The Standby StretchIRA Trust: A New "Best Practice"

by Gregory C. Freeman, President of
ADVISORSERVE

ADVISORSERVE presents a new, easy-to-implement "Best Practice" in the wake of the SECURE Act that could be worth **millions** of dollars to your high net worth clients, and potentially hundreds of thousands of dollars, to your practice. We also offer a valuable ***Freebie***.

Executive Summary

Clients with large retirement plan assets need to consider putting in place a Standby StretchIRA Trust ("SIT") during their life. The SECURE Act requires most inherited IRAs to be distributed and taxed within ten years of the plan owner's death. These taxes can be extremely costly for heirs, but taxes can be deferred by use of a SIT. These trusts can result in millions more dollars for client heirs, and can enable advisors to retain millions in assets that might otherwise be lost upon a client's death. We have identified a simple, easy, turnkey and cost effective provider: Sterling Foundation Management. We have arranged with Sterling to provide our advisor friends with a valuable ***Freebie***.

Brain Teaser

Here's a brain teaser: What Nobel Prize winning strategy has inspired retirement related legislation that is wildly popular with Democrats and Republicans, and the conservative Heritage Foundation and the liberal Brookings Institution?

Hint: the answer is NOT "the SECURE Act." Yes, the SECURE Act was wildly popular, at least in the sense that it had widespread bipartisan support and passed easily. It became law on January 1, 2020. But SECURE has nothing to do with the Nobel Prize. We'll get to the Nobel strategy, but first let's look at some challenges caused by the SECURE Act.

SECURE Act Killed the Old "Stretch" IRA

The SECURE Act has many provisions. Among those is a provision that killed the ability for non-spouses who inherit an IRA to "stretch" the IRA over their own lifetimes. (In this article, when we say "IRA" we refer to regular IRAs, 401(k)s, 403(b)s, and similar qualified retirement plans.)

Now, when a non-spouse inherits an IRA, the entire IRA must be distributed and taxed within ten years. This amounts to a large, new tax on large retirement plans.

The Benefit of Deferral

The advisor community has done a very good job over the last several decades educating clients on the value of investing pre-tax dollars in a tax-exempt vehicle. It is exactly the combination of funding with pre-tax dollars, and tax-free growth inside the IRA that has made IRA's so popular. There is now over $15 trillion ($15,000,000,000,000) in IRA's and

401(k)s, and several trillion more in other types of defined contribution plans.

Clients have learned that if they don't need the money now, it's historically been a no-brainer to defer pre-tax dollars in a tax-exempt account (we say "historically" because the prospects of higher tax brackets in the future may change the math --- but that discussion is for a future article). The benefits of tax deductible deposits and tax protected accounts is why there are trillions of dollars in qualified plans. That's why your larger retirement plan clients have half a million, a million, or in a few cases, many millions, of dollars in their IRAs. And that's why you'll want to know about the Standby StretchIRA Trust. We're getting to it.

The Old Stretch Rules

Under the old stretch IRA rules, when a non-spouse, say a child, inherited an IRA, the child could elect to withdraw the IRA over the child's lifetime.

For example, suppose a parent died and left a $1 million IRA balance to a child who was 55. If that child had a 30 year life expectancy, the child could elect to keep the inherited IRA in an IRA, and withdraw it (according to the required minimum distribution rules) over 30 years. In other words, under the old rules, the inheriting child could have "stretched" the benefit of the IRA and current taxes due over 30 years.

The stretch makes sense, because if the client (or in this case the child) doesn't need the lump sum, it almost always makes sense to allow pre-tax dollars to grow in a tax-deferred or tax-exempt account, and take the money out only as needed or required.

A Better Stretch With a StretchIRA Trust

After the SECURE Act became law, we began to look for ways to restore the stretch.
Many commentators began discussing the potential use of a qualified tax-exempt trust to replace the old stretch for large IRAs.

The technique is simple. A client sets up a trust which qualifies for tax-exempt status under section 664. (If you are familiar with charitable remainder trusts, you know that section). The client then names the tax-exempt trust as the beneficiary of the IRA. The client can name anyone – spouse, children, nieces, nephews, etc., – to be the income beneficiary of the trust.

While the client is alive, nothing changes. During life, the client retains complete control and flexibility with the investments, any desired income, or even any beneficiary changes. The money stays in the IRA just as if no trust had been set up.

But when the client dies, the IRA pays into the trust. Because the trust is tax-exempt, 100% of the money goes from the IRA to the trust. **<u>There is zero income tax</u>**. You keep 100% of the value of the IRA invested, earning for the client's beneficiaries.

The term of the trust can be as long as three generations. For example, consider a client who is 84 with an 83-year-old wife, a 55-year old son and a 30-year old granddaughter. If the client dies at 88, the wife will get the income for the remainder of her life, then the son will get the income for the rest of his life, and after the son dies the granddaughter will get income for her life. Actuarially, this expected trust term will often be in the range of 50 to 60 years.

Adding Liquidity and Even More Flexibility

If this is all that a client does, the client's family will be way ahead. However, AdvisorServe has added its own modifications to this very creative strategy. Funds placed into the Standby StretchIRA Trust will generate income for a very long time, but we also would like to assure that the family has access to principal on a tax-favored basis. We like to see the client add a 2nd trust up front, funded with a life insurance policy. Then, when the SIT is implemented, there are two buckets of funds available. The IRA funds end up in a trust that pays out an income for decades to come. At the same time, the life insurance trust receives the tax free proceeds of the life insurance policy. The life insurance trust can support the family with tax-advantaged income or principal as needed and as determined by the selected Trustee. This is a double play that addresses all kinds of family needs beyond a steady income stream. Beneficiaries might even use funds from the life insurance trust to pay the taxes on the income drawn from the SIT.

Much of the life insurance cost has no impact on the amount distributed by the IRA, since premiums can be funded from the required minimum distributions that occur in the client's later years. For clients over age 72, the insurance would be funded totally from RMD's. For younger clients, we would start with a lower premium level, just to assure the delivery of the death benefit and avoid any loss of insurability that could occur before the client reaches age 72. Those premiums can come from small, early IRA distributions or other funds.

AdvisorServe is happy to model this double play for you at any time. This might be one of those ideas that makes you a hero to your clients.

Turnkey Solution

Back to the Standby StretchIRA, it's one thing to have a good idea. It's a better thing to have a good idea and an easy, cost effective way to implement the idea.

We have identified Sterling Foundation Management, a nationally recognized firm, which offers a completely integrated, easy-to-implement, low-cost turnkey solution for your clients to implement a SIT. It's quick, simple, and costs only $1000.

With Sterling's solution, you get not only a good, effective solution for your client, but you also keep the assets right where they are, even after your client dies. When the client dies, you complete the funding of a trust account, which you manage. The assets go from the IRA into the new trust account. You and your successor advisors manage the assets then, possibly for as long as 50 to 60 years.

We have worked with Sterling, and they are working with a large and growing number of RIAs, fee-only planners, and broker/dealer advisors. You can contact Sterling's CEO at Roger.Silk@SterlingFoundations.com to learn more from their perspective.

Answer to Brain Teaser

The answer to our question of the Nobel Prize winning strategy is the idea of the "nudge." The idea of a "nudge" is that little changes can make it easier for people to do the right thing. Economist Richard Thaler got the Nobel in 2017 for the idea.

The "nudge" idea inspired retirement legislation that lets companies include employees in 401(k) by default. If the employee doesn't want to be in the 401(k), the employee can fill out a simple form to opt-out. Vanguard estimated this simple change *more than doubled* participation.

We can apply the same "nudge" idea to help our clients with large IRAs to act to preserve their IRA assets for their heirs. We can do it by presenting the Standby StretchIRA Trust as the natural plan for clients with large IRAs. Of course, we can and should offer them the opportunity to "opt-out" any time their objectives change.

But more importantly, we need to make it easy for clients to continue letting their pre-tax dollars grow in a tax-exempt account, even after the client dies. We do that by having them set up a Standby StretchIRA Trust.

How To Get Your *Freebie*

Our goal is to provide value added to fee only planners. To provide additional value for you, we have arranged with Sterling to waive the $1,000 fee on your own personal Standby StretchIRA Trust. This offer is limited to the first 50 advisors who mention the "**AdvisorServe *Freebie***" to Sterling and setup their own personal Standby StretchIRA Trust this year. To learn more, contact **AdvisorServe** or Sterling directly. You can reach Sterling's CEO, Roger Silk, at Roger.Silk@SterlingFoundations.com. Our contact information is shown here in our website.

It's a Wrap

By combining a Standby StretchIRA Trust with a supplemental Insurance Trust, you can create a platform for family income that can last for generations. These funds will have significant creditor protection in most states and be protected by the management clients want to have in place for their families.