How to Keep Your Family from Blowing Your Retirement Plan

By Lee S. McCullough, III
Six Options for the Beneficiary of Your Retirement Plan

- Charity
- Individuals
- Revocable Trust
- Conduit Trust
- Accumulation Trust
- Trusteed IRA
What is a Conduit Trust?

- A conduit trust is prepared by an attorney and administered by a trustee.
- Purpose of a conduit trust is to protect and control the principal of the IRA while retaining the ability to stretch out required minimum distributions over the life expectancy of the beneficiary.
- A conduit trust requires the trustee to immediately distribute any and all amounts withdrawn from the IRA including all required minimum distributions each year.
What is an Accumulation Trust?

- An accumulation trust is prepared by an attorney and administered by a trustee.
- The purpose of an Accumulation Trust is to protect and control the principal and income of the IRA while retaining the ability to stretch out required minimum distributions over the life expectancy of the beneficiary.
- The trustee of the accumulation trust may accumulate the income and principal (including RMDs) within the trust.
What is a Trusteed IRA?

A Trusteed IRA is prepared and administered by a financial institution. During the life of the original IRA owner, the Trusteed IRA works the same as a traditional IRA.

However, the beneficiary designation form allows the original IRA owner to place greater controls on the identity of the future beneficiaries and the timing of future distributions. Because it is technically a trust (instead of a custodial relationship as in a typical IRA), it qualifies for the protections available to spendthrift trusts and discretionary trusts under state and federal law. Custodial IRAs are defined at IRC Section 408(h) and Trusteed IRAs are defined at IRC 408(a).
## Pros and Cons of Various Options

<table>
<thead>
<tr>
<th>Beneficiary</th>
<th>Options for Deferral</th>
<th>Asset Protection For Beneficiaries</th>
<th>Control Over Future Beneficiaries</th>
<th>Control Over Timing and Amount of Distributions</th>
<th>Cost and Complexity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Beneficiaries</td>
<td>Spousal Rollover or Inherited IRA</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Free and Simple</td>
</tr>
<tr>
<td>Typical Revocable Trust</td>
<td>5 Year Deferral if Owner Dies before 70 ½ or Life Expectancy of Participant</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Free and Simple</td>
</tr>
<tr>
<td>Conduit Trust</td>
<td>Inherited IRA</td>
<td>Partial - MRDs not protected</td>
<td>Yes</td>
<td>Partial - MRDs must be paid</td>
<td>Complex and Costly</td>
</tr>
<tr>
<td>Accumulation Trust</td>
<td>Inherited IRA</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Complex and Costly</td>
</tr>
<tr>
<td>Trusteed IRA</td>
<td>Inherited IRA</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Simple. Cost varies</td>
</tr>
</tbody>
</table>
Asset Protection Advantages of Conduit Trusts, Accumulation Trusts and Trusteed IRAs

- The Trustee of a Conduit Trust, Accumulation Trust, or a Trusteed IRA can make sure that RMDs are paid each year even if the account owner is incapacitated. This can avoid a 50% excise tax if the account owner fails to make sure RMDs are being paid.

- Unlike a traditional IRA, the Trustee of an Accumulation Trust or Trusteed IRA can disburse funds for the benefit of the account owner (as opposed to making distributions directly to the account owner), such as paying bills for the account owner if the account owner is incapacitated.
Asset Protection Advantages of Conduit Trusts, Accumulation Trusts and Trusteed IRAs

- Unlike a traditional IRA, the Trustee of an Accumulation Trust or Trusteed IRA can withhold RMDs in order to allow a beneficiary to qualify for government benefits.

- Unlike a traditional IRA, the Trustee of an Accumulation Trust or Trusteed IRA can withhold payments or make indirect payments for the benefit of the beneficiary if the beneficiary is going through a divorce, lawsuit, bankruptcy, or collection proceeding.
Asset Protection Advantages of Conduit Trusts, Accumulation Trusts and Trusteed IRAs

- Unlike a traditional IRA, the assets of a Conduit Trust, Accumulation Trust, or Trusteed IRA would be exempt from the bankruptcy of a beneficiary because of the spendthrift provision.

- Unlike a traditional IRA, the beneficiary of a Conduit Trust, Accumulation Trust, or Trusteed IRA can be prohibited from changing future beneficiaries outside of the blood family of the original account owner.
The Advantage of Deferral

- Assume the IRA owner dies at age 68 and the beneficiary is 38 years old.
- Assume a beginning IRA balance of $500,000, a growth rate of 8% and a 40% combined federal and state tax rate.
- Further assume that after-tax proceeds from the IRA are reinvested at a growth rate of 8% (6.4% after combined federal and state capital gains rate of 20%).
<table>
<thead>
<tr>
<th>Year</th>
<th>Immediate Distribution</th>
<th>5 Year Distribution</th>
<th>Required Minimum Distributions</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>$409,100</td>
<td>$434,268</td>
<td>$706,866</td>
</tr>
<tr>
<td>10</td>
<td>$557,876</td>
<td>$592,197</td>
<td>$983,022</td>
</tr>
<tr>
<td>20</td>
<td>$1,037,418</td>
<td>$1,101,241</td>
<td>$1,852,480</td>
</tr>
<tr>
<td>30</td>
<td>$1,929,168</td>
<td>$2,047,852</td>
<td>$3,341,253</td>
</tr>
<tr>
<td>40</td>
<td>$3,587,454</td>
<td>$3,808,157</td>
<td>$5,652,011</td>
</tr>
</tbody>
</table>

(Data for this table was taken from an article entitled, New IRS Ruling Validates The “IRA Inheritance Trust”, by Robert S. Keebler, CPA, ultimateestateplanner.com).

(The economic advantage of deferral will be smaller if the income tax rates of the beneficiaries are lower than the 40% combined rate).

(The advantage of deferral is often more theoretical than practical as approximately 80% of IRAs are liquidated within two years of the death of the account owner).
Who is a Good Candidate for a Conduit Trust, Accumulation Trust or Trusteed IRA?

- Clients with substantial funds in qualified retirement plans.
- Clients in a second marriage who want to be sure their IRA makes it to their own children.
- Clients who want to leave retirement funds for the benefit of disabled children who otherwise may qualify for government assistance.
- Clients who have spendthrift children and want to force the children to stretch out the distributions.
- Clients who don’t get along with their children’s spouses.
- Clients who have heirs with judgments against them or other liability issues.