LONG TERM SECURITY FOR YOUR LOVE ONES OR INSTANT GRATIFICATION?

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I first wrote on the topic of IRA Trust in the fall of 2015. It is such a powerful planning tool that I thought it would be prudent to write on the topic again for those who missed it, as well as those who considered taking action but failed to do so.

The purpose of the IRA Trust planning tool is to capture your retirement assets and to protect your loved ones from themselves and others.

Retirement Plans - In modern times, retirement savings plans make up a larger percentage of retiree's portfolio than any other time in history. This is due in part to significant tax benefits provided by such plans. By "Retirement Plan" I mean an account that allows for tax deferral and is subject to the minimum distribution rules (RMDs) of section 401(a)(9) of the Internal Revenue Code, such as 401(k) and IRA plans.

Required Minimum Distributions and the Tax Stretch - If you have any such retirement plans, then you must take required minimum distributions (RMDs) starting in the year after you attain the age of 70 ½ years or face severe penalties. These RMDs are based on your life expectancy under the uniform lifetime table and the amount of your retirement plan holdings at the end of each calendar year. It is important to note that these accounts are not available to most creditors, such as those involved in a bankruptcy (these assets are, however, available for the purposes of making an application for the Medicaid long term care benefit (pays for long term care), a fact that shocks many of my clients and will shock you if you have not been educated on this most serious topic).

Upon your death, your named beneficiary has the right to request all funds in the retirement plan be distributed to him over a relatively short period of time, typically one to five years.

If your named beneficiary chooses a short period pay out (as most do), then he will incur a substantial tax bill and be giving up substantial tax deferred (tax free) growth. Unfortunately, this also means he will have given up the long term financial security the asset would have created, which we all know is priceless.

Being Tax Smart - The *tax smart* option is for the named beneficiary to <u>receive the RMDs over his life expectancy</u> and thereby continue the tax deferred status of the retirement account. When an individual defers the taxes over many years, the growth can be significant.

Following is an example from Fidelity Investments: Should you leave your 45 year old beneficiary the sum of $100,000, with a given life expectancy of 38.8 years (pursuant to the appropriate table) and assuming a 7% rate of return and a 25% federal tax bracket, as well as reinvestment of income dividends and capital gains distributions, would result in the following: 10 years - $145,760; 20 years - $275,889; 30 years; $508,006; and 40 years – $905,958. This example illustrates the power of tax deferral and compounding of interest over a beneficiary's lifetime.

We can imagine why many named beneficiaries are not taking advantage of the Tax Stretch. Perhaps the named beneficiary is not sophisticated enough to understand the financially devastating decision they are making.

One theme is the "need" for the money now due to life circumstances. There are also those spendthrifts who just can't wait to get their hands on someone else's (your money) so they can stop working, buy a new expensive car, truck, boat and vacation home (honestly, how would you finish this sentence?).

Another possibility is the pressure from an overbearing spouse to cash it in for immediate gratification (after all it is not your child that is doing the spending, it's that person they married). Unfortunately, we are all also well aware of the problems of drug and substance abuse, as well as gambling, in our society.

Whatever the rationale, I'm sure we all can agree that in many cases it just isn't necessary and the math shows us that ***the financial cost of taking early distributions is way too high***.

A Golden Opportunity: Retirement Tax Stretch/Asset Protection Trust - In my opinion, one of the ***best estate planning opportunities in recent times*** is the use of a Retirement Tax Stretch/Asset Protection Trust (a.k.a. IRA Trust).

I write this as an Elder Law Attorney, and also as an individual who understands the time value of money and the instant gratification credit card society we live in.

These are revocable trusts (mostly) that you set up during your lifetime, in which you name the trust, rather than your child, as the beneficiary of all or a portion of your retirement account. For example: "50% to Abraham Lincoln, as Trustee of the Retirement Benefit Trust for George Washington."

These trusts have two significant points of value that will help you sleep at night:

Tax Stretch and Asset Protection

In regards to Tax Stretch, there are two basic types of Tax Stretch trusts, <u>conduit</u> and <u>accumulation</u>. Under <u>conduit trusts</u>, all RMDs are paid to the named trustee and in turn the trustee is directed to distribute the RMDs to your child, thereby creating an income stream and long term security. Under <u>accumulation trusts</u>, all RMDs are also paid to the named trustee, however, the Trustee is not directed to distribute the RMDs to your child, rather the trustee has the right to receive and hold the RMDs. Thereafter, the Trustee has the power to determine when and how much of the RMDs are paid out to your child, on an as needed basis. This type of trust is most helpful for disabled beneficiaries, especially those who receive public assistance.

As can be seen, your child does not have the right to request any withdrawals from the plan administrator. In contrast, your named trustee retains the right to withdraw amounts above the RMDs if, in the trustee's judgment, your child is in need of additional funds. I'm sure you can see how this type of planning would provide a lifetime security for you loved.

In regards to Asset Protection, if you should choose to name your child directly, then the retirement plan will be owned by her. If your child has, or develops, a creditor issue (think divorce, being sued, bankruptcy) or have other creditor issues then the account is available to such creditor. The most common creditor example is divorce, in which case approximately one-half of what was your retirement savings (the security you wanted to benefit your child with) now belongs to your ex-son or daughter-in-law.

In contrast, if you should choose to name a properly drafted Retirement Tax Stretch/Asset Protection Trust as the beneficiary of your retirement plan, your child would NOT be the owner of the inherited retirement plan and therefore the funds held by the plan should not be available to your child's creditors. Did you just get goose bumps?

I urge you to come in to discuss this topic with me to learn more about this powerful planning tool.

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