Stretch your IRA

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Stretching your individual retirement account (IRA) is a simple strategy that can help you to stretch out your retirement distributions over multiple generations. The strategy can defer and help minimize the income taxes on the wealth you pass to your heirs from your IRA. With a properly designed IRA, your spouse, children, and even grandchildren can continue to enjoy the benefits of tax-deferred growth of the IRA assets along with a stream of income.

How it works

Often, your spouse inherits your remaining IRA assets upon your death. If you have no spouse or if your spouse has sufficient assets outside of the IRA to live comfortably, your children, grandchildren or other individuals can be named as beneficiaries.

When your spouse is named as beneficiary, upon your death, they often transfer your remaining assets into their own IRA. The spouse then designates a younger beneficiary(ies) — such as your child or grandchild. If your spouse is over age 70½, they will take required minimum distributions based on their life expectancy.

Upon your spouse's death, your child or grandchild is required to take annual distributions over their life expectancy. That way, they only pay income taxes on the amount withdrawn from the IRA yearly, rather than incurring a huge tax on the entire lump sum. The younger the beneficiary, the longer the distribution period.

Upon inheriting the IRA, the beneficiary can name a subsequent beneficiary. If the first beneficiary dies before depleting the account, the subsequent beneficiary can also maximize tax deferral and growth by continuing to take distributions over the remaining life expectancy of the original beneficiary.

Illustrating the power of stretching

For example: suppose your spouse is age 73 when they inherit your IRA worth $300,000 and transfer the IRA into their own IRA. Your child, age 44, is named as the beneficiary. If your spouse dies five years later at the age of 78, your child, then age 49, or their subsequent beneficiaries, may extend the distribution period for an additional 35.1 years, based on their single life expectancy. This, in effect, stretches the original $300,000 IRA, resulting in total distributions greater than $1.2 million (assuming a hypothetical 6% return).

Other advantages

While you're living, you retain complete control of the IRA, and reserve the right to liquidate as much of the IRA as necessary. Similarly, a beneficiary can at any time take more than their required minimum distribution, including a full distribution. Also, since the money is paid out as death distributions, there is no 10% penalty, even if the beneficiary is under age 59½.

Estate taxes still due

Don't forget that any estate taxes will be due upon your death, if the beneficiary is not your spouse. Estate taxes are due within nine months of the surviving spouse's death. Ideally an estate has enough liquidity outside of this IRA to cover the estate taxes. Working with your independent tax/legal advisor, your RBC Wealth Management® financial advisor can show how life insurance can be used to fund this tax.

Start stretching your IRA today

To put this concept to work, you must designate a beneficiary or beneficiaries with your IRA Custodian. Also, all of your primary beneficiaries must be people — beneficiaries like institutions or charities cannot stretch an IRA.

Stretching an IRA can be a powerful estate-planning tool. Working with your independent tax/legal advisor, your RBC Wealth Management financial advisor can show you the advantages for you and your loved ones.