A Look Back at (and Beyond) the 'Stretch' IRA

By Kerry Pechter *Thu, Jan 9, 2020*

Under the new SECURE Act, most non-spouses must withdraw and pay taxes on inherited IRA assets within ten years instead of "stretching" the process over (possibly) decades. What will that mean for annuities, and how might advisers respond?

The "stretch IRA" was a time-honored tactic in tax-efficient estate planning. It allowed children or grandchildren who inherited large traditional or Roth IRAs to spread the distributions—and their income tax liabilities—over the entire remainder of their lives.

A stretch strategy could be executed with trusts, annual withdrawals over a beneficiary's IRS **life expectancy**, or life annuities. An IRA owner might buy a joint-life single premium immediate annuity (SPIA) and name a child as co-annuitant, or a child could buy a life annuity with the inherited assets.

As of January 1, 2020, however, the stretch has been outlawed. With the passage of the SECURE Act in December, only spouses and a few other "exempt" beneficiaries can distribute inherited traditional or Roth IRAs over their lifetimes. Others must empty them—and pay income tax on the distributions—within 10 years of receiving them.

The change was expected, but its suddenness—the ban on stretch IRAs became effective just 12 days after the SECURE Act passed on December 19—triggered a wave of webinars, articles, and LinkedIn conversations over the past weeks. (Kitces.com will host a **webinar** by accounting guru Jeffery Levine today, Thursday January 9, at 4 p.m.)

Simulating the stretch

Advisers who feel robbed by the SECURE Act must now consider simulating the tax benefits of stretch IRAs through other means. The main options for replacing the lost tax benefits (for non-exempt IRA beneficiaries) include:

Spend down traditional IRA faster. If the original IRA owner wants to minimize the tax burden on non-spouse beneficiaries, he or she can always take distributions, pay the tax, and gift the after-tax amount to anyone immediately.

Convert to a Roth IRA. If the IRA owner (original or surviving spouse) wants to keep distributions (net of income taxes) growing tax-deferred for up to 10 years after his/her death, they can gradually transfer them to a Roth IRA.

Name grandchildren rather than adult children as the beneficiaries of the IRA. The grandchildren will still have to distribute the IRA assets over 10 years, but they're likely to be in lower income tax brackets than their parents.

Buy life insurance. IRA owners who are young enough and healthy enough can try to offset the anticipated tax burden of IRA distributions on beneficiaries by purchasing life insurance, which will render a tax-free inheritance. The owner will have to pay taxes on any IRA withdrawals used to buy the life insurance, and the cost of insurance premiums could be prohibitive. One source recommends buying a hybrid life/long-term care policy to take advantage of potential tax deductions for the premiums.

Buy a life annuity with a period certain or a cash refund. The IRA owner would receive income until he or she died, at which time the beneficiary would receive a refund of any unpaid premium. This strategy would not provide tax benefits for the beneficiary, however. (Check with the carrier to determine the length of the period certain duration they will permit.)

Name a charitable remainder annuity trust (CRAT) or unitrust (CRUT) as the beneficiary of the IRA; and name children or grandchildren as trust beneficiaries. Charity-minded IRA owners can arrange to bequeath their IRAs to irrevocable charitable remainder trusts. A charity receives a tax-exempt contribution, the estate of the IRA owner receives a tax deduction, and the beneficiaries receive taxable income from the trust for a specific period or until they die. A CRAT distributes a fixed annual annuity and does not allow additional contributions; a CRUT distributes a fixed percentage of the initial assets and allows additional contributions.

The $400,000 difference

These strategies, even more than the techniques they replace, are complex and labor-intensive. Predicting their eventual value is impossible, unless you knew exactly how long your clients will live, what their tax brackets will be each year, and what their beneficiaries' ages, financial needs and tax brackets are. You would also need to know what the beneficiaries will earn on their subsequent investments.

As a rule, the wealthier the client and the greater his or her bequest motives, the more valuable such strategies obviously become. How valuable? In a recent **article** at the

Financial Advisor website, James Blase, a St. Louis tax attorney, estimated the growth of $1 million IRA inherited by a hypothetical 60-year-old and held till he reached age 85.

If distributed within 10 years and reinvested at 5%, the IRA assets would grow to $1.85 million or $1.76 million after 25 years, depending on whether the IRA was emptied over the first 10 years or at the end of 10 years, he calculated. Under the old stretch IRA formula, the $1 million would have grown to $2.2 million, assuming that the beneficiary took only required minimum distributions (according to IRS unified life tables).

The martyred 'stretch'

Killing off the stretch IRA will raise federal tax revenues by $15.7 billion over the next 10 years, according to a **study** published last April by the Congressional Budget Office (CBO). The new revenue offsets the estimated $16.3 billion that other provisions of the SECURE Act will cost the government.

Moving the starting age for required minimum distributions from IRAs to 72 from 70½ will cost $8.9 billion, according to the CBO. The SECURE Acts' legalization of open multiple employer plan ("Open MEPs") will cost an additional $3.4 billion, because it will likely increase participation in (and tax-deferred contributions to) retirement plans. The removal of penalties of Roth IRA distributions for births and adoptions will cost an estimated $1.2 billion.

Some observers have cheered this trade-off. Ben Norquist, the CEO of Convergent Retirement Solutions, which educates sellers of IRAs and small retirement plans, noted on LinkedIn this week that the stretch IRA itself did nothing to promote retirement income security.

"I'm already on record as being understanding/supportive of the basic premise of reallocating the tax revenue resources historically foregone (delayed) due to second generation stretch strategies to areas that can more directly move the needle on retirement plan coverage and retirement security," Norquist wrote.

Chief mourner

Gary Mettler

But Gary Mettler, a Florida-based immediate annuity specialist and **author**, was disappointed by end of the stretch IRA. On January 3, he posted an article on LinkedIn with the headline, "How the SECURE Act WRECKED the SPIA/DIA and Pension Business." SPIAs are single-premium immediate annuities. DIAs are deferred income annuities.

Mettler, an insurance agent and former executive at Presidential Life (now part of Athene) has long recommended SPIAs because their design—they use mortality pooling and are illiquid—allows them to offer retirees significantly more immediate monthly income per dollar of investment than a deferred annuity with a guaranteed lifetime withdrawal benefit (GLWB) or the 4% "safe withdrawal" method can.

He believes that the life insurance industry, which lobbied for the SECURE Act, was willing to trade away the stretch IRA to get two provisions that it wanted more: Open MEPs and a "safe harbor" clause that could make 401(k) plan sponsors much more willing to allow their participants to contribute to annuities.

While the SECURE Act will in theory ease the introduction of *any* type of annuity into 401(k) plans, in reality life insurers are more inclined to sell deferred annuities with GLWBs (or GLWBs as riders on target date funds) than to try to sell SPIA to plan participants.

That's no secret. Demand for SPIAs is small, but the potential market for portable, liquid annuities with GLWBs as lifetime income options in 401(k) plans is potentially huge.

With the SECURE Act, "I think the life insurers wanted to put themselves in a better position to offer deferred annuities with guaranteed lifetime withdrawal benefits in retirement plans," Mettler said in an interview. "They won't use mortality-pooling products [such as SPIAs]. I think they even intended to put a pall over the SPIA product design." As a SPIA aficionado, Mettler can't help but regret that.