Stretching Out Your IRA for Future Generations to Enjoy

Even with the decline in the stock market this past year, there are trillions of dollars still being held in IRAs. In fact, for a large number of people, their IRA represents one of the largest assets they own at death. However, the problem with owning an IRA with a significant balance at death is that the tax laws for IRAs were designed for accumulation of wealth for retirement not for accumulation of wealth to pass to future generations.

Most commonly, the owner of an IRA lists a beneficiary on their account in the event they do not consume the entire IRA during their lifetime. This person is most often the IRA owner's spouse. They also often list a contingent beneficiary if the spouse and IRA owner were to parish in a common accident or disaster. This contingent beneficiary is usually the IRA owner's children.

This "contingency" plan works just fine so long as the children "stretch out" the IRA. What this means is that they do not cash out the IRA or take more than the required minimum distributions (RMDs) based on their own life expectancy. There are two main reasons why children blow this "stretch out" opportunity. The first is poor money management meaning that they think a bird in the hand today is worth more than two tomorrow. The second reason is failure to understand the rules related to IRAs.

For example, father Richard dies leaving $500,000 in an IRA and no spouse. Rick, Jr., Richard's only child (age 39), calls up the IRA plan administrator and requests the money in the IRA. The plan administrator doesn't admonish Rick of the tax implications. If Rick were to cash out his father's $500,000 IRA today the net result would be a check for approximately $295,000. But if Rick had been forced to "stretch out" the IRA, this account could have yielded him about $2,274,691 based on a conservative 6% rate of return. This stretched out amount is nearly 8 times more than what Rick would have received if he cashed out the IRA right after his father's passing due to all other taxes and penalties associated with an early IRA withdrawal.

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One innovative way to spearhead this problem is to list a special type of trust (called an IRA Trust) as the beneficiary of your IRA. The IRA Trust not only forces the stretch out of your IRA for your children (or other designated beneficiaries of the Trust), but it acts as an asset protection vehicle as well. Creditors, predators and divorcing spouses of your children cannot reach the money held in the IRA which is held in the Trust.

Specific Trust Plan Asset Protection

There is a specific way that the Trust must be drafted to ensure this extra "asset protection" for your children which is an accumulation type IRA Trust. That means that the Trustee can "accumulate" the RMDs within the Trust instead of kicking them out to the beneficiaries of the Trust. In the alternative, a 2005 IRS Private Letter Ruling has provided some guidance on drafting a traditional "conduit" type IRA Trust language with the option to toggle to an accumulation type trust if the Trustee saw trouble on the horizon for a beneficiary.

In the end, for those with large IRA balances, it is wise to consider the IRA Trust to protect children not only from others, but from themselves.

About the Author – Brenda Geiger, J.D.

Mrs. Geiger's practice is located in Carlsbad, California. Her firm focuses on Business Planning, Asset Protection, Estate Planning, Trust Administration, and Elder Law. She obtained her law degree from the University of San Diego School of Law where she served as an Editor on the board of the San Diego International Law Journal.

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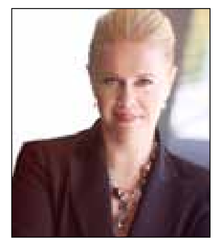

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Mrs. Geiger is admitted to practice before the United States Federal Court for the Ninth District and California State Courts and is an accredited V.A. Planning Attorney. On a more personal note, Brenda is married to Len, the CEO of a San Diego based company and has two young children. She loves running, travel and spending time with her family.

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