

Dynasty Trust – An Alternative to the Stretch IRA

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Stretch individual retirement accounts (IRAs) have been a hot topic in the news lately. On July 10, 2013, the Senate Daily Policy Note showed that the United States Senate moved to eliminate stretch IRAs in order to increase tax revenue and keep the 3.4 percent interest rate in place. This would be in place on federally subsidized Stafford loans for one more year for low and moderate income students.¹ This is not the first time stretch IRA elimination has been suggested. In 2012, Finance Committee Chairman Max Baucus (D-Mont.) suggested their elimination in the Highway Investment Job Creation and Economic Growth Act of 2012.² President Obama included it in his fiscal 2014 budget proposal released April 10, 2013, and the American Bar Association mentioned it in a letter about a tax simplification proposal to the Senate and House tax-writing committees on October 3, 2013³. With this idea gaining ground amongst law makers, it is important for Americans to understand the stretch IRA and what alternatives they have.

What is a Stretch IRA?

A stretch IRA is an asset transfer tool that allows investors to transfer an income stream to future generations. This strategy names the owner's spouse as the primary beneficiary on an IRA account and only takes the required minimum distributions while the account owner is alive. When the owner passes away, the spouse rolls the IRA into their own IRA account and lists a younger individual(s), like a child or grandchild, as the new beneficiary(s). The spouse would then take only the required minimum distributions after they turn 70½. When the spouse passes away, the younger generation would inherit the assets into a Beneficiary IRA and continue to take only the required minimum distribution over their lifetime, again listing a younger individual(s) as the beneficiary.

Stretch IRAs are currently used by many wealthy Americans to transfer assets to younger generations. This strategy is contingent on the spouse and the younger generations taking out only the required minimum distributions, so it is important that the owner's intent is fully disclosed when the account is established. Once the account is passed on to the beneficiary(s), there is nothing to stop them from distributing the assets in their entirety.

Dynasty Trust: A Stretch IRA Alternative:

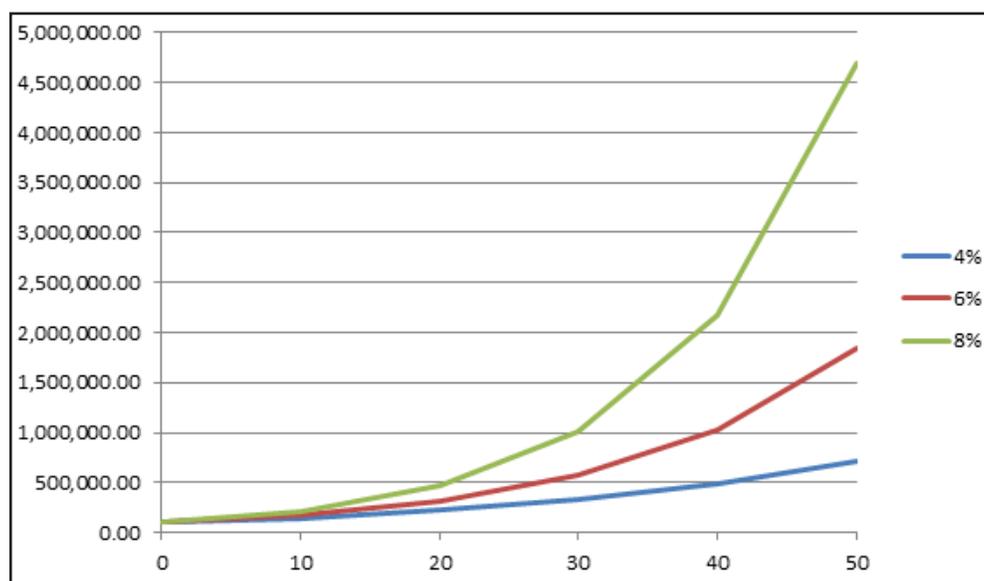
With the possibility of stretch IRA elimination on the horizon, wealthy Americans should start to look for an alternative. A possible alternative is the dynasty trust. Dynasty trusts allow you to pass wealth from generation to generation without incurring transfer taxes such as the estate and gift tax. It also has the added benefit of lasting 21 years after the death of the last listed beneficiary. In theory, this trust could last for over 100 years. Dynasty trusts are irrevocable and a trustee is appointed to manage the trust.

To utilize this strategy, the owner must establish a dynasty trust for the benefit of a younger beneficiary(s) and name the trust as the beneficiary of the IRA. So long as the trust qualifies as designated beneficiary, the trust can choose to receive only required minimum distributions from the IRA, thus preventing the possibility that the IRA funds will be cashed out early and increasing the likelihood that the trust would continue for many generations. To qualify as a designated beneficiary the trust must meet the following requirements per IRS Publication 590:

- 1.** It must be valid under state law;
- 2.** The trust must be irrevocable or will, by its terms, become irrevocable on the death of the plan participant;
- 3.** The beneficiaries of the trust who are beneficiaries of the trust's interest in the plan participant's benefit must be identifiable from the trust instrument;
- 4.** The trust administrator must provide the plan administrator with a copy of the trust document or a list of all of the beneficiaries of the trust.

When used correctly, the dynasty trust could be an alternative to the stretch IRA because the owner is ensured that the beneficiaries will only be allowed to take out required minimum distributions and thus, the trust could continue on for many generations. When allowed to continue, the assets in the trust could have significant growth. Chart 1 below shows the potential compound growth of an account over a 50-year period at a four, six, and eight percent average rate of return. As illustrated below, when left alone, a dynasty trust has the potential to pass on a significant income stream to future generations.

Chart 1 – Compound Growth of \$100,000 over 50 Years



*The rates of return shown above are purely hypothetical and do not represent the performance of any individual investment or portfolio of investments. They are for illustrative purposes only and should not be used to predict future product performance. Specific rates of return, especially for extended time periods, will vary over time. There is also a higher degree of risk associated with investments that offer the potential for higher rates of return. You should consult with your representative before making any investment decision.

Points to Consider

As with all strategies, there are advantages and disadvantages to dynasty trusts. For example, any income generated on the trust will be taxed at trust tax levels. These levels may be higher than an individual's tax rate. For this reason, it may be advisable to invest in non-income producing assets inside of the trust. One may also consider that the dynasty trust is irrevocable, meaning once the trust is funded, the grantor can't change their mind later, and the beneficiaries can't alter the terms of the trust when family or financial circumstances change. The grantor must determine what will be good for their distant relatives decades in advance.

As the Senate continues to debate the future of stretch IRAs, Americans who desire to pass on income from their IRAs to future generations should consider seeking the counsel of a qualified Advisor to determine what steps would be most appropriate given their individual situation. An Advisor can help you establish a plan to pass on assets according to your wishes, should the Senate eliminate the stretch IRA.

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¹July 10, 2013, the Senate Daily Policy Note,

²Highway Investment Job Creation and Economic Growth Act of 2012,

³2014 Budget Proposal released April 10, 2013, Tax simplification proposal letter to the Senate and House tax-writing committees on October 3, 2013)

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