FINANCIAL ADVISOR

Stretch IRA: Are Its Days Numbered?

November 29, 2017 • [Ian Shearn]

It’s been on the Congressional chopping block for the past five years, and some believe time is about to run out on the stretch IRA, a staple of estate planning for the affluent.

Bolstered by hefty revenue projections ($5.5 billion over 10 years), the Senate Finance Committee voted 26-0 to end the stretch IRA for non-spousal beneficiaries.

Under current law, a stretch IRA is a way to limit required distributions on an inherited IRA, avoiding a sizable tax bill in the process. Instead of naming a spouse as the IRA’s beneficiary, an account holder can name children, grandchildren or great-grandchildren, who can stretch out the withdrawals over their expected lifespan. This provides them decades, even lifetimes, of tax deferred growth (or tax free, in the case of Roth IRAs).

The proposed bill, called the Retirement Enhancement and Savings Act, would require beneficiaries of an inherited IRA to pay all taxes due on the account within five years of the owner’s death. The bill does contain a $450,000 exclusion for non-spousal beneficiaries. That means an inherited IRA worth $1 million would be taxed only on $550,000.

Similar versions of the bill have been proposed and withered in recent years, and experts are divided over the bill’s current chances. But Ed Slott, one of the nation’s most highly regarded authorities on all things IRA, believes 2017 will be the year it finally makes its way into law.

“It’s really gonna happen next year,” says Slott. “It’ll be slipped in under the radar as a revenue enhancer, and sail right through without anyone noticing.”

“The likelihood of stretch IRA revisions becoming law will depend on whether either general retirement legislation like the RESA bill, or broader tax reform legislation, becomes law next year,” says Brigen L. Winters, a principal at Groom Law Group in Washington D.C., where he chairs the firm's Policy and Legislation practice group. “It is unlikely to move as a stand-alone provision.”

And that’s how Slott sees it. “The stretch IRA elimination language is all set to go and can easily be inserted into any tax bill, especially since Congress is being told that this provision will produce billions in revenue,” he says. And the odds are good tax legislation is coming since president-elect Trump has promised comprehensive tax reform.

The problem, Slott asserts, is that it won't generate any revenue. In fact, it is more likely to lose revenue, he says.

"They just make up the (projected revenue) numbers," he asserts. "And for one thing, most beneficiaries don't stretch the IRAs; they go through them like water. It's human nature."

Another factor believed to be nudging Congressional action is a 2014 U.S. Supreme Court decision, which took a bite out of the stretch IRA's benefit. The court unanimously ruled that inherited IRAs cannot be considered a retirement fund, and thus are not subject to an exemption under bankruptcy laws.

U.S. retirement assets totaled $25 trillion as of September 30, accounting for more than one-third of household financial assets, according to the Investment Company Institute in Washington, D.C. Of those assets, $7.8 trillion were in IRAs.

If the bill does pass, it should prove a boon to financial advisors, since elimination of the much used inherited IRA will compel many to retool their estate plans.

"This will force people to do better financial planning," says Slott, who thinks even now there are better ways to set aside money for future generations.

"I would say, 'Forget the stretch IRA. You're better off taking the money out now, paying the taxes and putting that money into a life insurance policy that will be tax free when it's cashed in.' You could easily take a $300,000 IRA and turn it into a $1 million life insurance policy."

Or, he adds, wealthier clients could easily simulate a stretch IRA with a life insurance trust or a charitable remainder trust, either of which would allow payments to future beneficiaries over their lifetime or a set term of years, subject to the terms of the trust.

Still, there are those who don't think the bill will move next year -- like Deborah Jacobs, author of *Estate Planning Smarts: A Practical, User-Friendly, Action-Oriented Guide*.

"Those who most benefit from the stretch are the families of the rich," Jacobs says. "More than ever, in a Trump Administration we can expect legislation that favors the rich and their descendants."

But she does offer this hedge: "It's sometimes said that she who lives by the crystal ball is destined to eat glass."