

STRETCHES FROM PENSION PLANS, IRAs OR ANNUITIES

By: Ryan Wilson, J.D.

You may have heard the term *stretch IRA*, and wondered what it means. *Pensions, IRAs* and *nonqualified deferred annuities (NQDAs)* can all potentially be stretched at the account owner's death. "Stretch" means that the beneficiary can delay the federal income tax consequences associated with the transfer of the account.

Exactly how a stretch works may differ based on the

- Timing of the *taxpayer's death*,
- Type of account,
- *Relationship of the beneficiary*, and
- Timing of the stretch election.

The wording of the *beneficiary designation* for your account will also dictate the potential *federal income tax consequences* to the beneficiary or beneficiaries of the account.

An individual beneficiary is entitled to the account at the taxpayer's death. The named beneficiary will also have some flexibility as to the timing of distributions from the account. In general, the required distributions from the account are taxed as they are made.

Naming the *estate* the beneficiary of an account is usually *not recommended*. Estates cannot usually take advantage of the same kind of tax deferral that a named beneficiary can. In addition, naming an estate beneficiary will force the plan assets through *probate*, and that is not usually desirable.

A special kind of trust, referred to as the *look-through trust*, may be named the beneficiary of a pension account or IRA. If properly drafted, the trustee of the trust may be able to elect stretch options.

Here are some general rules for naming beneficiaries of pensions, IRAs and NQDAs:

- Take extra care to make sure that the beneficiary designation is consistent with your overall estate planning objectives.
- A named *surviving spouse* beneficiary of the account will have the most options for deferring taxes at the account owner's death.
- If naming the spouse is not desired or possible, an individual non-spouse beneficiary will have the ability to stretch at the account owner's death. *Younger beneficiaries* will be able to stretch the income tax result longer than older ones.
- If you want to name a *trust beneficiary* of a qualified account, make sure the client's attorney has drafted the trust as a look-through trust. It is less desirable to make a trust the beneficiary of a nonqualified annuity.

In discussing stretch, the focus is on the *smallest amount* that a beneficiary can receive. However, a beneficiary can usually opt to take bigger distributions, even after choosing to stretch, if they are needed. In most cases, bigger distributions simply mean a bigger current income tax result for the beneficiary.

Alert: Dividing an Inherited IRA Before Year-End

December 31, 2010 is an important deadline for individuals who inherited an IRA from an IRA owner who died in 2009. Where there are multiple beneficiaries for the IRA, splitting up the account into several accounts no later than December 31, 2010, can yield important tax and other benefits for each beneficiary.

Designating several beneficiaries for an IRA may put the younger one (or ones) at a disadvantage if they want to keep required minimum distributions (“RMD”) as small as possible, and keep IRA deferrals going for as long as possible. As a general rule, where there is more than one IRA designated beneficiary, the one with the shortest life expectancy (that is, the oldest one) is treated as the designated beneficiary for determining required distributions.

There is a post-mortem planning solution. The beneficiaries can split up the IRA into separate accounts no later than the end of the year following the year in which the decedent died. Where an IRA is divided into separate accounts (i.e., subaccounts), the RMD rules separately apply to each separate account.

For the separate or “subaccount” IRA to be treated as a separate account for RMD purposes, it must be established no later than the last day of the year following the year of the IRA owner’s death.

Additionally, a separate accounting must allocate all post-death investment gains and losses for the period before the separate accounts were established on a pro rata basis in a reasonable and consistent manner among the separate accounts. However, once the separate accounts are actually established, separate accounting can provide for separate investments for each separate account, under which gains and losses from the investment of the account are only allocated to that account.

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