

Stretching Your Retirement Plan

The Pension Protection Act (PPA) §829 created a way for non-spouse beneficiaries to stretch their retirement benefits. In the past, only spouse beneficiaries could directly roll over a retirement account. A non-spouse beneficiary had to take the distribution, and pay income tax on the distributions, from the retirement account within 5 years of the date of death of the account owner. Effective Jan. 1, 2008, every retirement plan sponsor must allow a non-spouse beneficiary to roll over an inherited account. There are various rules that must be adhered to, but a non-spouse beneficiary will be able to “stretch” the distributions according to their life expectancy.

How does this “stretch” the distribution? Under the new rules, a non-spouse beneficiary may roll the account over to him or herself and take distributions over his or her life expectancy rather than over five years. The younger the beneficiary, the smaller the annual required distribution which means more money remains in the IRA where it continues to grow tax-free.

For instance, assume Grandmother dies and leaves her Granddaughter, Mary, as beneficiary of her \$30,000 IRA. Mary's age in the year after grandma's death is 6. According to the IRS tables, Mary has a life expectancy of 82 additional years. Thus, to calculate her first required withdrawal Mary will divide the value of the IRA by 82. The next year she'll divide by 81, the next she'll divide by 80, and so on.

Now, let's assume the investments in the IRA earn 8% per year and that Mary only takes out the minimum amount required each year. Thanks to the effects of compounding and tax-deferral, by the time she is age 88, Mary will have received more than \$2,000,000 from grandma's \$30,000 IRA!

The inherited IRA can be a powerful financial tool, but caution must be used when setting this up. To achieve the desired result, a “direct transfer” to the inherited IRA must be achieved. Also, the inherited account must be its own account. A beneficiary cannot mix the beneficiary's own money or money from other inherited IRA's. Finally, the non-spouse beneficiary must start withdrawing a minimum amount of money from the inherited IRA by December 31st of the year after the plan participant died.