Ensuring the Stretchout

*By Philip J. Kavesh and Edwin P. Morrow III**

Ed Morrow and Phil Kavesh compare and contrast the use of standalone trusts, Trusteed IRAs and annuities as options to "guarantee" the stretchout of an inherited IRA.

The Mind-Blowing, Long-Term Value of IRA "Stretchout"

IRAs—in particular, inherited IRAs—now represent one of the greatest family wealth building opportunities available under the tax laws. Thanks to the 2002 IRS final Regulations,[1] the owner and his or her spouse may now utilize a more favorable uniform distribution table (reflecting longer life expectancies) when computing required minimum distributions ("RMDs").[2] This longer "stretchout" of RMDs results in longer tax-free compounding and greater opportunity for wealth accumulation. Although many people think of their IRAs as retirement vehicles which will be depleted over their lifetime, if an IRA grows at an annual rate of 8 percent, the IRA may not actually start depleting until the RMDs exceed 8 percent, which is not until age 89![3]

Better yet, thanks to the new IRS rules, when an IRA is inherited by non-spouse IRA beneficiaries, such as children or grandchildren, they may now use their own, even longer life expectancies when calculating their RMDs, resulting in exponentially increased potential for family wealth building.[4] For example, if a child is age 40, that child now has over 43 years of table life expectancy during which to stretchout the RMDs! If instead a grandchild age 10 inherits the IRA, he or she has over 72 years of life expectancy during which to stretchout the RMDs! When funds are kept in an inherited IRA for a much longer term period, the power of tax-free compounding inside the account (as well as compounding of the withdrawals, after income taxes) can be enormous.

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Example

An IRA owner dies at age 65, naming his estate (or non-qualifying trust) as beneficiary of his $500,000 IRA. The only beneficiaries of the estate are the IRA owner's son (age 40) and the IRA owner's grandson (age 15). In this case, the estate is not a qualified designated beneficiary. As a result, the IRA must be completely liquidated within a five-year period because the IRA owner had not reached age 70½. (For sake of ease, it is assumed in this example that the IRA is distributed ratably over a five-year period starting in the year following the year of the IRA owner's death.)

In addition to the above, assume that all IRA distributions are taxed at a 25 percent ordinary income tax rate and that the after-tax distributions are reinvested in a taxable investment account. Also, assume that the IRA has a pre-tax rate of return of 7 percent and the taxable investment account has an after-tax rate of return 5.5 percent. Further, assume that any transfer taxes that may be due are covered by other assets.

Based on the above facts and assumptions, the following are the investment assets held at the son's death and the grandson's death:

Figure 1

Amount @ Son's Death	$4,118,998
Amount @ Grandson's Death	$14,888,487

As an alternative, let's assume that the IRA owner named his 40-year-old son (or qualifying see-through trust) as the primary beneficiary and his 15-year-old

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grandson the contingent beneficiary of his IRA. In this situation, the IRA is payable over the son's life expectancy because he is a qualified beneficiary.

Assuming that the son will only take RMDs from the IRA until it is completely exhausted and dies at age 83, the following are the investment assets held at the son's death and the grandson's death:

Figure 2

Amount @ Son's Death	$5,466,150
Amount @ Grandson's Death	$19,757,889

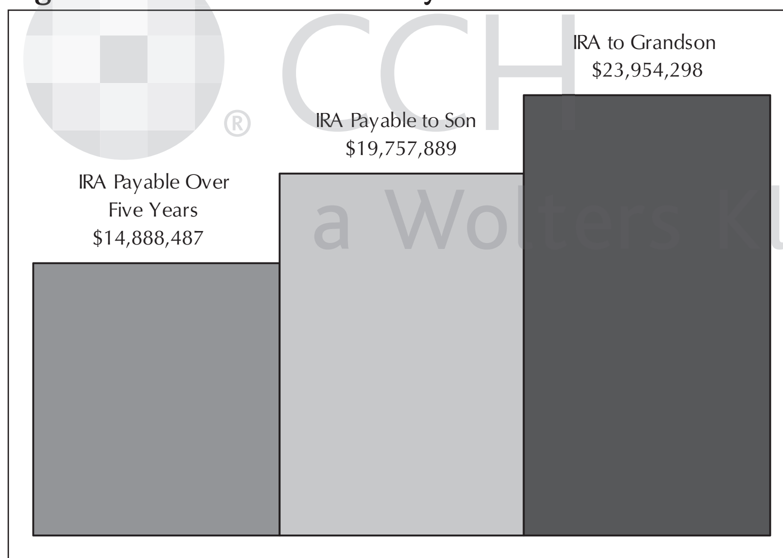
Finally, assume that instead of naming the son the primary beneficiary, the IRA owner names his 15-year-old grandson (or qualifying see-through trust). Given this new assumption, the following are the investment assets held at the son's death and the grandson's death:

Figure 3

Amount @ Son's Death	$7,027,533
Amount @ Grandson's Death	$23,954,298

The following charts summarize each of the three scenarios discussed above:

Figure 4 Total Assets Held by Grandson at his Death



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Different CPAs, financial planners and number crunchers would certainly use different assumptions and methods and come up with a wide range of potential numbers. Some would say the assumptions above are too high, others too low; others may want to account for different tax rates or inflation. But under any reasonable method and assumption, the shape of the graph and the obvious importance of the differing lines of growth will come out the same.

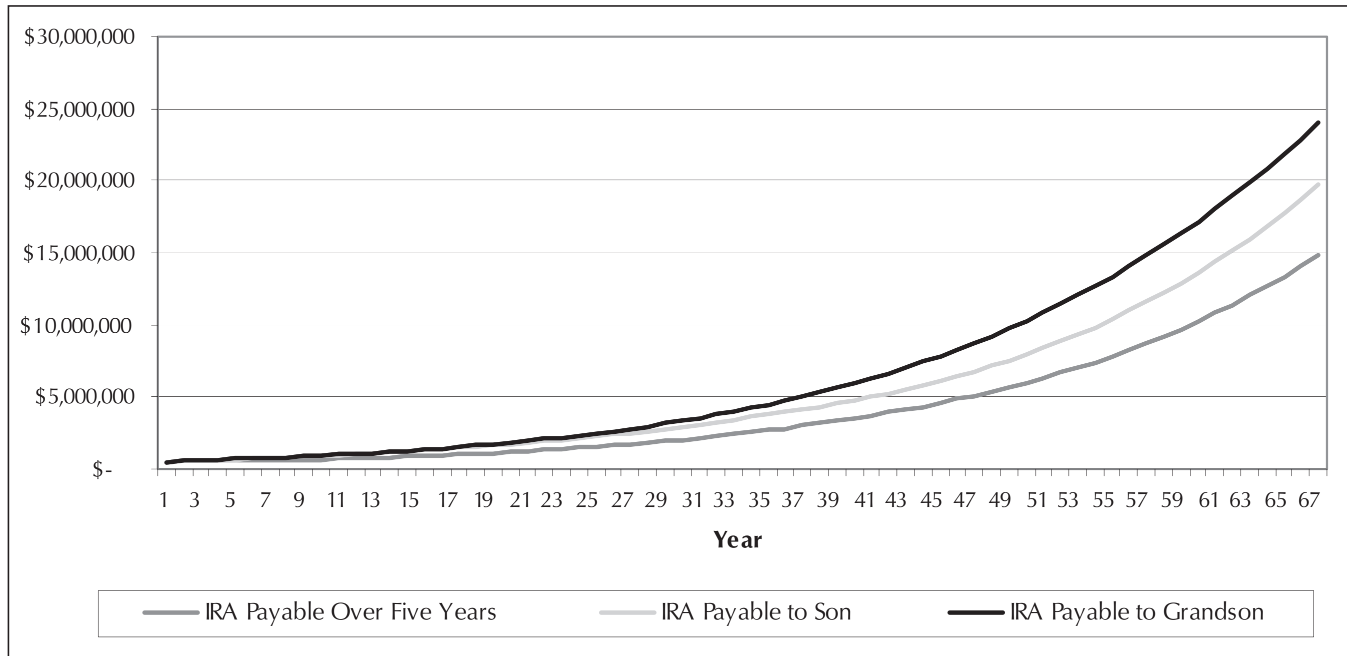
The "Myth" of the Stretch

Unfortunately, beneficiaries do not always optimize the RMD stretchout after the IRA owner's death. In fact, often the reality is that beneficiaries will withdraw funds from the IRA much earlier and to a greater extent than the RMD rules mandate. This occurs for a host of reasons. Sometimes, beneficiaries are not aware of the tax rules and their choices. As soon as they find out that they have been named as IRA beneficiaries, they immediately cash out the account, before they even consult with any professional advisors. Sometimes, beneficiaries wrongfully believe they can rollover the inherited IRA tax-free to an IRA in their own names when, actually, this is deemed a taxable distribution of the entire inherited IRA[5].

When a beneficiary prematurely takes out the IRA, this results in the "blowout" rather than stretchout! The distributions are immediately taxed and the great opportunity for future tax-deferred wealth compounding is lost. (Although qualifying Roth IRA distributions may not be taxed, even if taken before required by the RMD rules, the missed opportunity may be greater—the loss of tax-free wealth compounding inside the IRA.) Keep in mind that withdrawals taken before required cannot be corrected by simply rolling back the monies into the IRA. Unlike the original IRA owner, a beneficiary, other than a surviving spouse with respect to a rollover IRA, cannot take advantage of the "60 day put back rule"[6]. The result of the "blowout" can be devastating. In the above example, if the child had withdrawn the entire IRA in one year, he or she, and his or her family, would have conceivably lost millions of dollars!

Clearly, IRA owners want to help assure that, when their accounts are inherited, the beneficiaries do not mistakenly or intentionally withdraw them too quickly and lose the tremendous potential tax-deferred compounding of family wealth. (This may be even more crucial with a Roth IRA, because beneficiaries generally pay no taxes upon withdrawal—thus there is no immediate disincentive for them not to do so[7].) Many IRA owners assume their beneficiaries will have the good common sense, knowledge or proper

Figure 5 Total Investments – IRA and Outside Account



professional advice to avoid this "blowout" and properly utilize the "stretchout". This assumption is dangerously naïve. But even if this assumption proves correct, there are other lurking threats to the potential family wealth represented by the inherited IRA.

Asset Protection for the IRA

Asset protection for IRAs is often overlooked. We mean this term in the broadest sense, not merely in reference to creditors. IRA beneficiaries may be exposed to the potential loss of some or all of their inherited IRAs, for many reasons, including the following:

The beneficiary may lose some or all of the IRA in a divorce. Although inherited property is usually in theory separate and not marital property, beneficiaries can lose this protection by withdrawing the IRA and commingling the funds with marital property ("transmutation"). In addition, even if the inherited IRA is not deemed to be marital property, it definitely is "on the table" when a settlement negotiation takes place, which occurs far more frequently than a full court trial and judge decision. Considering the high incidence of divorce (now over 50 percent in many states), this is a real life threat to the long-term enjoyment of the IRA by the owner's family.

Loss of some or all of the IRA to lawsuits and creditors. State statutes vary on how much they exempt IRAs from lawsuits and creditors' judgments. Some only offer protection for IRA contributors, not inheritors. Some include inheriting spouses, but not other heirs[8]. Some limit protection to what is "reasonably necessary" for the debtor and/or dependents or set a low limit[9]. Although the new federal Bankruptcy Act does offers a limited exemption for inherited IRAs[10], that exemption can only be availed by the beneficiary in extreme situations such as when he or she has already lost most of his or her other assets (qualifies for bankruptcy) and chooses to (or is forced to) file a public bankruptcy proceeding.

Needless wasting of the IRA because of the beneficiary's spendthrift habits (or the spendthrift habits of the beneficiary's spouse or of some other third party influencing the beneficiary). There is a great temptation to withdraw the IRA immediately because permissible IRA investments typically can be liquidated into cash within a matter of days, whereas other assets inherited outside the IRA, such as real estate, may be more illiquid.

Loss of some or all of the IRA because of the beneficiary's poor money management skills. Even if, at the time of the owner's death, the account investments were being handled properly by a financial advisor, each of the beneficiaries may simply move his or her share of the account to another custodian and manage it on his or her own. Or, they make take the advice of a poorly educated or unscrupulous financial advisor. Even a helpful and well-meaning financial advisor can

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easily blow the re-titling of the account after the owner's death, thereby losing the stretchout.

Diminution of the IRA (or loss of control) because the beneficiary's affairs are subjected to a conservatorship or guardianship. If a beneficiary is too elderly or disabled to act for himself or herself, or has a drug or alcohol problem, a court may take over control of that beneficiary's interest in the IRA (exposing the IRA to not only court interference and delays, but also additional court costs and professional fees, such as for annual accountings). If the IRA passes directly to a minor grandchild, an in-law spouse (even one previously divorced from the IRA owner's child) could control the IRA as that grandchild's guardian or through an UTMA or similar arrangement.

A company retirement plan—such as a §401(k), §403(b), §457 or other qualified plan—may override the stretchout rules. Although the Pension Protection Act of 2006 ("PPA") now allows a company plan to do a trustee-to-trustee rollover into an "inherited IRA" established for a non-spouse beneficiary, by December 31 of the year following the participant/account owner's death, the plan is not required to do so[11]. Most plans require the entire account to be distributed over 5 years or less after death, effectively preventing this rollover and use of the IRA stretchout rules. If the plan participant/owner has not reached retirement age (and thus is not yet permitted by the plan to do an "in service distribution" IRA rollover), or the participant has retired but just fails or chooses not to do such a lifetime rollover, the loss of stretchout that may occur could literally cost a family millions of dollars. Even assuming a plan's documents permit (or in the future are amended to permit) the post-death rollover under PPA, the requirements are tricky[12] and there is still the chance an individual beneficiary may inadvertently fail to do it properly, resulting in the same potentially catastrophic loss (or worse, since mistitling might not only trigger the tax but it could also trigger an additional excise tax for improper contributions to a prohibited IRA).

The surviving spouse or non-spouse beneficiary may re-direct the remainder of the account at his or her death to third parties not wanted or intended by the original IRA owner (like a surviving spouse who may name his or her children of another marriage or a future spouse as successor beneficiary). This likelihood is especially troubling, considering the known statistics on remarriage.[13] Most IRA custodial agreements permit the primary beneficiary to change the next successor beneficiaries (or the account may be withdrawn by the primary beneficiary or transferred via trustee-to-trustee transfer to a custodian that permits it).

A beneficiary may lose his or her needs-based government benefits, such as supplemental or disability income or Medicaid nursing care benefits, because he or she directly receives the inherited IRA. The beneficiary may be forced to withdraw the IRA early in order to obtain or reinstate the government benefits. Alternatively, the government authority providing the benefits may seek reimbursement of those benefits after the recipient's death, forcing the IRA to be withdrawn.

Although many people think of their IRAs as retirement vehicles which will be depleted over their lifetime, if an IRA grows at an annual rate of 8 percent, the IRA may not actually start depleting until the RMDs exceed 8 percent, which is not until age 89!

The IRA may be exposed to estate or inheritance taxes (federal and/or state) when the first beneficiary passes away and the balance of the IRA is distributed to the next beneficiary. IRA owners often take pains to use the estate tax exemption or exclusion amount and proceed to waste the generation skipping transfer tax exemption (both currently at $2 Million). A child inheriting a $2M IRA outright that grows to $3M ten years later puts $3M into the child's taxable estate, whereas with proper planning the $3M might have been exempted by allocating GSTT exemption and not distributing the IRA outright. The original owner's Generation Skipping Transfer Tax exemption does not get used when the primary beneficiary is a child who receives the IRA directly.

The IRA, at the death of a married owner, may fail to fully fund his or her federal estate tax exemption (or "exclusion amount"). This increases the exposure to estate taxes when the surviving spouse dies and the account goes to the next beneficiaries. Often when the first spouse/IRA owner dies, the account passes directly to the surviving spouse and is not available to fund the first to die's exemption. Considering the

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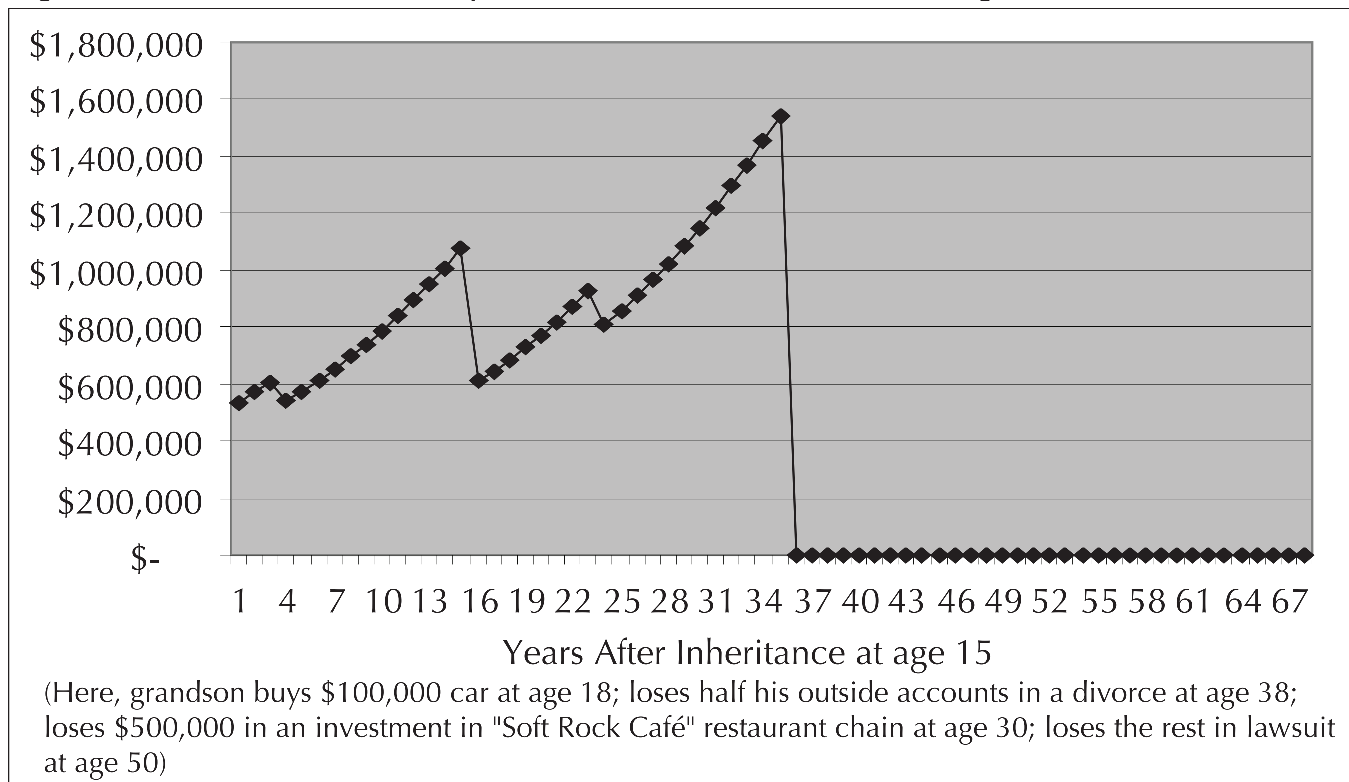
Figure 6 Total Assets – Ordinary “Stretch” IRA to Grandson Outright



(Here, grandson buys $100,000 car at age 18; loses half his outside accounts in a divorce at age 38; loses $500,000 in an investment in "Soft Rock Café" restaurant chain at age 30; loses the rest in lawsuit at age 50)

IRA may represent one of the owner’s largest assets, the loss of the owner’s exemption may cause significant future estate taxes. Alternatively, the exemption funding formula in the first to die’s estate plan may accelerate the income taxation of the IRA even though not yet withdrawn.[14]

A *young beneficiary* may take over complete control of the IRA and potentially blow it at the “age of majority”. The age of majority varies based upon the law of the particular state, usually anywhere from 18 to 21. Even at age 21, the beneficiary is likely to be unable to properly manage the money or may be tempted to withdraw and spend it. Realize that this could happen even when a young person is not named as primary beneficiary; for example, if the primary beneficiary (the IRA owner’s child) is deceased, the account may then pass to that beneficiary’s children (the owner’s grandchildren). This example is even more likely to occur if the child does survive, takes only RMDs and dies within a few years.

Given all these potential problems associated with naming individuals directly as IRA beneficiaries, there seems to be a good probability that one or more of these issues will apply to virtually every beneficiary.

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Example

See the attached chart that includes such a “reality check” when a $500,000 IRA, using the same assumptions and parameters as the previous example, is left to a grandchild outright. This chart shows what happens when grandson buys a blinged out sport car for $100,000 at age 18. At age 30 he takes out and loses an additional $500,000 for investment in a "Soft Rock Café" restaurant chain. At age 38, he loses half his outside accounts (not the IRA, which is less likely to be commingled) in a divorce. At age 50, Michael Moore is finishing his final documentary and slips and falls on the grandson’s property while chasing him for an interview. John Edwards wins a $2M lawsuit from him and cleans out the rest of his assets.

Options for the IRA Owner to Achieve the Goals of Stretchout *and* Protection for his Beneficiaries?

Assuming the IRA owner will only take RMDs during his or her lifetime because he or she has other assets available to cover living expenses, there may still be a significant balance in the IRA upon the owner’s

death and great opportunity to create future family wealth. Several relatively new planning options have been created in response to the new RMD rules, to address the stretchout and protection issues already discussed. These "new" planning options include the Trusteed IRA (with an IRA provider that offers flexible estate planning options), an annuity (as the IRA investment with an insurance company that offers a "Restricted Beneficiary Payout"), and a standalone trust (carefully drafted so as to qualify as a "Designated Beneficiary"). The remainder of this article will explore the details of these three strategies, contrast the differences between them and offer brief guidance as to the appropriateness of each of their applications to different client/IRA owner fact patterns.

What is the "Trusteed IRA"?

Sometimes also referred to as an "Individual Retirement Trust" or "IRT"[15], the Trusteed IRA is an arrangement that is established as part of the IRA agreement. Code Sec. 408 of the Internal Revenue Code essentially says that IRAs can be in the form of a trust or a custodial agreement and that for income tax purposes under that section the two forms should be treated identically[16]. By far, most IRAs are custodial arrangements. With a Trusteed IRA, the bank or trust company acts as trustee instead of custodian of the IRA. At the owner's death, the beneficiaries receive a "conduit" arrangement, whereby all minimum required distributions will be paid out to the beneficiaries. This guarantees stretchout treatment under the IRS Regulations[17]. The most restrictive default option will provide for beneficiaries to only receive RMDs. This would usually be ill-advised for the same reason such rigid maximum floors are not normally included in trusts. Usually the Trusteed IRA is drafted to permit further IRA withdrawals and payments to the beneficiaries, for such traditionally defined needs as health, support, maintenance and education. Like any trust, the restrictions may be lifted or eased over time, such as lifting such restrictions at age forty.

What is an IRA Annuity "Restricted Beneficiary Payout"?

An "IRA Annuity" may generally refer to a contractual arrangement specified in the Code for IRAs in the form of annuities[18], or as a custodial or Trusteed IRA that happens to have purchased an annuity contract as an investment. The latter type of IRA Annuity is quite common. Some annuity providers (a minority) offer as part of their contract something called a Restricted Beneficiary Payout ("RBP"). It is basically a special restricted beneficiary form, which provides for the annuity company to control the payout of distributions after the annuitant's death in accordance with the choice made by the annuity/IRA owner. However, these RBPs typically have fewer flexible payout options than Trusteed IRAs. Annual payouts may be limited only to RMDs and a small amount or percentage of the remaining account. RBPs typically do not provide for further discretionary distributions to be made by the company when beneficiaries may need additional funds for health, support, maintenance and education. In fact, the company would probably not want such discretionary authority, and perhaps may not be legally able to offer such fiduciary services typically provided by trustees.

What is the Standalone IRA Trust?

Also known as a "Stand-Alone Retirement Beneficiary Trust", "Designated Beneficiary Trust", "IRA Trust", or "IRA Inheritance Trust℠", this is a trust document established by the IRA owner, separate from the IRA agreement and beneficiary designation form. It is a revocable, "standby" trust which remains unfunded during the IRA owner's lifetime (or funded with a de minimis amount), but is made the IRA beneficiary (or each sub-share of the trust becomes the beneficiary) at the owner's death. This trust is structured in a way that may maximize the stretchout of required minimum distributions over the life expectancy of each primary beneficiary. The most significant, unique feature of the IRA Trust is that, unlike the Trusteed IRA or IRA Annuity, it can be structured to hold back RMDs (be an "accumulation" trust) which may offer much increased asset protection for the beneficiary.

The IRA Trust should be set up separate and apart from the IRA owner's Will or Living Trust. In theory, a carefully drafted Living Trust or even a testamentary trust created under a Will could offer the above advantages. However, there are various drafting problems and post-mortem administrative problems that are lessened by using a separate trust just for retirement benefits. Though not exhaustive, some benefits of a separate trust established only to hold retirement plan/IRA assets after death include:

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1) Debts, taxes and expenses will not and cannot be paid from the retirement plan trust, which helps to avoid losing Designated Beneficiary status.
2) A separate trust allows the main Will and/or Living Trust to easily name older beneficiaries, charitable beneficiaries and allow for the normal definition of descendants that includes married and adopted beneficiaries. These beneficiaries, if named in the IRA Trust, can wind up reducing or eliminating the stretchout. Also, the main Will and/or Living Trust may contain broad general and limited powers of appointment, and other clauses that permit great flexibility—clauses that are problematic in a trust designed to hold retirement plan assets.
3) A separate trust allows the Living Trust to have the broadest spendthrift, in terroram, incentive/disincentive or other clauses that act to restrict or eliminate income payouts to a beneficiary, which would be problematic in a trust designed to hold retirement benefits and qualify for maximum stretchout.
4) A separate trust avoids the tremendous **danger** of having a pecuniary bequest in a master trust triggering IRD in such plans[19] and/or allows the master trust to use a pecuniary funding formula.
5) A separate trust makes it easier to do later amendments when tax law or retirement asset mix changes the dynamics of the planning. Especially where trusts are designed to potentially accumulate retirement plan assets ("accumulation" trusts)—the state of the tax law is ever evolving with PLRs still coming out to explain the 2002 Regulations. Revising just the beneficiary designation or separate trust years later when things change is easier than reworking the entire master trust.[20]

Since the customization options of an individually drafted trust document are virtually unlimited, the IRA Trust offers the most flexibility with respect to the amount and timing of IRA withdrawals and distributions to beneficiaries, including the RMDs. If any IRA withdrawals accumulate in the Trust, such as for protective reasons, the IRA Trust may be designed so that the primary beneficiaries may still be able to maximize the RMD stretchout over their lifetimes.

> Unlike the original IRA owner, a beneficiary, other than a surviving spouse with respect to a rollover IRA, cannot take advantage of the "60 day put back rule".

Conclusion

This article is not intended to be an exhaustive analysis of the merits and drawbacks of each of these three methods of "ensuring the stretch". However, some general guidelines can easily be gleaned from the differences noted on the chart. First, most cases will argue for using a standalone trust. More people are still working than retired and are ineligible to rollover the bulk of their retirement plans to IRA Annuities or Trusteed IRAs now. Likewise, retirees that choose to leave their plans at their ex-employer during their lifetime can't setup an IRA Annuity or Trusteed IRA now to utilize the PPA after-death rollover. Unlike a Trusteed IRA or IRA Annuity, individual customization does not have to be approved by an insurance company, bank or trust company. This is also the best way to achieve the maximum flexibility of the "accumulation" trust that enables RMDs to be accumulated for future distribution and to enjoy a higher level of asset protection until distributed. A standalone trust may even be structured to "toggle" from a conduit trust to an accumulation trust with a trust protector provision if unforeseen circumstances or needs of a beneficiary merit more protection after death[21]. However, the great flexibility in drafting calls for greater care in both protecting the beneficiary as well as protecting the trustee and IRA owner's wishes. The IRS rules relating to accumulation trusts are complex and in a state of flux, and therefore only a properly skilled attorney should draft these types of standalone trusts.

In some circumstances using a Trusteed IRA or IRA Annuity can greatly simplify both the planning and the post-mortem administration of these benefits. Annuities are clearly more appropriate for smaller and moderate-sized IRA accounts that may not justify the potentially higher expenses and fees of a Trusteed IRA or standalone trust. Annuities can offer some asset protection, which is just as important, if not more so, for low and middle income families as for those with higher incomes.

Trusteed IRAs are even more underused and underappreciated. This may be because the millions of dollars spent on IRA rollover marketing are done by companies that are not knowledgeable about trust and

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Table 1

	IRA Annuity w/ Beneficiary Restrictions	Trusteed IRA w/ Beneficiary Restrictions	Standalone IRA Trust
Easy to setup?			
	Simplest to setup; usually very limited options.	Simple to setup; may contain more flexible options to choose from, depending on provider.	A complex trust document requiring customization since greatest amount of flexible options. Requires coordination with IRA beneficiary designation form.
Minimum account size?			
	Mimimum set by insurance company; can be used with accounts as small as a few thousand dollars.	Minimum set by trustee; usually only made available for larger accounts, starting at about $250,000.	No minimum; may be advisable for accounts as low as $50,000, depending on whether trustee is family or independent and needs of the beneficiaries.
Initial (and long-term) cost?			
	No establishment fee. Unlike other options, there may be surrender charges while the owner is living. Internal expenses may be higher than ordinary IRA.	Attorney fees may be involved, though probably much less than a full trust. Minimum fees vary but preclude smaller accounts as a practical matter. Annual fees similar to wrap fees of 1-2% for investment management. Some companies allow a separate investment advisor, which lowers trustee fee, but may increase fees overall.	Attorney fees involved, generally one-time only, from $2-$7,000. Administration fees, incl. fiduciary tax return preparation after IRA owner's death. Trustee may charge an annual fee of up to 2%, though it does not begin until after death and family trustees may waive or hire outside investment advisors.
IRS approved?			
	Not required since simply part of the beneficiary designation form. Most custodians/annuity companies have an approved IRA prototype.	Most are IRS approved "prototypes", but any customization would by definition not be preapproved; Any attempt to create accumulation trust-like provisions or far-out and extremely unique provisions would also probably not be approved by the trustee.	Clear that the IRS approves such trusts in theory, and has approved several such trusts in numerous Private Letter Rulings (see endnote #15). However, the exact terms and parameters of the IRS rules are still in flux. Complex technical requirements must be met to fall under these many Rulings and the 401(a)(9) Regulations and the trust should include provisions permitting it to adapt to changes in these laws.
Guarantees stretchout of RMDs by beneficiaries?			
	Yes	Yes	Yes (if so designed); although there may be some uncertainties in the law, it may be designed to "self-reform" through Trust Protector actions after the owner's death.
Immediate management upon disability?			
	Requires separate, durable power of attorney executed by the IRA owner (otherwise, may require a court to appoint a conservator).	Trustee is authorized to use the assets for the owner without the account being frozen until a conservator is appointed (but does not necessarily avoid appointment of a conservator).	Since it is a standby trust to receive IRA withdraws after death, it does not provide immediate disability management; owner must execute a separate durable power of attorney (otherwise, a court may need to appoint a conservator).
Accepted by IRA custodians?			
	Not all annuity companies offer a restricted beneficiary payout option.	Only a few IRA providers currently offer a Trusteed IRA.	Works with any IRA; may need to provide custodian a "hold harmless" or "indemnification" agreement.
Easy to implement after death?			
	Yes (easiest)	Yes; some complexity if trustee has discretion to make principal distributions beyond RMDs.	Most complex; certain actions may need to be taken in a timely manner by the Trustee, a Trust Protector and/or the beneficiaries if stretchout benefit to be maximized.
Flexibility to distribute more than required minimum distributions to beneficiaries?			
	Inflexible after death of owner. Even when distributions greater than RMDs are permitted, usually restricted to a fixed dollar amount or percentage of the account established by owner.	Yes, but depends on IRA trustee, form and/or any attorney customization.	Yes; broadest flexibility to distribute to beneficiaries for any reason chosen by client and counsel. May include tailored powers of appointment, incentives/disincentives, etc.
Enhanced asset protection for beneficiaries (against divorce, creditors, lawsuits, bankruptcy, etc.)?			
	Depends on state and/or federal bankruptcy IRA exemptions. RMDs (and possibly principal) may be subject to third party attack. Some states may have a statute that offers creditor protection for annuities as well.	Also gets state and/or federal bankruptcy exemptions; may also receive state spendthrift protection. RMDs may be attached in some states, though under the Uniform Trust Code such mandatory distributions are not attachable until in the hands of the debtor/beneficiary.	Depends on trust terms. Potentially has the greatest maximum protection if it may accumulate RMDs and is fully discretionary as to distributions. If there are ascertainable standards or mandatory distributions, there is still good but somewhat lesser level of asset protection.

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Can have the level of protection of a spendthrift trust?		
Unlikely, but one could argue that it is close enough to a spendthrift trust to have the same protection. One might find protections for annuities under state case law.	Yes. However, no case found by the authors has ever tested a third party created spendthrift trust that happens to be an IRA.	Yes; In addition, it may allow a later change of situs to another state with stronger spendthrift protections.
Can help protect against beneficiary's loss of government benefits (as a "special needs trust")?		
No	No	Yes (if so designed); may even adjust to become a special needs trust after the owner's death, if appropriate for beneficiary at that time.
Can adjust level of asset protection needed by a beneficiary, after the owner's death?		
No	No	Yes (if so designed); can "toggle switch" between a "conduit" (immediate payment) trust or a more protected "accumulation" trust (including a spendthrift or special needs trust) within a certain period after the IRA owner's death.
Protection for minor beneficiaries?		
No, unless permits payment to a custodian for minors account	Usually permits payment to a custodian for UTMA (minors) account	Yes (if so designed). Offers maximum flexibility in this regard.
Can fund exemption trust and/or marital ("QTIP") trust for estate tax purposes?		
Maybe, but less options make problematic, especially for QTIP	Yes (but again, depends upon the IRA provider's agreement)	Yes (if so designed)
Can avoid estate taxation when primary beneficiary dies and IRA passes down to younger generation (take advantage of generation skipping transfer tax exemption)?		
Maybe (but if annuitized for the life of beneficiary there would never be any assets left to pass)	Yes, but depends on IRA trustee, form and/or any attorney customization	Yes (if so designed)
Primary beneficiaries may name successor beneficiaries and how remainder is to be distributed to them?		
Depends on Restricted Beneficiary Payout form. May name successor beneficiary but manner of distribution may be locked in.	Yes, but depends on IRA trustee, form and/or any attorney customization	Broadest power to name next beneficiaries and how distributed to them (if so designed, typically utilizing a limited or general power of appointment).
Disclaimer planning may be done by beneficiary?		
Yes	Yes	Yes
Owner can change beneficiaries?		
Yes (but sometimes irrevocable designations are made)	Yes, with new beneficiary designation form	Yes, with trust amendment
Owner has right to revoke the agreement?		
Yes, but there may be surrender charges	Yes, but some trusteed IRA providers may have account termination charges.	Fully revocable at any time, by simply changing the beneficiary designation form
Owner can change company or person in charge during lifetime?		
Yes, but there may be surrender charges	Some Trusteed IRA providers will allow IRA owner to self-direct investments or appoint outside financial advisor.	Yes, all terms completely amendable at any time
Surviving spouse has flexibility to change beneficiaries?		
Depends on whether restrictions are placed on spouse's share.	Maybe, it depends on IRA trustee, form and/or any attorney customization;	Yes (if so designed)
Flexibility given beneficiaries to change person or company in charge after death?		
No, but might be eligible for 1035 exchange	Maybe, but depends on trusteed IRA provisions. Some are restrictive	Yes (if so designed)
Can invest in any and all investment options available to IRAs		
No, limited to funds chosen by insurance company (may be variable or fixed)	Yes in theory, but some trusteed IRA providers may limit to certain specified investments and/or money managers	Yes; maximum flexibility and control by owner and beneficiaries (if so designed)
Can be used with a Roth IRA?		
Yes	Yes	Yes
Applicable for a corporate retirement plan when participant working or retired and plan is still at work (IRA rollover not yet done)?		
No - but some plans allow in service distributions	No - but some plans allow in-service distributions	Yes, but check to see whether plan permits post-death transfer to inherited IRA for full stretchout.
May roll over a corporate retirement plan into it, after death, to guarantee RMD stretchout? (per Pension Protection Act of 2006)		
No	No, but it could roll into an inherited trusteed IRA established by the beneficiary, not the owner)	Yes, but check to see whether plan permits transfer to inherited IRA.

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estate planning or simply do not offer Trusteed IRAs. If a standalone trust is structured only as a conduit trust, one might achieve the same goal with greater simplicity and less risk with a Trusteed IRA in many situations.[22] Admittedly, Trusteed IRAs are unlikely to fit special beneficiary needs or situations where the greater asset protection of an accumulation trust is desired. However, there is clearly much more investment flexibility than with an annuity. Unfortunately, there are only a handful of Trusteed IRA providers offering flexible options.

In summary, there is currently a tremendous lack of knowledge, misinformation and misunderstanding among professional advisors and the public regarding available IRA beneficiary planning choices. Many completely ignore basic asset protection and tax advantages of the three options discussed in this article and frequently advise outright beneficiaries to "keep it simple". It is the opinion of both authors that such simple planning is often a disservice to clients and their families and if professional advisors fully understood the scope and availability of these options for their clients' IRAs then IRA planning would better reflect the needs and objectives of their clients.

Endnotes

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1. Reg. §1.401(a)(9)
2. Some practitioners prefer to use the acronym "MRD" for minimum required distributions. The authors will use RMD throughout this article but the terms are identical.
3. This does not apply to Roth IRAs, which do not have RMDs during the owner's lifetime; see Code Sec. 408A
4. Reg. §1.401(a)(9)
5. *See* the case of LTR 200228023 (Apr. 15, 2002). Code Sec. 408(d)(3)(C) prohibits rollover of any distributions from an inherited IRA. The IRS does not tolerate innocent mistakes.
6. Code Sec. 408(d)(3), generally only a spouse can, Code Sec. 402(c)(9). See Reg. §1.408-8, A-5(a).
7. Code Sec. 408A.
8. *See* Ohio's R.C. § 2329.66(A)(10)(c) and Indiana's CODE § 34-55-10-2(c)(6).
9. *See* Title 14 of Maine's Revised Statutes, section 4422(13)(E) & (F)—$15,000 or "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor".
10. Act Sec. 224 of the Bankruptcy Abuse Protection and Consumer Protection Act of 2005 (P.L. 109-8).
11. Act Sec. 824 of the Pension Protection Act of 2006 (P.L. 109-280); Code Sec. 402(c)(11); Notice 2007-7.
12. *Id., e.g.*, only "designated beneficiaries" are permitted to rollover, not just any beneficiary, and the rollover can only be done through a trustee-to-trustee transfer completed by December 31 of the year after the IRA owner's death and the account must be properly retitled as an inherited IRA.
13. Consider the recent case of *Gee, C.T.*, 127 TC 1, Dec. 56,568 (2006). In 1998, Ray Campbell died and left $1M IRA outright to wife Charlotte aged 51. She rolled over the IRA to her own IRA account. Four years later Charlotte remarries and decides to withdrawal $977,888 as a taxable distribution from the IRA. SEI Private Trust Company, the IRA custodian, sends her the check for $977,888 and a 1099-R noting an early distribution. Charlotte and her new husband do not declare the 10 percent early withdrawal penalty, arguing that the IRA should be exempt from early withdrawal because it came from her late husband. The IRS imposes a negligence penalty on top of the 10 percent penalty and the tax on the full distribution. In court, effective counsel managed to squeak by and avoid the negligence penalty. But would Ray Campbell (or his kids) have considered this $97,788 penalty and devastating loss of tax deferral and asset protection a victory merely because Mrs. Gee avoided negligence penalties? We do not know for sure from the case, but it would not surprise anyone if the new husband Mr. Gee ultimately enjoys the fruit of Mr. Campbell's labors more than the Campbell family.
14. *See* CCA 200644020 (Dec. 15, 2005).
15. Natalie Choate, LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS, (6th Ed. 2006), p 288-289, and Natalie Choate, THE 170 BEST AND WORST PLANNING IDEAS FOR YOUR CLIENT'S RETIREMENT BENEFITS (6th Ed #2 2006), p 70.
16. Code Secs. 408(a) and 408(h)
17. Reg. §1.401(a)(9)-5 A-7 (c) Example 2
18. Code Sec. 408(b)
19. *See* CCA 200644020 (Dec. 15, 2005).
20. *See* Robert S. Keebler, Family Tax Planning Forum, *LTR 200537044—Guidance When Trusts Are Named Beneficiaries of IRAs*, CCH TAXES—THE TAX MAGAZINE, Vol. 83, No. 12, at 7.
21. *See* the Private Letter Ruling obtained by co-author Phil Kavesh—LTR 200537044; also *see* Philip J. Kavesh, *The IRA Inheritance TrustSM Gains IRS Approval*, ED SLOTT'S IRA ADVISOR NEWSLETTER, January 2006; *See www.irainheritancetrust.com* for further articles and details on drafting standalone IRA Trusts.
22. *See* Edwin P. Morrow III, *Contrasting Conduit Trusts, Accumulation Trusts and Trusteed IRAs*, J. RETIREMENT PLANNING, May–June 2007, at 21.

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