It's a Stretch….

By Thomas Malinowski

In a prior newsletter article, we described the changes resulting from the passage of the SECURE ACT in December of 2019. Perhaps the most detrimental impact of this law related to the elimination in most instances of the "stretch IRA" technique. This practice allowed IRA owners to name children, grandchildren, and even great-grandchildren as beneficiaries of their IRAs and "stretch" the period over which the beneficiary was required to receive distributions each year based upon that beneficiary's life expectancy. This allowed for the "magic" of compounding to continue while deferring much of the income tax burden, in many cases, for decades. The SECURE ACT now requires that the entire IRA balance be distributed within ten years of the owner's death.

This ability to stretch out the distribution period following an owner's death remains available for a relatively limited group of beneficiaries including a spouse, a disabled or chronically ill beneficiary, a beneficiary who is not more than ten years younger than the owner, and for a minor child (but only during the time prior to majority).

There is, however,r a technique available which could provide similar tax-free compounding benefits. This entails the use of a charitable remainder trust (CRT). Instead of naming an individual as beneficiary, a CRT would be the named beneficiary of an IRA. In general terms, a CRT could pay out to individuals or groups of individuals over their lives or for a fixed period of years not to exceed 20. The payout amount could be a percentage of the initial value of the trust or a percentage of an annual valuation of the trust. Following this payout period, the remaining amount would be distributed to the charity or charities named in the document.

Unlike an individual, when a CRT receives an IRA balance upon the owner's death no income tax will result because a CRT is a tax-exempt entity. Therefore, the IRA proceeds can continue to grow tax deferred. Distributions received by a beneficiary of the CRT will be subject to tax based upon complicated four-tier accounting rules. Suffice it to say that distributions will be subject to ordinary income tax until at least the original IRA balance is met. A CRT will allow the owner to create a single trust that distributes annual payments to multiple beneficiaries and depending upon the percentage payout described in the document, the annual payment may be greater than would otherwise be required under an IRA life expectancy format. There may also be potentially estate tax savings associated with a CRT which would not be available with a traditional IRA payout.

Perhaps the greatest benefit of a CRT is that it allows you to meet your philanthropic objectives by leaving a portion of your assets to a charity or charities of your choice once the annual payout period ends. Typically, the use of a CRT is only beneficial where there exists some philanthropic purpose.

As with any sophisticated tax device, costs will result from the drafting and annual maintenance of a CRT.

There are many variations of this technique available. The best approach for you will be based upon your personal objectives which we will be pleased to explore with you.