



IRA Legacy Trusts

Over sixty percent of inherited money is spent within less than three years. Until now, parents have generally left their tax deferred retirement accounts to their beneficiaries (usually their child or children) outright. There have not been any restrictions or parameters placed on the account. This frequently leads to unintended consequences. For example:

- The child cashes in the retirement account and is subjected to huge tax liabilities.
- The child loses out on years and years of “tax deferred growth” opportunities given to him by the Internal Revenue Service (“IRS”).
- The child loses the retirement account balance to a divorce; creditor; or predator
- The child is incapacitated or a minor at the time of the death of his parent.

All of the above unintended consequences can be eliminated by simply leaving the retirement account to your heir (whether it be child; grandchild; niece or nephew) in an IRA Legacy Trust – a concept that the IRS has approved of – to permit your child to “stretch” the tax deferred growth in the retirement account over years and years. Moreover, the trust provides your beneficiary with some asset protection that would otherwise be unavailable when the beneficiary of your retirement account is your child instead of this specially designed Legacy Trust.

Some Background Information

(Before you read on, you should be aware that the concepts discussed in the remainder of this writing also apply to 403(b) and 457 plans, but generally not to 401(k) plans. Virtually all 401(k) plans require the account to be paid in full within one to five years of death. This is one of the most important reasons for rolling over a 401(k) plan into an IRA. It is often helpful to speak to a good financial planner to determine whether it is best to keep the funds in a 401(k) or roll them into an IRA.)

Most of the time a spousal beneficiary can defer paying income taxes on the withdrawal of a 401(k) by rolling the plan into an IRA, a non-spousal beneficiary is not so lucky and if they try to do so, the 401(k) proceeds are income taxable immediately, and the beneficiary has made an illegal contribution to his IRA.

If the retirement plan funds are in an IRA, the child can continue the IRA under the parent's name. Generally, the account is titled as follows: "John Smith, deceased; Marcia Does as beneficiary." In the event that there is more than one child as a beneficiary, the account can be divided into separate accounts, one for each beneficiary. The child/beneficiary is not permitted to make any contributions to the "inherited IRA," and is required to make distributions over his/her life expectancy.

Beneficiaries are required to begin distributions in the calendar year following the plan owner's death. As an illustration, a 40 year beneficiary, according to the IRS tables, is required to withdraw a little over two percent in the year following the account holder's death, and a slightly higher percentage each subsequent year. A beneficiary is permitted to withdraw more, but withdrawals are always income taxable and the beneficiary loses the ability to grow the money that was withdrawn in a tax deferred basis.

As a comparison: if Child A (age 40) immediately withdraws the \$100,000 IRA he inherits, depending on the income tax rate he is in, he is going to pay approximately 40% in taxes. Whatever the remaining \$60,000 earns each year is taxable in that year.

If Child B, instead of taking the whole thing, only takes the minimum required distributions and earns a 6% rate of return, he will ultimately have expendable distributions of \$332,466 whereas Child A will have been limited to \$134,237 over the same period. The moral of the story is to take only minimum distributions!!

In the event that your child dies before the complete distribution of your IRA, it can be passed to your grandchildren or other beneficiaries who may continue the same withdrawal schedule. Thus your legacy continues as the IRA still retains your name.

The IRA Legacy Trust – A Means to Stretch-Out and Protect

The IRA Legacy Trust is a separate trust for each beneficiary/child. Your living trust states that upon your death, all or part of your child/beneficiary's inheritance will not be left outright to your beneficiary/child, but will be distributed to the separate trust for his/her benefit. Your IRA names each beneficiary's trust as beneficiary.

You may design this trust to continue for your child's lifetime. Upon his/her death, it can pass to your grandchildren or whomever you designate. You can even provide that your child has the right to indicate where the remaining trust property will pass upon his/her death.

You can make your child or anyone else the trustee of his/her trust. Sometimes you may want to have an independent trustee to serve as trustee.

Your child can still invest the inheritance as trustee of his/her trust. The principal can be used for his health, education, maintenance, and support. It is available if it is need. Additionally, if it is prepared correctly, it can be protected from divorce, creditors, and predators because the assets are not owned by your child, but by his/her trust.

Thus you can protect your beneficiaries' inheritance. Wise individuals frequently choose to leave their children's inheritance to them in trust. You protect them and provide the ability for the IRA to stretch. What a Legacy!