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Scarpetti & Scroggins
PRESERVATION AND CONSERVATION OF WEALTH

Stretch IRAs

The term "stretch IRA" has become a popular way to refer to an IRA (either traditional or Roth) with provisions that make it easier to "stretch out" the time that funds can stay in your IRA after your death, even over several generations. It's not a special IRA, and there's nothing dramatic about this "stretch" language. Any IRA can include stretch provisions, but not all do.

Why is "stretching" important?

Earnings in an IRA grow tax deferred. Over time, this tax-deferred growth can help you accumulate significant retirement funds. If you're able to support yourself in retirement without the need to tap into your IRA, you may want to continue this tax-deferred growth for as long as possible. In fact, you may want your heirs to benefit--to the greatest extent possible--from this tax-deferred growth as well.

But funds can't stay in your IRA forever. Required minimum distribution (RMD) rules will apply after your death (for traditional IRAs, minimum distributions are also required during your lifetime after you reach age 70½). (Note: The Worker, Retiree and Employer Recovery Act of 2008 waives required minimum distributions for the 2009 calendar year.)

The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow. You'll want to check your IRA custodial or trust agreement carefully to make sure that it contains the following important stretch provisions.

Key stretch provision #1

The RMD rules let your beneficiary take distributions from an inherited IRA over a fixed period of time, based on your beneficiary's life expectancy. For example, if your beneficiary is age 20 in the year following your death, he or she can take payments over 63 additional years (special rules apply to spousal beneficiaries).

The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow.

As you can see, this rule can keep your IRA funds growing tax-deferred for a very long time. But even though the RMD rules allow your beneficiary to "stretch out" payments over his or her life expectancy, your particular IRA may not. For example, your IRA might require your beneficiary to take a lump-sum payment, or receive payments within five years after your death. Make sure your IRA contract lets your beneficiary take payments over his or her life expectancy.

Key stretch provision #2

But what happens if your beneficiary elects to take distributions over his or her life expectancy but dies a few years later, with funds still in the inherited IRA?

This is where the IRA language becomes crucial. If, as is commonly the case, the IRA language doesn't address what happens when your beneficiary dies, then the IRA balance is typically paid to your beneficiary's estate. However, IRA providers are increasingly allowing an original beneficiary to name a successor beneficiary. In this case, if your original beneficiary dies, the successor beneficiary "steps into the shoes" of your original beneficiary and can continue to take required minimum distributions over the original beneficiary's remaining distribution schedule.

What if your IRA doesn't stretch?

You can always transfer your funds to an IRA that contains the desired stretch language. In addition, upon your death, your beneficiary can transfer the IRA funds (in your name) directly to another IRA that has the appropriate language.

And if your spouse is your beneficiary, he or she can also roll over the IRA assets to his or her own IRA, or elect to treat your IRA as his or her own (if your spouse is your sole beneficiary). Because your spouse becomes the owner of your IRA funds, rather than a beneficiary, your spouse won't have to start taking distributions until he or she reaches age 70½. And your spouse can name a new beneficiary to continue receiving payments after your spouse dies.

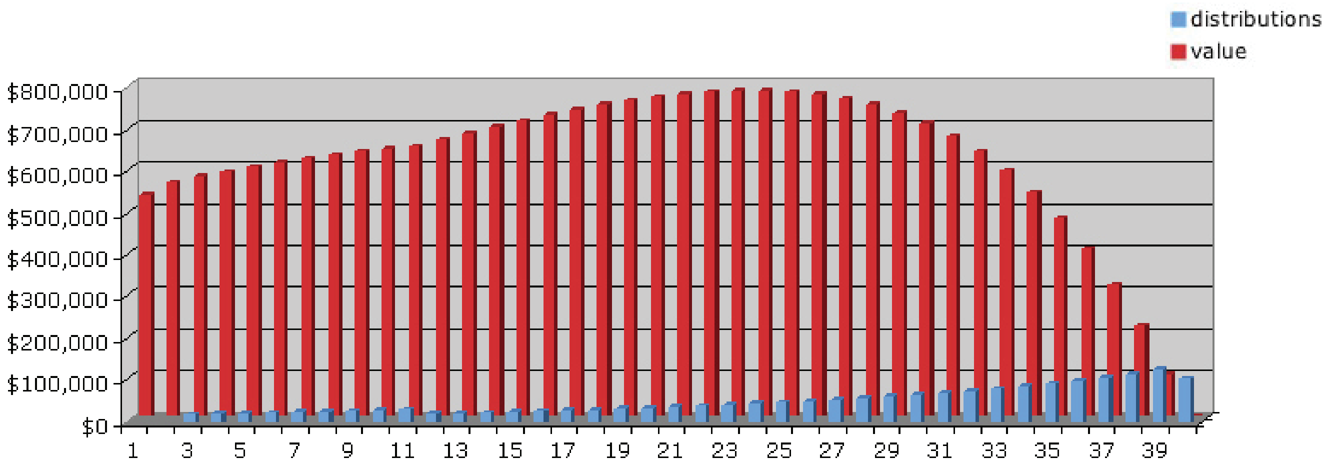
A word of caution

While you might appreciate the value of tax-deferred growth, your beneficiary might prefer instant gratification. If so, there's little to prevent your beneficiary from simply taking a lump-sum distribution upon inheriting the IRA, rather than "stretching out" distributions over his or her life expectancy. It's possible, though, to name a trust as the beneficiary of your IRA to establish some control over how distributions will be taken after your death. Your financial professional can help you sort through your stretch IRA options.

See disclaimer on final page

Stretching your IRA--A case study

Jack dies at age 78 with an IRA worth $500,000. He had named his surviving spouse, 69-year-old Mary, as his sole beneficiary. Mary elects to roll over the funds to her own IRA. Mary names Susan, her 44-year-old daughter, as her beneficiary. At age 70½, Mary begins taking required minimum distributions over a period determined from the Uniform Lifetime Table. (Mary is allowed to recalculate her life expectancy each year.) At age 79, Mary dies and Susan begins taking required distributions over Susan's life expectancy--29.6 years (fixed in the year following Mary's death). Susan names Jon, her 30-year-old son, as her successor beneficiary. Susan dies at age 70 after receiving payments for 16 years, and Jon continues receiving required distributions over Susan's remaining life expectancy (13.6 years). (See assumptions below.)



Year 1--Mary becomes owner of Jack's IRA

Year 3--Mary begins taking distributions at age 70½ over her life expectancy

Year 12--Susan begins taking distributions the year after Mary's death over Susan's life expectancy

Year 28--Jon begins taking distributions over Susan's remaining life expectancy

Year 40--All of Jack's IRA funds have been distributed

Assumptions:

- The rate of return on the underlying investments is a constant 6%, although the underlying securities in the account may involve risks that cannot be predicted
- All earnings are reinvested, and distributions are taken at year-end
- The projected figures assume that Mary takes the smallest distribution she's allowed to take under IRS rules at the latest possible time without penalty
- The projected figures assume that tax law and IRS rules will remain constant throughout the life of the IRA
- The projected figures do not take inflation into consideration

Results:

- Starting balance: $500,000
- Total payments: $2,010,324
- Payment years: 40, over 3 generations

Note: Payments from a traditional IRA will generally be subject to income tax at the beneficiary's tax rate. Qualified distributions from a Roth IRA are tax free.

Disclosure Information -- Important -- Please Review

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