When should you use a stretch IRA?

If you do not need all the assets in your IRA to cover your expenses in retirement, consider the stretch IRA strategy. This strategy can “stretch” the time during which the IRA’s assets have the potential to grow tax-deferred. As a result, a stretch IRA can serve as an important estate-planning tool.

How do you stretch a traditional IRA?

- If you name your spouse as beneficiary of your traditional IRA, he or she can roll the balance into his or her own traditional IRA when you die and name a younger beneficiary.
- Your spouse then may take required minimum distributions (RMDs) over his or her life expectancy. If your spouse is under age 70½ when you die, he or she can delay taking RMDs until he or she reaches 70½. After your spouse dies, the second generation beneficiary may transfer the assets to an inherited IRA and begin taking RMDs over his or her own life expectancy. It’s called an inherited IRA because it can hold only inherited assets.
- Alternatively, you may name a younger nonspouse beneficiary directly who can choose to transfer the assets to an inherited IRA and take RMDs over his or her life expectancy after you die.

Because employer-sponsored retirement plans [such as a 401(k) plan] often limit beneficiary distribution options, they usually don’t allow use of the stretch IRA strategy. However, nonspouse beneficiaries now are permitted to roll over inherited assets from an employer plan to an inherited IRA. From this IRA, the beneficiary can choose to employ the stretch IRA strategy. However, there is no guarantee that your beneficiary will know to roll the assets over and continue the tax-deferred treatment. Therefore, you may choose to roll your former

Stretching an IRA for generations of income

- In this example, assume the account owner, age 54, rolls over $400,000 from his employer retirement plan into a traditional IRA and names his wife, age 48, as beneficiary. At age 70½, the account owner begins taking RMDs.
- He dies at age 85. His wife, age 79, then rolls over the assets in her husband’s IRA to her own traditional IRA, continues taking RMDs based on her life expectancy and names her son as the new beneficiary.
- When she dies at age 89, her 60-year-old son transfers the assets to an inherited IRA and continues taking RMDs based on his life expectancy.
- After a 67-year “stretch” period, IRA distributions totaling $4,320,480 have depleted the account.

This hypothetical example is illustrative only. It assumes a 6% annual compound return, from the rollover until the account is depleted, that the account owner rolls over the account on Jan. 1 of the year he or she receives the assets, that all distributions are taken on the last day of each distribution year and that all distributions are the required minimum amount as determined by IRS regulations. These amounts are not adjusted for inflation and do not reflect any state or federal income tax that may be due upon distribution. The projections are not a guarantee of future returns or investment performance and are not intended to replace the calculations that need to occur on a yearly basis for calculating actual required minimum distributions for clients or their beneficiaries. It also does not reflect the volatility that can occur in an equity-based account and assumes current tax laws remain in effect throughout.
employer-sponsored retirement plan assets over to a traditional IRA while you still have control of the assets and name the appropriate beneficiary on the account. This will ensure that your named beneficiary will have the option of using the stretch strategy without first having to roll the assets into an IRA. It is important that you and your beneficiaries understand that the financial impact of a stretch IRA depends on limiting distributions to the required minimum. It can be a good idea to include your beneficiaries in your planning discussions. Withdrawals are taxed as ordinary income and are subject to a 10% additional federal tax, unless you are age 59½ or older, unless the following exceptions apply: qualified higher education expenses; qualified first home purchase (lifetime limit of $10,000); certain major medical expenses; certain long-term unemployment expenses; disability; or substantially equal periodic payments.

How do you stretch a Roth IRA?

Stretching a Roth IRA is similar to stretching a traditional IRA. If you name your spouse as beneficiary of your Roth IRA, he or she can roll the balance into his or her own Roth IRA when you die and name a younger beneficiary. With a stretched Roth IRA, however, your spouse is never required to take RMDs. That means the assets may continue their tax-deferred status longer than in a stretched traditional IRA. When your spouse dies, his or her beneficiary must begin taking RMDs based on his or her life expectancy. Because they will be taken from a Roth IRA, those distributions (if qualified) will be tax-free.

How can you get started?

If you’re seeking a strategy that can extend the tax-advantaged status of your IRA assets well beyond your lifetime, call your Financial Advisor to discuss the stretch IRA strategy. Your Financial Advisor, who is committed to understanding your specific needs, can help you develop customized strategies that fit your goals, risk tolerance, investing style and time horizon. To learn more about Merrill Lynch services, visit www.totalmerrill.ml.com.

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1  A Required Minimum Distribution (RMD) is the minimum amount the Internal Revenue Service requires the account holder of a traditional IRA to withdraw annually upon reaching age 70½. If you fail to withdraw the full amount of your RMD by the applicable deadline, you may be subject to an excise tax equal to 50% of the amount you should have withdrawn but did not. An RMD also is the minimum amount that a beneficiary must withdraw each year from an inherited IRA. Depending on the distribution option chosen, RMDs for beneficiaries are calculated based on the value of the account at the end of the prior year and the life expectancy of the beneficiary, the deceased account owner or, if there are multiple beneficiaries, the oldest beneficiary.

2  The option of rolling over inherited assets to a traditional IRA continues to be available to spouse beneficiaries. Unlike nonspouse beneficiaries, spouse beneficiaries can roll inherited assets to their own IRA.

3  If any portion of your employer plan account balance is eligible to be rolled over and you do not elect to make a direct rollover (a direct payment of the amount of your employer plan benefit to an IRA), the plan is required by law to withhold 20% of the taxable amount. This amount is sent to the Internal Revenue Service as federal income tax withholding. State tax withholding also may apply.

4  In this example, distributions taken by the spouse’s beneficiary would be qualified if the spouse’s Roth IRA had been funded for at least five years at the time of distribution. There is a single, 5 year holding period when determining whether earnings can be withdrawn federally tax-free as part of a qualified distribution from a Roth IRA.