

# The Greatest Gift the IRS Ever Gave You

By Neal Frankle, CFP®

Last month I wrote about how important it is to name a beneficiary for your retirement accounts—and not only to have filled out that form once, but to make sure your bank still has it. Banks commonly lose the beneficiary forms. It happens as often as not.

Let's assume you understood the importance of all that and you now know for sure your bank still has the form designating your living, breathing beneficiary for your retirement accounts. You're probably feeling pretty good about yourself and how responsible you are. Well, you should feel pretty good, but your work isn't done just yet. The greatest gift the IRS ever gave you is the ability to defer tax on your retirement account contributions and earnings. Hey, if you have the choice of paying \$100,000 in taxes now or 50 years from now, pay it 50 years from now. That way, you'll use the government's money to generate interest for number one: yourself.

The government, in all its benevolent splendor, allows your money to exist in tax-deferred bliss for your lifetime and, in many cases, for generations after you've signed your last tax return in the sky. That's right, if you name the right beneficiary for your retirement accounts, he or she can continue to grow your retirement accounts and defer the taxes for decades after you are gone and, thus, grow a modest retirement account into a fortune. This is called an "inherited IRA" or "Stretch IRA." Of course, your beneficiaries will have to take a small taxable distribution each year (based on their life expectancy), but the bulk of the money grows without the IRS putting their paws on it.

However, to be eligible for this tax-deferral windfall, you have to name the right beneficiary. For example, let's say you're a widow with three children and you want to make sure each child receives a third of your retirement account when you go to meet your maker. For the kids to take advantage of the inherited IRA, you have to name them as the beneficiaries. That's a no-

brainer, and it's the easy part. Having named the kids the beneficiaries, you need to take three additional steps:

1. Make sure your current custodian (bank, insurance company, or mutual fund company) will allow the kids to take advantage of the inherited IRA once you pass away. Believe it or not, many don't!

2. Make sure your financial advisor is well versed in how to help your 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 your kids understand how important this is so they don't blow the money.

Let's tackle the first point, making sure your retirement account custodian will allow your beneficiaries to take advantage of the laws. You see, my dear friend, when it comes to retirement accounts, there are two sets of rules; the IRS has one set of rules and your custodian has the other set of rules. The trick is, you must comply with the stricter of the two, 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? Because even though the IRS allows your beneficiaries to stretch distributions of your retirement accounts over their life expectancy, many banks and mutual funds don't. So if your bank is among the many who feel they know better than the IRS, they'll force your beneficiaries to withdraw all your retirement assets (and pay taxes on them) over 1 to 5 years, losing the opportunity to stretch those payments and defer those taxes over decades to come.

To put some teeth into this, assume your daughter Martha inherits \$1,000,000 from your retirement account when you die. Let's assume Martha is 40 years old when you pass away. In this situation, the IRS will allow Martha to take distributions over 42 years, and if we assume she can earn 6 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 1 year? Well, she'll withdraw \$1,000,000 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 \$1,000,000 and pay tax on it. Am I getting through to you? Your bank can cost you a fortune if you don't deal with this pronto. Fortunately, the solution is straightforward. Simply call your 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.

1. No.
2. What's an inherited IRA?
3. Yes.

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

The inherited IRA is the single greatest gift the IRS ever gave you. It fails in most cases because of the custodian, the advisor, or the beneficiaries. Next month, we'll discuss how to make sure your financial advisor doesn't blow this windfall for you.

*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. To receive a free report on how to find the best funds, contact him by sending e-mail to Neal@WealthResourcesGroup.com.*