



Agent and Advisor Guide to Advanced Markets Concepts



“Stretch IRA”

One of the primary benefits of an Individual Retirement Account (IRA) is the ability to defer taxes. The longer the deferral, the faster, typically, the IRA will grow. Unfortunately, the Treasury Department eventually asks for its share of that growth, known as the Required Beginning Date.

The Required Beginning Date for IRA owners is no later than April 1 following the year the owner reaches age 70.5 (i.e.— If an IRA owner reaches age 70.5 in March 2009, the Required Beginning Date is no later than April 1, 2010). The Required Beginning Date for beneficiaries of IRAs is December 31 following the year of death; however in cases in which the IRA owner has not taken a Required Minimum Distribution (RMD) for the year of death, the beneficiary is also required to take this distribution by December 31 of that year. The failure to make these distributions will result in a 50 percent tax penalty.

When people refer to a “stretch” IRA, it means the RMD is taken each year by the account owner and their designated beneficiaries, thereby extending the period for maximum deferral. When someone is taking RMDs, it is most often a situation when the owner does not need the money and has other sources for current income.

To maximize the deferral period, the following guidelines should be followed. Each situation is different and should be planned based on variables such as age, marital status, age of spouse, number of children and grandchildren, and financial status. Generally the account should:

1. Name the spouse as primary beneficiary.
2. Name the children and/or grandchildren as contingent beneficiaries.
3. Ultimately divide the accounts into separate accounts before the IRA reaches the contingent beneficiaries.

Naming the spouse as primary beneficiary allows for the most flexibility when deferring taxes. Upon the death of the owner, the spouse has the option to:

1. Keep the account in the deceased person's name and defer RMDs until the deceased spouse would have been 70.5.
2. Complete a spousal rollover and assume the account as if it were his or her own. This would allow the spouse to defer RMDs until the spouse is age 70.5. The spousal rollover is available at any time.
3. Disclaim the property as if the spouse was never a beneficiary. This would make the contingent beneficiaries primary.

Once the spouse has decided the best course of action, the account needs to be divided into separate accounts. This allows each beneficiary to use his or her life expectancy for computing RMDs. If the accounts are not divided, the oldest beneficiary's life expectancy must be used. The account can be divided into separate accounts at any time, as long as it is before December 31 of the year following the year of death of the IRA owner. To guarantee that the separation will happen, many IRA owners will divide the IRA into separate accounts for each contingent beneficiary prior to death.

IRC Sec. 691(c) Deduction

The 691(c) deduction is another potential benefit of the stretch IRA. If estate taxes are payable on the IRA, there is a partial income tax deduction for the payment of those estate taxes. Special care needs to be taken when counseling inherited IRA owners because many times the estate tax return is prepared by advisors of the owner and not the advisors of the beneficiaries.

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In summary, the many benefits and the potential risk of the stretch IRA need to be discussed in detail with the IRA owner.

Benefits and Risks

Benefits

- 1. Income for Life:** A stretch IRA can provide lifetime income to the beneficiaries.
- 2. Minimize tax liability:** By withdrawing smaller amounts over time, there is a potential to pay lower taxes due to lower brackets.
- 3. Continued tax deferral:** Continued tax-deferred growth has the potential to increase the wealth passed to heirs.

Risks

- 1. Estate Taxes:** If estate taxes are due and the estate needs IRA monies to pay these taxes, there might not be anything left to stretch.
- 2. Tax laws may change:** Tax laws may change that significantly minimize the benefits of the stretch. e.g. - Tax rates in the future could be significantly higher.
- 3. Poor returns on the IRA:** Investment losses could completely wipe out the potential value of future IRA distributions.
- 4. Lump Sum distributions:** Beneficiaries have the right to withdraw more than the Required Minimum Distribution. If this is a concern the account owner should discuss with advisors establishing a trust should be discussed with their advisors. If done correctly, a trust can be used as a vehicle to guarantee that only the Required Minimum Distribution is withdrawn each year from the inherited IRA



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