The Benefits of a Multi-Generational IRA

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Many have substantial amounts kept in tax-deferred retirement accounts, such as an IRA, 401(k), 403(b), TSA, or 457 plan. All of this money is either tax-deferred wages or profits from a self-employed activities. For those who own businesses that make substantial profits, even larger amounts may be stored in a SEP-IRA, family 401(k), defined contribution, or defined benefit plan. For simplicity purposes, this article will designate all of these tax-deferred retirement accounts as an IRA. This article will cover the benefits of establishing a Multi-Generational IRA (MGIRA).

If you, John Smith, are married and designate your spouse Mary as your primary beneficiary, when you die the spouse has two choices. She can rollover all of your IRA funds into her own separate IRA, Or, she can designate your IRA funds as an inherited IRA, such as John Smith, deceased, IRA for benefit of Mary Smith. Either way avoids immediate taxation. However, if she does not implement the MGIRA strategy, upon her death all the IRA money gushes out typically in the year of her death and is taxed to the beneficiaries (typically the kids).

The benefit of the MGIRA strategy is that upon the death of the IRA owner, the funds can go to the kids or grandkids without all of it gushing out and being taxed immediately. If you had $500,000 in your IRA and 2 kids, without the MGIRA, each would get $250,000 in a lump-sum. If each kid had a good income, the extra $250,000 income would probably push them into the 40% combined federal and state income tax bracket. This would result in $100,000 of tax paid by each of your kids. If you had two 40-year-old twins as your only kids, a MGIRA would allow each to distribute only $5,868.54 from their $250,000, allowing most of it to grow. Per the IRS Required Minimum Distribution (RMD) rules, each year they would have to distribute a bit more, but most would remain in the IRA, growing tax-deferred.

Warning: Virtually no company 401k and few financial institutions allow a true MGIRA strategy when one has multiple kids and/or grandkids. A true MGIRA strategy allows one to name multiple beneficiaries, and each kid or grandkids is distributed their own RMD based on their separate age. Think about the company you work for. Assume that you have 2 kids, ages 30 and 40, and 3 grandkids ages 5, 7, and 10. Once you quit working, you are no longer making that company money. Does that company have the computer system or the desire to pay out the correct RMD every year to your 5-year-old grandchild for the next 90 years (assuming he lives until age 95)? If they don’t pay out the correct RMD, there can be up to a 50% penalty.

At least 90% of my clients, once they know that the MGIRA strategy exists, prefer that the kids and grandkids get an annual check every year for the rest of their life and are restricted from raiding the IRA principal. This way, it becomes (after your death) a lifetime annual gift to them. When we do the analysis, $300,000 deposited in a MGIRA can become $1-2 million of total income over the life of young kids or grandkids. However, the MGIRA is set up so that you retain total control, and can spend all the income or principal if you need it.

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