LIFE INSURANCE RETIREMENT SUPPLEMENT

RIP Stretch IRA: A life insurance alternative

Starting in 2020, beneficiaries of IRAs may be in for a shock. The ability to stretch inherited account distributions over a lifetime, allowing for additional growth within the account and spreading income taxes over multiple years, has largely been eliminated. The “Stretch IRA” as we know it is gone.

For deaths in 2020 and thereafter, all types of inherited IRAs, including Roths, must be distributed by the end of 10th year following the owner’s death. The elimination of the Stretch also applies to defined contribution plans such as 401(k), profit sharing and 403(b) plans. It is one of the most significant income tax and estate planning changes in decades. For beneficiaries of account owners who died in 2019 and before, the old rules still apply.

There are a few exceptions to the 10-year force out:

1. Surviving spouses have the same options as before including completing a spousal rollover.
2. Beneficiaries who are less than 10 years younger than the IRA owner (e.g., siblings) may use a lifetime Stretch.
3. Disabled or chronically ill beneficiaries may use a lifetime Stretch.
4. Minor children (but not grandchildren) of the IRA owner may delay the 10-year force out period until reaching the age of majority (age 18 in most states).

During the 10-year period, there is no required minimum distribution (RMD). For example, a beneficiary may leave the entire amount in the inherited account until the end of the 10th year. The beneficiary would then take a lump sum distribution of the entire account. Alternatively, a beneficiary may spread distributions evenly over 10 years – or any pattern they chose – so long as the account is completely distributed by the 10-year deadline.

The 10-year force out is intended to generate revenue for the federal government more quickly. This was accomplished by compressing the distribution period to a maximum of 10 years. To make matters worse, the accelerated distribution period could push a beneficiary into a higher income tax bracket creating a tax “double whammy” – compressed income taxed at a higher marginal rate.

The life insurance alternative

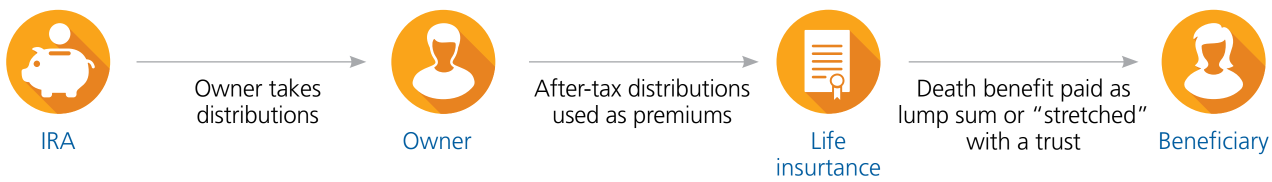
If the IRA, or a portion thereof, is intended as a legacy asset for heirs, repositioning the IRA into life insurance while the IRA owner is alive is a Stretch alternative that should be considered.

Repositioning the IRA is as simple as taking distributions from the IRA during lifetime. The IRA owner will pay any applicable income taxes. The after-tax amount can then be used to pay a life insurance premium. The life insurance policy ultimately passes an income tax-free, lump sum death benefit to heirs.

continued

Ohio National Financial Services®

Life insurance alternative to Stretch IRA



IRA owners should work closely with a tax advisor to determine the appropriate distribution pattern. In some cases a gradual distribution pattern to prevent bracket creep may be advantageous while in other cases a lump sum distribution may be appropriate.

Recreating a "Stretch" requires an additional estate planning step – the use of a trust. The trust can be drafted to give the trustee the authority to stretch the death benefit over the trust beneficiaries' lifetimes. In essence, it replaces the lifetime distribution pattern of a Stretch IRA. The trust can also protect the death benefit from the beneficiary's creditors.

The benefits

- Life insurance pays an income tax-free, lump sum death benefit.
- Unlike an IRA, life insurance can be removed from a taxable estate during lifetime.
- Life insurance does not have a 10-year force out. When placed in a trust, the death benefit can be paid out as needed. It's flexible.
- Life insurance can be coordinated with a trust to achieve a lifetime Stretch.
- When properly structured, life insurance is private and avoids probate.

Additional considerations

- To use a trust as a Stretch IRA alternative, the life insurance can either be personally-owned with a trust named as beneficiary (common for revocable living trusts) or it can owned by and payable to an irrevocable life insurance trust (common for larger estates where estate taxes are a concern).
- The life insurance alternative does not make sense for someone who needs the IRA for living expenses. It is best suited for wealthy clients who have adequate retirement income sources outside the IRA.
- The life insurance alternative provides maximum potential wealth preservation for beneficiaries who are in a higher income tax bracket relative to the IRA owner.
- Life insurance may not be available due to age and/or health.

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The Ohio National Life Insurance Company | Ohio National Life Assurance Corporation
One Financial Way | Cincinnati, Ohio 45242 | 513.794.6100 | ohionational.com
Post Office Box 237 | Cincinnati, Ohio 45201-0237

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