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Stretch IRA And Related Beneficiary Planning ©

Stretch IRA Plan. Stretch IRA planning is the utilization of an income tax benefit which is provided by federal tax law for heirs of retirement plans. Stretch planning applies to tax deferred Traditional IRAs only, and is not applicable to Roth IRAs since distributions from a Roth are non-taxable. Stretch planning allows tax deferral to continue after your death, often for many decades, spread over the lifetimes of your children or other heirs.

An heir or beneficiary of a Traditional IRA plan or a share of it may take a lump sum distribution of his/her entire share of the plan, or may "stretch" out distributions or payments of the plan share over his/her life expectancy. Either way, any payment received by the heir will be taxed at ordinary income tax rates. If the lump sum is large enough it pushes the heir into the maximum tax bracket. If an heir has a stretch plan he/she receives much smaller amounts than the lump sum, receiving yearly installments on the total IRA share spread over the heir's life expectancy. Since each year's payments are much smaller than the lump sum, the heir is very to likely to remain in a lower tax bracket.

Possibly the biggest benefit of stretch planning is that all money remaining in each heir's share of the IRA will continue to receive tax deferral treatment for on-going earnings in the plan. Thus stretch planning will often keep the heir in lower tax brackets while allowing the IRA to continue growing tax deferred. The amount of taxes saved, when spread over an heir's lifetime, can be huge and provide a nice supplement to the heir's pre and post retirement income. Unfortunately these benefits are almost always lost to individuals who inherit IRA money. To prevent that from happening to your heirs, see the topic "Pre-Plan The Stretch Benefit" on page 2.

Example Of The Power of The Stretch. The following example of the power of stretch IRA planning is taken from the free calculator on IRACentral.com (see last topic on page 2). Also, the calculator provides far more detail than presented here if you choose to calculate your own situation. The assumptions used in this example are: IRA owner present age – 65; none of the IRA is left to a spouse; the one IRA beneficiary calculated for is presently age 45; the current balance (or amount left to this one beneficiary) in the IRA is $100,000; the IRA owner takes only the required minimum distributions and starts these at age 70-1/2; the IRA is assumed to earn a modest 6% annually. The projected results:

Total distributions during owner's lifetime:	$120,425.61
Total stretch distributions during beneficiary's lifetime:	<u>$327,049.90</u>
Combined total distributions:	$447,475.51

Spousal Planning. There is not necessarily a need to do stretch planning for a spouse who will receive part or all of an IRA. Without doing anything other than listing a spouse as beneficiary of an IRA, he/she is automatically allowed to do any of the following with the IRA money of the deceased spouse:

- Elect his/her own stretch planning distributions of the money
- Take a lump sum, full distribution of the money
- Roll the money over to the surviving spouse's plan

IRA owners should understand that IRA money left to a spouse will come under the control of the surviving spouse, giving him/her the power to do anything the IRA rules allow with your money. That includes the three bullet point choices above, and in any case your surviving spouse will have the power to include or exclude your heirs from getting any remainder after his/her death. Therefore, to leave all or a portion of your IRA to your spouse, while planning for the remainder of that money to go to your heirs, requires both spouses to do identical stretch planning now, <u>*and*</u> for both spouses to trust each other to retain this planning until the death of the last spouse. So do your IRA beneficiary planning with an understanding of the power and control a surviving spouse has with IRA money you pass on to him/her.

If you choose to leave <u>all</u> of your IRA to your spouse, and you believe that your spouse is likely to consume all or the vast majority before his/her death, then stretch IRA planning is *probably unnecessary*. But, if you believe there is a reasonable chance that your spouse won't consume the vast majority of your IRA, <u>*or*</u> if you are leaving some of your IRA directly to children or other heirs, then your heirs can benefit from and you should consider a stretch IRA.

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Estate Tax Considerations For Married IRA Owners. Estate tax exemptions and rates have been in considerable flux at both the state and federal levels for several years. Fortunately estate taxes are not an issue for about ninety five percent of Americans, so this topic applies only to the other five percent. First, consider that anything you leave to your surviving spouse will escape estate taxes on your assets or estate. And if your surviving spouse sufficiently spends down what you leave him/her, then there won't be an estate tax problem on that inheritance. But there are cases where the surviving spouse can't sufficiently spend down the inheritance, or where even if the surviving spouse does spend it, he/she may still have other assets which can't be spent down enough to avoid estate taxes.

Note: Unmarried IRA owners will not be able to do direct estate tax planning either through the IRA itself or through a trust. Only some indirect planning, such as with gifting plans or life insurance, will mitigate estate taxes for unmarried IRA owners.

Where the surviving spouse is likely to have an estate tax issue, and where leaving your IRA to him/her either creates the problem or makes it worse, consider forming a family trust which incorporates comprehensive estate and death tax planning. In that case you would name the trust as the beneficiary for some or all your IRA. Either a living trust or a wealth protection trust from American Estate & Trust, LC (AE-Trust) will include this type planning, along with stretch planning for any IRA money which may be left over after the surviving spouse's death.

Where a married IRA owner's assets are <u>not</u> likely to cause an estate tax problem, which applies to most Americans, and especially where the surviving spouse is likely to use up most of the IRA, it will often make the most sense to name your spouse as the direct beneficiary of the IRA, rather than use a trust. If you plan to have a trust anyway, you might in that case choose to name the trust as contingent beneficiary to your spouse, and the trust should name your children or other heirs as either current or secondary beneficiaries (following your spouse). If the trust is created by AE-Trust, it will have all the proper beneficiary and stretch IRA planning built into it.

Note: Other than estate tax planning you don't need a trust for IRA beneficiary and stretch planning, and only a small percentage of Americans have estate tax issues. IRA beneficiary and stretch IRA planning can be handled directly in an IRA from American Estate & Trust.

Pre-Plan The Stretch Benefit. Most heirs will never know they can do the stretch. Even if they did know they could easily fail to get the full benefit, or they could easily be tempted to take the lump sum. IRA owners can do their heirs a big favor by setting this up in advance. The *Stretch IRA Option* from American Estate & Trust (AE-Trust) does just that. If you use this add-on option to your IRA, AE-Trust will carefully custom design your IRA to conform to your beneficiary planning and all federal tax rules. If you leave the remainder of your IRA to multiple beneficiaries, upon your death AE-Trust will split the IRA into multiple inherited IRA's (spouse's are treated differently, see topic on page 1), with each split matching the percentage which you left to each heir. As custodian of these split IRAs, AE-Trust calculates and pays each year's legally required amount to each of your heirs. With this arrangement you ensure that your heirs have the greatest tax savings and the maximum benefit available.

Using the AE-Trust optional *Stretch IRA Plan* allows you to do all IRA beneficiary and stretch planning very simply, whether you are married or not. To implement the AE-Trust plan you only need to fill out the *Stretch IRA Plan Supplemental Application Form*. The form is straightforward and easily steps you through the process in about thirty minutes. The *Stretch* form is included as part of the package of AE-Trust IRA enrollment forms. To access these enrollment forms, go to www.IRACentral.com and click on "Open An IRA" – on left side of page.

There is an extra charge for the *Stretch IRA Plan*. For pricing see the AE-Trust *IRA Fee Schedule*, which is included with the above referenced IRA enrollment forms.

Calculator For Additional Information. For some further interesting and much more detailed information, use the free calculator available at: www.IRACentral.com, click on "IRA & Retirement Calculators" – on left side of page, then scroll down to and click on "RMD & Stretch IRA Calculator".

American Estate & Trust, LC
www.IRACentral.com