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Maximizing Benefits With A “Stretch” IRA

The Stretch IRA is a planning strategy that allows the holder of an IRA account to enhance the IRA’s tax-deferred status by extending or “stretching” the payment of benefits over a period of time that can last well beyond the account owner’s lifetime. It can result not only in reducing mandatory distributions but in increasing long-term benefits to family members across several generations. This vehicle is best-suited for those individuals (and their spouses) who do not rely on distributions from their IRA accounts to pay for their daily living expenses and who desire to enhance the financial well-being of their heirs and even selected charities. This vehicle is not a new type of IRA but rather is a planning device that allows a taxpayer to benefit from existing provisions in the Internal Revenue Code.

To achieve the “stretch,” it is necessary to ensure that the IRA governing documents name the intended primary and contingent beneficiaries. Failure to do so will limit or reduce the possibility of extending the IRA’s growth as far into the future as possible. To increase the amount to be transferred to your beneficiaries, distributions from the IRA should be delayed until reaching the age of 70½ years, at which time the IRS requires that you to begin taking withdrawals. At that time, you should withdraw the “Required Minimum Distribution” or “RMD,” the smallest amount that the IRS will allow you to withdraw on an annual basis without incurring penalty. The extent to which there will be an estate tax liability should also be evaluated as part of the overall estate plan.

When selecting beneficiaries, you have a number of options: you may choose individuals such as family members and friends whose lives are anticipated to span several generations. The selection of your beneficiaries should coordinate with or compliment your other estate planning decisions. The use of a trust to act as a conduit for distributions intended for an underage, irresponsible or incapacitated beneficiary is permissible and will also “stretch” the benefit enjoyed by your beneficiaries.

If the appropriate beneficiary designations are in place, at the death of the account owner, the balance remaining in the IRA can be paid out to the beneficiaries over their lifetimes based upon each individual's life expectancy as directed by IRS regulations. If you have also named contingent or secondary beneficiaries, you have maximized planning flexibility as the primary beneficiary will not be obligated to accept the IRA. He or she can refuse or "disclaim" the gift, within nine months of the account owner's death, allowing it pass to the contingent beneficiaries, frequently grandchildren, nieces, nephews or others of a generation significantly younger than the original account owner. This constitutes the "stretch" and compounds the benefits of the tax-deferred growth of the IRA for several generations beyond the death of the initial account owner.

The rules and regulations governing the distribution of IRAs after the life of the original account owner are highly technical. The IRS requires strict adherence. Any deviation may result in a loss of the anticipated future deferral and compounding benefits of the retirement account and severely limit the planning opportunities which might otherwise be available.

While the "stretch " concept is simple - spreading IRA distributions over the lives of beneficiaries who are younger and have longer life expectancies, thereby capitalizing on the power of tax-deferral and growth-compounding (and, when properly implemented, providing a guaranteed and far-reaching income stream and potential economic well-being for multiple generations of your family) it is a strategy which requires careful and informed decision-making.

It is always advisable to consult with your legal advisors with respect to these important matters. We look forward to answering your questions about this subject and would welcome the opportunity to meet with you to discuss its applicability to your own unique situation.