

Who Should be the Beneficiary of my Retirement Plan?

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Clients ask this question every day. And every day I have the same answer...

It depends. It depends on whether you want the beneficiary to have more control over the assets or the assets to be better protected from the beneficiary's creditors, a lawsuit, or a failed marriage. It depends on how long you want the income tax on distributions deferred. It depends on whose death you want the assets to be taxed...and so on. Bottom line, the answer is very personal for each individual, and depends on your priorities and your objectives.



One major benefit of an IRA is the ability to defer income tax on the investment's growth. Distributions are taxed as they are made. Therefore, the investment can compound tax-free until then. As the account holder, you can delay taking distributions until you are 70½ years old. Then you must start taking a "required minimum distribution" (RMD) in an amount based on IRS tables. When you die, your named beneficiary must also take an RMD from the IRA. The amount of the RMD is based on who you name as the beneficiary and the beneficiary's age at the time of your death. Depending on the beneficiary's age, the IRA can continue to grow and compound for a very long time. Financial advisors

call this a "stretch" IRA because the distributions are stretched over the beneficiary's life expectancy.

Although this strategy sounds great from a financial point of view, some beneficiaries are young or do not have the self-discipline to receive the IRA in installments when they have the power to take it in a lump sum. Additionally, "bad things happen to good people." Even if your beneficiaries are great with money, they may still lose the IRA to an ex-spouse or a catastrophic lawsuit. Therefore, if you want to use a "stretch" IRA with minor children, "spendthrift" beneficiaries, or adults in high risk professions or "sketchy" relationships, it may

be more appropriate to designate a trust as the IRA beneficiary. If you do so, the trust must contain very specific provisions in order to qualify to receive the RMD. If the trust does not qualify, then ALL of the income tax on the IRA must be paid within five years of your death. Similarly, trusts require special language to receive the marital deduction for an IRA that pays installments to a surviving spouse.

While it may be appropriate to designate your revocable trust as the IRA beneficiary, most often we would design a separate "IRA Trust." If you think of the revocable trust as the "Minivan of Estate Planning," the IRA Trust is the "Indy Car of Estate Planning." It is a special planning vehicle, takes a very specific type of fuel (IRA) and is designed to do one thing exceptionally well – stretch out the RMDs as long as possible in an asset protected environment.

If you desire to leave your IRA to

charity, we usually recommend that you designate the charity directly as the beneficiary.

Summary:

1. If you are married and you want your spouse to have the IRA without restrictions or protections, name your spouse.

2. If you are married and you want your spouse to have the income or RMD from the IRA and then want to leave the principal to your children, name a trust that qualifies for the marital deduction.

3. If you are unmarried or if you do not want your spouse to be the beneficiary:

- If you want a "stretch" IRA and also want to keep the assets protected from taxes, early withdrawals, minor beneficiaries or creditors' claims, name a qualified trust that directs a trustee to make distributions in accordance with your wishes.
- If you want a "stretch" IRA but asset protection isn't a big concern for you, designate individuals by name.
- If you don't want a "stretch" IRA, name your revocable trust.

4. If you like the protections that trusts provide, please call us. Don't assume that your current revocable trust will qualify as a "designated beneficiary" of your IRA. It likely will not. If it does not qualify, your beneficiaries must pay ALL of the tax on the IRA within five years after your death, thereby destroying your planning goals.

5. Do not make a final decision without consulting your estate planning attorney, your financial advisor and your accountant.

In this article, "IRA" refers to all retirement plans generically, including 401(k), SIMPLE SEP, 403(b) and most other qualified retirement plans. While there are significant technical differences between a "qualified" plan and a "non-qualified" plan, the same general concepts apply to both. Contact us if you have questions. 719-444-0300.