pfau 23:18**

yeah, the like the \$15 million limit. Now,

**Alex Murguia 23:21**

wanted to make sure for folks listening, because you hear these terms a lot. I want them to understand. Okay, like I

**Wade Pfau 23:26**

gifted somebody \$20,000 this year, I'd have to keep track of the ex, the \$1,000 over the limit, that would apply against the \$15 million that is exempt from estate tax. So then, if my estate was ultimately exactly \$15 million and we got to account for all these inflation adjustments, but I'd, the fact that I had previously had another \$1,000 gift in there, well, I'm now like at \$15,001,000 as an estate.

**Alex Murguia 23:58**

There you go.

**Wade Pfau 23:59**

Gifting is not a loophole to avoid estate tax, other than you get that \$19,000 limit each year that you can work with, which can add up over time if you're just gradually making those gifts.

**Alex Murguia 24:10**

No, 100% especially if that money's just going to be invested, and you're looking at 30 years that you're giving whatever \$18,000 a year to kids adds up in a significant manner, and I think your point was well taken. You can give it, your spouse can give it, so then that's two injections

going in it. Yeah, there's, there's a lot of avenues, you know, for to potentially transfer this over if you do it in a steady and systematic way,

**Wade Pfau** 24:40

and that can be a way to also provide the inheritance while alive, and while you can enjoy the benefits of it, helping even if it's used for a family trip or things, but just helping, helping folks while you're still alive, rather than saving everything for an estate at death.

**Alex Murguia** 24:59

No, 100% like. If I mean, look, let's say you're sitting on \$8 million right, and you know you're not going to hit that 15 million. I mean, sorry, the limit, yeah, the 30 million for you,

**Wade Pfau** 25:13

like you may be worried that by the time you pass away, the limit could be reset to 1 million, and then you would have a huge estate tax bill.

**Alex Murguia** 25:20

I wasn't even thinking like that. I was thinking more like they know they're not going to reach it. They just said, you know, I don't. I'm fine starting to gift now, so I can see the benefits of it. But no, you're right. I mean, who's to say in a few years it doesn't go down,

**Wade Pfau** 25:34

right? And it's not that far back in history. I outline it in in the book of, in the early 2000s let's, yeah, right here. So, as recently as 2001 the individual estate tax exemption was \$675,000 It was still only \$2 million in 2008 So, the fact that it's \$15 million now, that doesn't mean it's going to stay that way forever. And that's the like, if you hadn't done any gifting, you're like, okay, I'm gonna have about \$10 million as an estate, I won't have to worry about estate taxes, I'm not going to do anything, but then the law changes, and there's now a \$1 million exemption, you now have \$9 million estate taxes are going to be due, so that's where you might still be thinking about taking some actions to possibility.

**Alex Murguia** 26:25

Now I don't know the answer to this. I don't suspect you'll know the answer to this, but I'm just thinking, let's say somebody, for whatever reason, gives this year \$7 million thinking, oh well, this date, you know, the thing, the limit is 15, so I'm good, but they roll it back like the next year, and now you've actually gifted over the limit.

**Wade Pfau** 26:47

Yeah, I don't know exactly how that works, but my impression is they must do some sort of calculation of like if you donated 7 million out of the 15 million that was almost 50% of what you're allowed, so maybe they say, okay, so you've gifted no.

**Alex Murguia** 27:04

I just thought of this right now, so forgive me. Wait up, I'm not even putting you on the spot. I don't expect you to know this. I just thought that could be an interesting sort of, uh, oh

**Wade Pfau** 27:13

yeah, I think they do some sort of prorated calculation that you're not, if you had gifted it with the current limits in place, you're not gonna have to worry about paying estate taxes on it. I think there's some pro rating, but yeah, I don't know exactly how that works.

**Alex Murguia 27:30**

Yeah, but it would seem fair. How do we introduce life insurance into this mix?

**Wade Pfau 27:38**

Well, that can be a consideration for legacy if it even if you don't have an estate tax issue, it could be a way to quickly provide liquidity to the estate, so that they can cover expenses without having to liquidate, especially if it's like a business. If you're they're receiving a business, it could be hard to liquidate and receive liquidity from that business, so the life estate could be a resource, or life insurance could be a resource to quickly get liquidity into the estate to pay bills, and then also from the perspective of estate planning, life insurance can play some interesting roles, because you can gift the premiums, and then if you or you set up like a life insurance trust, where as long as you live for another three years, the what goes into the estate is like the premiums that you paid rather than the death benefit, so I could basically make up numbers, but like gift now a million dollars to pay for a life insurance policy that's going to pay \$15 million upon death. If, as long as I live another three years, only that million dollars would contribute, would go into the state limits. The \$15 million death benefit exists outside of the estate limits, so that can be a strategy to help people manage estates, estate taxes, as well, and there are a number of other related irrevocable trusts that you can use as a process of help managing estate taxes, and I do outline the basics of how those work in the retirement planning guidebook, but for that sort of issue, you really do need to be working with a professional, like a state planning attorney, knowledgeable with the rules in your state to get the most effective use of those types of strategies, so we won't get too deep into the weeds with that.

**Alex Murguia 29:39**

Okay, and you started to get into trust on for estate taxes through the use of an insurance vehicle. Do you want to get into that more, or is that enough of an intro?

**Wade Pfau 29:52**

That's probably enough of an intro. The whole basic strategy is with these irrevocable. Trusts, you make a gift, so that you value what went into the trust is what goes against your estate, and then any subsequent growth or appreciation or life insurance, death benefit, all that growth exists outside of the estate, so it's a way to gift more without having to pay the estate taxes on it, that's the basic idea that feeds into using trusts for estate tax reasons, but those have to be irrevocable trusts, because the gift you can't use a living trust to avoid estate taxes, you have to make that gift, and it has to be, you have no longer control over the asset.

**Alex Murguia 30:39**

For semantics, can you please make a quick distinction between irrevocable versus living?

**Wade Pfau 30:44**

Yeah, an irrevocable trust can't be changed in the future. You've, you have no more control over that trust, it exists outside of your control, whereas a living trust is also called a revocable trust. You can make changes to it, but if you can make changes to it, it means you maintain control

over it, which means it hasn't been a completed gift for the purposes of gifting within the IRS rules.

**Alex Murguia 31:10**

Okay, and the last part that we wanted to cover was the RMDs on inherited accounts. I jumped the gun on it, and I think I may have confused more than elucidated, which is probably a reoccurring theme, but for RMDs on inherited accounts, touch base on that, just to lay it laid out for folks.

**Wade Pfau 31:32**

Yeah, yeah, and so that's inherited IRAs and inherited Roth IRAs. They have their own special rules, and we get a lot of questions that come in about this because there's so many scenarios for how it works and this is something that the Secure Act changed dramatically back in the end of 2019 and then also the Secure Act to point out a couple years later made further minor modifications but the basic issue is the lifetime stretch idea that people had in the past. A lot fewer individuals will be eligible for lifetime stretches. There's now 10 year windows, but yeah, maybe it's really worth going through the scenarios. There's a exhibit 11.1 in the retirement planning guidebook outlines this. There's a lot of potential scenarios. It's about so for an IRA or Roth IRA, did the or other employer plan? Did the owner or participant die before the required beginning date for required minimum distributions, which is April 1 in the year after they reach the age where RMDs begin, which is now 73 but will be 75 for people born in 1960 or later. There's a set of rules for if they died before reaching April 1 of the year after the year they reached their RMD age, or if they die after April 1 of the year after the age they reached their RMD age, and then there's different rules for whether that death took place in 2019 or earlier, or whether that death took place in 2020 or later, and then there's different rules based on the type of beneficiary spouses get the most flexibility, so spousal beneficiaries, non-spousal beneficiaries, and then non-person beneficiaries all have different types of rules, so the big highlight coming out of all that was that with the non-spousal beneficiaries, adult children, kind of the example you have in mind, before 2019 they would get a lifetime stretch, which allowed them to distribute that inherited IRA over their remaining lifetime using table one of the stretch

**Alex Murguia 33:48**

is the word for the length of the distribution,

**Wade Pfau 33:51**

and if you're an eligible designated beneficiary, you can still use that lifetime stretch, but like adult children will tend to not be eligible designated beneficiaries, which means they now have a 10 year window to spend down an inherited IRA. Now, if the death happened before the required beginning date of the owner, you could wait until year 10 to take everything out if you want, although that for tax reasons you might want to spread it out over time, but if the owner's death happened after the required beginning date for taking RMDs, there is also a required minimum distribution every year in that 10 year window, with the remaining balance having to come out in year 10, and that was a thing that was unclear for a few years and was excused from 2021 to 2024 but in 2025 and later. If you have an inherited IRA and you're a non-spousal beneficiary and not an eligible designated beneficiary, and was, and that individual passed away after april 1 of the year after. Or they reach the age where RMDs begin, then you do have to take an RMD for each of the 10 years, and any remaining account balance has to come out in year 10,

**Alex Murguia 35:11**

and just to be clear, these are the this is going to be taxed at your income level, that's why the timing of these payments for somebody, let's say in their 50s, is important, because let's just assume that you know from a career perspective that's most likely going to be a high earning year for these folks.

**Wade Pfau 35:30**

Yeah, yes, so taxable assets don't have any embedded taxes because of that step up in basis. Roth assets, though, there will be the RMDs to distribute them. There's no taxes due on that income taxes, I mean, no income tax. But inherited IRAs have an embedded income tax liability. Those distributions are now taxable to the beneficiary at their income tax rates, and if those accounts are big enough, like if the estate's big enough, there's an estate tax bill, and any estate taxes paid, you get to offset against these income taxes, but if there's no estate tax issue, there's still this embedded income tax liability. Now that gets into, like, if you are charitably inclined, IRA assets are often the most powerful asset to leave to a charity, because that embedded income tax liability. Well, if the charity gets to pay at a 0% tax rate, let them, quote unquote, pay the tax bill at 0% leave that asset to the charity, and then leave other assets to the other, like child beneficiaries, and so forth.

**Alex Murguia 36:39**

And how does the just to make it clear to everyone, what are the key differences between the Roth and the regular IRA from a distribution standpoint?

**Wade Pfau 36:50**

Well, there's not a lot of key differences, the key, I mean, the key difference is those required minimum distributions from the inherited Roth IRA are not taxed, they have to come out, but they're not taxed. And then what you can see me do is reinvest them in a brokerage account.

**Alex Murguia 37:07**

The time is the same, though. The time in which they need to distribute is the same

**Wade Pfau 37:12**

or not. Now, spouses have a lot of options and a lot of flexibility for inherited. They could just pull it over into their own IRA and use their own age for RMDs. They could leave it in the name of the deceased, and if that person was younger, maybe they'll get better RMD treatment that way. Yeah, they just, they have more flexibility than other types of beneficiaries, and then the beneficiaries with the least flexibility are like the non-humans, the estate or charity, or other certain types of trusts. They have either a five year window to take the distributions if the death happened before the required beginning date, or a type of lifetime stretch, but a less advantageous one if the death happened after the required beginning date,

**Alex Murguia 38:13**

and the buck covers it.

**Wade Pfau 38:15**

Sure does. Yeah, this is these details are all accounted for in Chapter 11 of the Retirement Planning Guide, but because there's a lot of the complications associated with that, I also talk

about taxes on inherited annuities at a very basic level, because that gets even more complicated than inherited IRAs and Roth IRAs, and then also a caveat on inherited health savings accounts, that's like an inherited IRA, but with a one year window to take the distributions, so that's where, if you leave a big inherited HSA and you didn't leave your receipts for them to

**Alex Murguia 38:53**  
offset,

**Wade Pfau 38:54**  
they may have a big tax bill due in one year for that account.

**Alex Murguia 38:58**  
Got you all right, folks, you heard it here, and you can read it in Chapter 11 of the Retirement Planning Guidebook.

**Wade Pfau 39:06**  
That's right, and we're getting closer to the end of the series, but we'll continue on the next episode with the non-financial considerations. All

**Alex Murguia 39:13**  
right, everyone. Thank you for listening to Retire with Style. I'm Alex, signing off. Wade,

**Wade Pfau 39:19**  
thanks, everyone.

**Briana Corbin 39:21**  
Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you. Consult your financial advisor. All investing comes with a risk, including risk of loss. Past performance does not guarantee future results.