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## **Inherited or Stretch IRAs**

Why this is the smartest move your high-net-worth clients can make today.

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One of the smartest provisions of the tax code allows your clients to defer tax on their retirement account contributions and earnings. This is especially powerful for your high-net-worth clients. Clearly, if your clients have the choice of paying \$100,000 in taxes now or spreading those tax payments over the next 50 years, you should have them pay it over the next 50 years. That way, they'll use the government's money to generate interest for themselves.

The government allows most of your clients' retirement money to exist in tax-deferred bliss for their lifetimes. That's right, if they name the right beneficiary for their retirement accounts, they can continue to grow your clients' retirement accounts and defer the taxes for decades after your clients are gone and, thus, grow a modest retirement account into a fortune. This is called an "Inherited IRA" or "Stretch IRA" (see related [story](#) in this issue). Of course, based on their life expectancy, your clients' beneficiaries will have to take a small taxable distribution each year (Code Section 408(d)(3)(c)), but the bulk of the money grows without the IRS putting their paws on it.

However, to be eligible for this tax-deferral windfall, your clients must name the right beneficiary. For example, let's say your client is a widow with three children and she wants to make sure each child receives a third of her retirement account (Code Section 401(a)(9)). For the kids to take advantage of the inherited IRA, all your clients have to do is name them as the beneficiaries. That's a no-brainer, and it's the easy part. Having named the kids as the beneficiaries, they need to take three additional steps:

1. Make sure the current custodian (bank, insurance company or mutual fund company) will allow the kids to take advantage of the inherited IRA once your client passes away. Believe it or not, many don't!
2. Make sure your client's financial advisor is well versed in how to help their beneficiaries take advantage of the inherited IRA. My experience is that Fat Albert can do more sit-ups than you can find advisors who'll set this up correctly.

### 3. Make sure the kids understand how important this is so they don't blow the money.

Let's tackle the first point, making sure your clients' retirement account custodian will allow their beneficiaries to take advantage of the laws. As you probably know, when it comes to retirement accounts, there are two sets of rules; the IRS has one set of rules and the custodian has the other set of rules. The trick is, you must comply with the stricter of the two rules, and often the custodian is more stringent than the IRS. That's right. It may steam your broccoli, but it's true.

Why is this important for you and your client? Because even though the IRS allows your clients' beneficiaries to stretch distributions of their retirement accounts over their life expectancy, many banks and mutual funds don't. So if their bank is among the many who feel they know better than the IRS, they'll force your clients' beneficiaries to withdraw all their retirement assets (and pay taxes on them) over one to five years, losing the opportunity to stretch those payments and defer those taxes over decades to come.

To put some teeth into this, assume your client's daughter, Martha, inherits \$1 million from mom's retirement account when mom dies. Let's assume Martha is 40 years old when mom passes away. In this situation, the IRS will allow Martha to take distributions over 42 years, and if we assume she can earn six percent on the money, she'll withdraw more than \$3.1 million over the 42 years.

But that's assuming the bank is at least as lenient as the IRS. As I said, many aren't. What if the bank forces Martha to withdraw the retirement assets within one year? Well, she'll withdraw \$1 million and pay taxes on that, leaving her with about \$600,000 to spend.

Now, I know I'm from California, but even out here, we'd rather have \$3.1 million and pay tax on it than have \$1 million and pay tax on it. The bank can cost your client a fortune if you don't solve this problem for your clients.

Fortunately, the solution is straightforward and it's an opportunity for you to vastly expand your practice. Invite your client to come in to your office and bring her beneficiaries with her. Explain the problem and then call the clients' custodian and ask to speak to the retirement department. Ask if they allow beneficiaries to take advantage of the inherited IRA provisions.

You'll receive one of three answers.

- No.
- What's an inherited IRA?
- Yes.

If you receive answers #1 or #2, help the client shop for a new retirement custodian. If you receive answer #3, confirm that the custodian will allow the beneficiaries to withdraw retirement funds over their lifetimes as provided by the IRS — and get it in writing.

Regardless of what happens, you've accomplished three very important goals:

- You've helped the client avoid a financial meltdown.
- You've solved a problem for the kids and as a result, had an opportunity to compete for their tax business.
- Become the hero and saved the day — yet again. This helps cement your relationship with your clients and their beneficiaries. Next time your client plays golf with friends and he recounts this story, his golfing buddies will wonder why their CPA didn't make that call for them. This is yet another chance for referral business for you.

By making sure your high-net-worth clients take advantage of the inherited IRA you will be helping them pass a fortune on to their family. This allows your clients' beneficiaries to defer income tax on the lion's share of the IRA for decades and opens the door for you to expand your practice. It fails in most cases because the custodian, the advisor, or the beneficiaries are unfamiliar with it. Use this as an opportunity to help your clients and expand your practice.

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**Neal Frankle** is the author of *Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity*. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. If you would like a free monthly e-newsletter you can use to help your clients make better investments please e-mail [Neal](#).

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