“Stretch IRAs” – A Strategy for Managing Retirement Assets

By Gary Case

Who should benefit from your retirement assets — you and your family or the tax coffers? By retirement, you and your spouse may have assets in four or five — or even more — employer-sponsored retirement plans and individual retirement accounts (IRAs). How you coordinate those accounts at retirement can make a big difference in the amount of assets available to pass on your heirs.

The Tax Bite

First, there’s federal income tax plus state income tax on the plan distributions you receive during your lifetime. Any remaining tax-deferred contributions and account earnings distributed to your family after your death also will be subject to income tax.

Then, there’s estate tax. And, if you leave the assets to grandchildren, your estate may have to pay a generation-skipping transfer tax as well. In a worst-case scenario, your retirement assets could be reduced by as much as 80% before your heirs get to enjoy them, even if you use a Roth IRA.

Stretching Assets

One way to reduce taxes and leave more of your assets to your family is to “stretch” your IRA assets. To illustrate: Alice, age 60, is ready to retire. She has $300,000 of retirement assets in three employer-sponsored retirement plans and two IRAs. Two of the accounts were inherited from her deceased husband. She would like to leave some of the assets to her favorite charity and the rest to her two children, Sue and Bob.

Here’s how Alice can use a stretch IRA strategy in her estate planning. When she retires, Alice rolls over her retirement plan benefits directly into traditional IRAs, consolidating her assets so that she has three IRAs of $100,000 each. She names Sue beneficiary of the first IRA, Bob beneficiary of the second IRA, and the charity as beneficiary of the third IRA.

Alice begins withdrawals at age 70 ½, but is able to reduce the withdrawal amount by including her children’s life expectancies in the withdrawal calculation. After Alice’s death, her children must continue to receive annual distributions from the IRAs based on their individual life expectancy. The charity can withdraw all of the assets from its IRA without paying any income tax.

Are stretch IRAs the right strategy for you? It depends on your and your family’s personal financial situation. Your professional advisor can help you make that decision.

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