Estate Planning: Asset Protection

IRA Beneficiary Trust
A Living Trust for your IRA/401k

New IRS rules now permit an individual to create an IRA Beneficiary Trust® to insure that your beneficiaries (those who will receive the IRA's after the client's death) "stretch-out" their taxable, required minimum IRA distributions over a much longer period of time. And, if they do it right, the IRAs can continue to compound for many years income-tax free -- and may literally grow to be worth millions of dollars! In 2005, the IRS issued a private letter ruling 200537044 (the "PLR") that approved this new type of revocable trust created solely to be the beneficiary of an IRA account. As a result of this PLR, it is now possible for you to create a stand-alone IRA Beneficiary trust.

IRA Beneficiary Trusts® insure that your beneficiaries will stretch-out payments from the IRA after they inherit their shares of the account so that the funds will grow inside the account without being taxed. This type of trust has also been referred to as an IRA trust, an IRA inheritance trust, a stand-alone IRA trust, an IRA stretch trust or an IRA protection trust. An IRA Beneficiary Trust is basically a revocable Living Trust for your IRA/401k.

If your children and grandchildren who inherit IRA funds keep the funds in the IRA over their lives and only take the required minimum distributions each year (the "stretch-out"), the amount of money that can be earned, accumulated and paid to the beneficiaries can be staggering.

This wealth accumulation strategy only works if the beneficiaries retain the inherited funds inside the IRA account. If a beneficiary takes all of the funds out of the IRA account at the time of the client's death (called a "blow-out" because it blows the stretch-out), this wealth accumulation technique will be lost. One of the reasons to create an IRA Beneficiary Trust® is because it can insure the stretch-out and can prevent a blow-out. This blow-out happens more often than you may think. The beneficiaries may not be aware of the tax rules and their distribution choices, so they may immediately withdraw the IRA's at the first opportunity (or worse yet, do a prohibited rollover!). Or the beneficiary, influenced by his or her spouse, may just decide to withdraw the IRA's to foolishly spend it. If the "stretch-out" isn't done properly by the beneficiaries and income taxes are paid up front shortly after the IRA's are inherited, your client's family may lose hundreds of thousands of dollars (or more).

Even if you assume that your beneficiaries will do the right thing (that is, keep the funds in the IRA account for their lives to maximize the income tax "stretch-out" of the IRA's), the IRA's may still be seriously exposed to one or more of the following threats that can arise years after you have passed:

The beneficiary's spouse may snatch half (or more) of the inherited IRA's in a divorce. The divorce rate is over 50% and a big pile of inherited money may

Estate Planning: Asset Protection

become a divorce incentive for the ex-spouse. Even though inherited property is separate property, the beneficiary's ex-spouse's divorce lawyer will probably go after the IRA funds because the IRA account is frequently the largest asset and the lawyer knows there is a good chance the spouse who inherited the IRA will give a large portion or all of the IRA account just to end the divorce and to be rid of the ex-spouse.

The beneficiary's poor spending habits, creditors and lawsuits may grab all of an inherited IRA's.

The beneficiary could lose his or her needs-based government benefits (if he or she ever requires them), such as supplemental income (SSI) or long-term nursing care (Medi-Cal).

And even if the beneficiary never encounters any of these problems, he or she may get walloped with a huge estate tax when he or she passes the IRA's down to the next generation.

One of the big advantages to the IRA Beneficiary Trust® is the option to give a "Special Trustee" the right to elect out of the "conduit trust" (i.e., where the MRD must be paid to the beneficiary on an annual basis) to a fully discretionary "accumulation trust" (i.e., where the trustee can hold the beneficiary's MRD inside the trust). This election must be made, if at all, by September 30 of the year following the client's death. Making this election may result in a shorter "stretch-out" because the age of the oldest "possible beneficiary" must be used (the Special Trustee is also given the power to limit such possible beneficiaries to minimize this issue); however, having this option to elect between the different forms of trusts provides the flexibility to consider all factors known at the time of death and up to the election deadline (e.g., creditor problems, disability, etc.) the benefits of which may greatly out-weigh the increase in the income tax costs.

In summary the primary advantages of designating an IRA Beneficiary Trust as the beneficiary for your retirement account are;

- IRA Beneficiary Trust is a revocable Living Trust that can be changed by you at anytime
- Lifetime asset protection for your retirement funds for your children
- Maximum "Stretch-out" of the tax deferred growth of your retirement funds based on the individual child's age
- You decide who will control the distribution and investment of your retirement funds after you pass on
- You can control who will inherit your retirement funds when your children pass on
- Minimize estate taxes on your children's estate