The Stretch IRA is No More: What this Means for Your Family

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On December 20th, the bipartisan SECURE Act was signed into law. At the risk of oversimplifying, its provisions generally result in the following:

- Make it easier for many to begin saving for retirement
- Simplify retirement distributions (RMDs)
- Reduce the amount of wealth transferred to your family by eliminating the stretch IRA

This article will consider how the inheritance you leave to your family may be impacted by the loss of the stretch IRA and some ways in which you may adjust your planning to compensate for the loss.

Who is at Risk?

Anyone with large retirement balances including IRAs, 401(k), 403(b) and 457 plan accounts.

That Was Then…A Primer on the Stretch IRA

A stretch IRA was an estate planning strategy used to "stretch" the amount of wealth, owned in IRAs and retirement plans, that could be transferred to subsequent generations of your family. Your children inherited your IRA and were required to take relatively small taxable annual distributions from it while the bulk of the money would remain invested, thereby experiencing tax-deferred growth.

If they invested the IRA prudently and managed withdrawals carefully, they could likewise pass the IRA balance to their children. In this manner, withdrawals from an IRA could potentially be "stretched" for multiple generations spanning many decades. But there was a problem with this strategy: the tax revenues received by the IRA would also be stretched over multiple generations and many decades.

This Is Now…The Stretch IRA is Eliminated

The SECURE Act requires most non-spouse beneficiaries to distribute their inherited IRA balance within ten years. This could result in your children paying higher income taxes and realizing significantly less long-term growth than they would have otherwise experienced had the stretch IRA strategy remained intact.

Note that provisions allow for stretch IRA distributions for those who are disabled, chronically ill, minors and to non-spouse beneficiaries who are not more than 10 years younger than the deceased IRA owner.

Ways to Replace your Stretch IRA

Create tax-free accounts to pass to your family. With the elimination of the stretch IRA, the importance of Roth IRAs has increased since distributions from them are not taxed. There are three ways for you to add money to Roth accounts; be aware that limitations and conditions apply for each thus advanced income planning may be in order:

1. Contribute to a Roth IRA. Note that your contributions are phased out at higher income levels however using a "back door Roth" strategy may help overcome this hurdle (although the pro rata rule applies).
2. Make Roth 401k/403b contributions into a retirement plan offered by your employer. Doing so becomes less attractive at higher income levels, however.
3. Convert your IRAs into Roth IRAs (a.k.a. Roth conversions). You will pay income tax when converting pre-tax dollars. To help soften the tax blow, there are strategies you may use to opportunistically convert your IRAs over time.
4. Structure your life insurance to provide a tax-free inheritance. Life insurance can be used to provide a tax-free inheritance for non-spousal beneficiaries.

Use charitable planning to create tax benefits for you and income for your family. When you contribute an appreciated asset (for example, shares of stock, real estate, ownership of a business) to a charitable vehicle, you receive a tax deduction for the value of the asset and avoid paying capital gains that you would have paid had you sold the asset. On top of this, certain charitable trusts may create additional income for your family.

Coordination of Roth conversion and charitable planning. If you time your gift to coincide with a Roth conversion, you may use the tax deduction to offset the taxable income created by the conversion.

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