

MONEY MYTHS SERIES

Should You Cash Out an Inherited IRA? The Tax Math Influencers Skip

What cashing out an inherited IRA really costs in 2026 federal and California tax, and how the 10-year rule lets most heirs keep more.

By Eric Ridley, attorney, Ridley Law · Updated September 2026 · Read online with live links: ridleylawoffices.com/cash-out-inherited-ira-california/

Part of our [money myths series](#), where we check the money advice on Instagram, TikTok and YouTube against the actual rules.

The claim: You inherited an IRA? Cash it out. There's no penalty, it keeps things simple, and you can put the money to work somewhere better.

The verdict: The no-penalty part is true. The rest usually costs you. Every dollar from an inherited traditional IRA is taxable income in the year you take it, so pulling it all out at once can push a middle-income heir into the 35% and 37% federal brackets plus California's top rates. Most heirs have until the end of the tenth year after the death to spread withdrawals out (IRC § 401(a)(9)(H)), and in our example that keeps about \$62,000 more in the family.

10 years

Most non-spouse heirs' deadline to empty the account (IRC § 401(a)(9)(H))

\$255,758

Tax on a \$600,000 lump sum, hypothetical single heir, 2026

\$193,440

Tax on the same \$600,000 spread over 10 years

0%

Early-withdrawal penalty on inherited IRA distributions (IRC § 72(t)(2)(A)(ii))

\$109,000

2026 income where a single filer's Medicare premiums start to rise (SSA)

Who gets paid when you cash it out? The IRS and the California Franchise Tax Board, first and most. After that, whoever is selling the thing you're told to buy with the money. A cashed-out inheritance is exactly what annuity and permanent life insurance salespeople look for, and California law knows it: when a life agent offers an annuity or life policy to someone 65 or older, the agent must warn in writing that liquidating an IRA to fund the purchase may have tax consequences and that the buyer may want independent advice (Ins. Code § 789.8). The same pitch shows up as "be your own bank" whole life, covered in our [infinite banking](#) page. Indexed annuities can cap your upside; FINRA's example is an index that rises 12% while the contract credits only 7%.

Is there a penalty for cashing out an inherited IRA?

No. The 10% early-withdrawal tax doesn't apply to distributions made to a beneficiary after the owner's death (IRC § 72(t)(2)(A)(ii)), no matter how old you are.

The U.S. Supreme Court leaned on the same point when it held that inherited IRAs aren't "retirement funds" protected in bankruptcy: the heir can't add money to the account and can take the whole balance out at any time (*Clark v. Rameker* (2014) 573 U.S. 122). So the influencer has the penalty rule right. The cost was always the income tax.

How is a cashed-out inherited IRA taxed?

As ordinary income, in the year you take it, at your own federal and California rates. There's no capital gains rate and no special inheritance rate.

Brackets are where a lump sum hurts. The 2026 federal brackets for a single filer run 10%, 12%, 22%, 24%, 32%, 35% and 37%, and the 37% rate starts above \$640,600 of taxable income (Rev. Proc. 2025-32). California taxes the same income at its own graduated rates, with a 12.3% bracket above \$742,953 for a single filer on the 2025 schedule, the latest the FTB has published. A distribution that sits on top of your salary is taxed at your highest rates.

IRA distributions aren't net investment income, so the 3.8% NIIT doesn't apply to them directly (IRC § 1411(c)(5)). They do raise your adjusted gross income, though, which can pull other income into that tax.

How much more does a lump sum cost than spreading it out?

In our hypothetical, \$62,318, using these assumptions:

- A parent died in 2025, before the age when required distributions start, leaving a \$600,000 traditional IRA to one adult child.
- The child is single and earns \$90,000 a year.

- Option A: withdraw all \$600,000 in 2026. Option B: withdraw \$60,000 a year for 10 years.
- We use 2026 federal brackets and the standard deduction every year, ignore investment growth, and estimate California tax from the 2025 Schedule X with no deductions or credits.

■ Federal ■ California

A: cash out in 2026

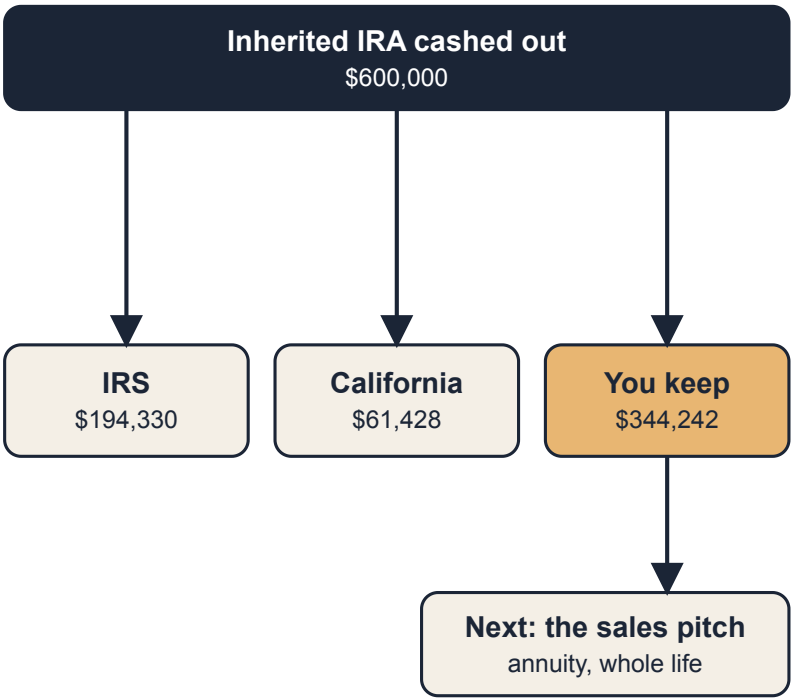


B: \$60,000 a year for 10 years



Strategy	Federal income tax on the IRA money	California income tax on the IRA money	Total tax	What the heir keeps
A: Cash out \$600,000 in 2026	\$194,330	\$61,428	\$255,758	\$344,242
B: \$60,000 a year for 10 years	\$137,640	\$55,800	\$193,440	\$406,560
Difference	\$56,690	\$5,628	\$62,318	\$62,318

Option B also leaves most of the money invested and tax-deferred for years, which the example ignores. A smaller account shows the same pattern: on a \$200,000 IRA, the same heir pays about \$72,264 cashing out at once and about \$62,600 spreading it over ten years.



What does the 10-year rule actually require?

For most heirs other than a spouse, the whole account has to be out by December 31 of the tenth year after the year of death (IRC § 401(a)(9)(H)). Whether you also owe a minimum withdrawal every year in between depends on when the owner died.

If the owner died on or after their required beginning date, Treasury's final regulations (T.D. 10001, published July 19, 2024) require annual distributions in years one through nine as well, and they apply to required distributions for 2025 and later. The IRS waived the excise tax for missed annual amounts through 2024 in Notice 2024-35. If the owner died before the required beginning date, you can take money on any schedule you like, as long as the account is empty by the deadline. Our page on [the inherited IRA 10-year rule in California](#) covers the details, and the [inherited IRA calculator](#) runs your own numbers.

Some heirs aren't on the 10-year clock at all. "Eligible designated beneficiaries" include a surviving spouse, the owner's minor child, a disabled or chronically ill person, and someone not more than 10 years younger than the owner (IRC § 401(a)(9)(E)(ii)). They can stretch withdrawals much longer, and a cash-out throws that away.

Can you undo it if you cash out by mistake?

No. A non-spouse heir can't roll inherited IRA money into another IRA. IRS Publication 590-B says you "can't roll over any amounts into or out of the inherited IRA," and IRC § 408(d)(3)(C) denies rollover treatment for inherited accounts.

The only way to move the money without tax is a direct trustee-to-trustee transfer into an inherited IRA titled in the deceased owner's name for your benefit. Once a check is cut to you, the distribution is taxable. That's why the order of steps matters: open the inherited IRA first, move the money by direct transfer, then decide how fast to take it.

Can a lump sum raise your Medicare premiums or other costs?

Yes, if you're on Medicare or close to it. Social Security sets Part B and drug-plan premiums from the most recent tax return the IRS provides, usually from two years earlier, and a single filer's premium rises once modified adjusted gross income passes \$109,000 (SSA; CMS, 2026). A one-year spike can mean a year of higher premiums down the road.

A large one-year income spike can also affect financial aid formulas, health-insurance subsidies and other income-tested benefits. Those depend on your situation; check before you withdraw.

What should you do instead of cashing out?

- 1 Find out which clock you're on**
Spouse, eligible designated beneficiary, or regular 10-year heir. Ask the custodian whether the owner died before or after the required beginning date.
- 2 Move it by direct transfer into an inherited IRA**
Never take a check first. Make sure the account is titled as an inherited IRA.
- 3 Map withdrawals to your low-income years**
A year between jobs, a sabbatical, or early retirement before Social Security can absorb withdrawals at lower rates. Spreading evenly is a baseline, not the only plan.
- 4 Compare after-tax dollars before buying anything**
If someone wants you to cash out to fund a product, ask for the commission, the surrender schedule and the after-tax math in writing.

If you're the one leaving the IRA, check that your beneficiary forms say what you mean. They override your will and trust, as we explain in [your will says one thing, your 401\(k\) another](#). Naming a trust as beneficiary is sometimes right and needs careful drafting; see [naming a trust as a beneficiary](#).

	Cash it all out now	Spread withdrawals over the 10-year window
10% early-withdrawal penalty	None	None
Tax rate on the money	Your top bracket, often 35% to 37% federal plus California	Lower brackets, spread across up to 10 tax years
Tax-deferred growth	Ends immediately	Continues on what's left
Medicare premiums and income-tested benefits	One large spike	Smaller, planned increases
Can be reversed	No	You can always speed up later
Simplicity	One transaction	One transfer, then a yearly decision

When does cashing out an inherited IRA make sense?

Sometimes. A small account, where the tax difference is a few hundred dollars, may not be worth the paperwork. A year when you have little or no other income can be the right year to take a big piece. Paying off high-interest debt can beat the tax cost, though you should run the numbers. An inherited Roth IRA is generally tax-free when it comes out, so the bracket problem doesn't apply, but you'd still give up years of tax-free growth by emptying it early. Even then, splitting a large withdrawal across December and January puts it in two tax years.

Frequently asked questions

Should I cash out my inherited IRA?

Usually not all at once. There's no 10% penalty, but the whole amount is taxed as ordinary income that year. Most heirs can spread withdrawals over up to 10 years under IRC § 401(a)(9)(H) and keep more after tax.

How much tax will I pay if I cash out an inherited IRA?

Your federal and California rates on the full amount, stacked on your other income. In our example, a single heir earning \$90,000 pays about \$255,758 on a \$600,000 lump sum in 2026, versus about \$193,440 spread over 10 years.

Can I roll an inherited IRA into my own IRA?

Only a surviving spouse can treat an inherited IRA as their own. Other heirs must keep it as an inherited IRA and move it only by direct trustee-to-trustee transfer (IRS Pub. 590-B).

Do I have to take money out of an inherited IRA every year?

If the owner died on or after their required beginning date, yes, starting in the year after death, under the final regulations that apply from 2025. If the owner died before that date, you only need the account empty by the end of the tenth year.

Is an inherited Roth IRA taxable if I cash it out?

Generally no, if the Roth account met the five-year holding rule. The 10-year emptying deadline still applies to most non-spouse heirs.

Does cashing out an inherited IRA affect Medicare?

It can. Medicare Part B and drug-plan premiums for 2026 rise for single filers with modified adjusted gross income above \$109,000, based on a tax return from about two years earlier.

This page is general information about federal and California tax law, not legal, tax or investment advice for your situation. The example is hypothetical and simplified.

For the full rules, see [the inherited IRA tax map for California beneficiaries](#) and our [retirement and beneficiary guides](#). More myths are in our [money myths series](#).

SOURCES

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Questions about your own plan?

Ridley Law helps California families with trusts, wills, trust administration and probate from Port Hueneme, serving Ventura, Santa Barbara and Los Angeles counties. The first call is free and runs 30 minutes.

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