What are tax-deferred plans?

IRAs, 401(k)s, 403(b)s, pension, profit sharing, Keogh and others are plans that were created to help you save for retirement. They are called tax-deferred plans because you did not pay income taxes on this money when the contributions were made. Income taxes are deferred until you withdraw the money at a later time, ideally at your retirement when your income and tax rates are lower.

When do I have to start taking money out and how much do I have to take?

Uncle Sam says you must start taking money out on your required beginning date. Generally, this is April 1 following the year in which you become age 70 1/2.

The amount you are required to withdraw each year is called your required minimum distribution. To determine this amount, every year you divide the year-end value of your account by a life expectancy divisor found on The Uniform Lifetime Table, provided by the IRS. You can withdraw more than the required amount at any time.

Why is my beneficiary so important?

If you don't use all of your tax-deferred savings before you die, you may want the account(s) to continue to grow tax-deferred for as long as possible, and be protected from taxes, creditors and irresponsible spending. As you will see, whom you name as beneficiary will have a significant impact. While not every possibility is covered in this brochure, this information will help you begin to understand the basics and importance of this planning.

Shouldn't I name my spouse as beneficiary?

Most married people, especially those who have been married for some time, name their spouse as beneficiary. This can be a good choice because 1) the money will be available to provide for your surviving spouse and 2) it gives your spouse the spousal rollover option.

The rollover works like this. If you die first, your surviving spouse can "roll over" your tax-deferred account into his/her own IRA, further delaying income taxes until your spouse must start taking required minimum distributions. Your spouse names a new beneficiary, preferably a much younger one, such as a child or grandchild.

After your spouse dies, the new beneficiary's actual life expectancy will be used for the remaining required minimum distributions. Depending on the beneficiary's age, that could mean decades more of tax-deferred growth.

If your spouse dies before you, you can name a new beneficiary and after you die, the distributions will be based on your new beneficiary's life expectancy.

Sounds great. What could go wrong?

There are some possible disadvantages to consider. Your spouse will have full control of this money. That may not be what you want, especially if you have children from a previous marriage or feel that your spouse may be too easily influenced by others after you're gone. Your spouse doesn't *have* to do a rollover; a lump-sum distribution could be tempting, even though all of the income taxes would have to be paid at once. If your spouse becomes incapacitated, the court could take control of this money. It could be lost to your spouse's creditors. And leaving a substantial tax-deferred account to your spouse could cause you to waste some of your estate tax exemption.

What about my children as beneficiaries?

If your spouse will have plenty of assets, or if you have reason to believe your spouse will die before you, you could name a child, grandchild or other individual as your beneficiary. The tax benefits can be great. If your beneficiary is much younger than you, as your children and grandchildren would be, the tax-deferred growth can be "stretched out" over their longer life expectancies.

But any time you name an individual as beneficiary, you lose control. After you die, your beneficiary can do whatever he/she wants with this money, including cashing out the entire account and destroying your carefully made plans for long-term, tax-deferred growth. There is a risk of court interference if your beneficiary is a minor or becomes incapacitated.

And then there are the beneficiary's creditors. The U.S. Supreme Court recently ruled that the entire inherited IRA is available to a beneficiary's creditors in bankruptcy court. The Justices reasoned that because the beneficiary cannot make additional contributions or delay distributions until retirement, an inherited IRA is not a retirement account of the beneficiary. There is, in fact, nothing to prevent the beneficiary from withdrawing funds or even clearing out the account at any time. Therefore, these funds must also be available to satisfy creditors. Following the same logic, an inherited IRA is also subject to divorce proceedings.

What about my living trust?

Naming your living trust as beneficiary would give you more control. That's because the distributions would be paid not to an individual, but into a trust that contains your written instructions stating who will receive this money and when. The tax-deferred growth can continue over a beneficiary's life expectancy and protect your hard-earned savings from the beneficiary's creditors and/or irresponsible spending. Your trust could provide income to your surviving spouse for as long as he or she lives. Then, after your spouse dies, the income could go to your children or grandchildren.

Your trustee will be able to withdraw more money from the tax-deferred account if needed to follow your instructions, but the rest can stay in the account where it is protected and growing tax-deferred.

Are there disadvantages?

Distributions from your tax-deferred account that are paid to the trust are subject to income tax and, if they were to stay in the trust, higher tax rates would apply. But usually the trustee is given authority to distribute the income to the beneficiaries of the trust, who then pay the income tax at their own, usually lower, tax rates.

The bigger problem is that the life expectancy of the oldest beneficiary of the trust must be used for the distributions. This would probably be your spouse, so you would not get the tax-deferred growth over the younger beneficiaries' life expectancies. As an alternative, many attorneys now recommend that your tax-deferred assets be divided and placed into separate shares or "stand alone retirement trusts," one for each beneficiary.

Why would I want a retirement trust?

A stand alone retirement trust protects the tax-deferred account from the beneficiary's creditors; it prevents a beneficiary from cashing out the account; and can ensure tax-deferred growth over the beneficiary's own life expectancy. You can give the trustee discretion to withdraw more from the account if the beneficiary needed funds for education, to start a business, buy a home, and so on, but the beneficiary would not be able to cash out the tax-deferred account unless the trust allows it.

Must the beneficiary receive distributions?

That's up to you. A retirement trust can be set up as

either a *conduit* trust or an *accumulation* trust. A conduit trust requires that all distributions from the tax-deferred account are distributed to the trust's beneficiary. The trust simply acts as a conduit from the plan to the beneficiary. There is no asset protection on the paid distributions.

An accumulation trust allows the distributions to be kept in the trust instead of being distributed to the beneficiary. Any undistributed income kept in the trust is subject to the higher trust income tax rates but is protected from creditors. These are often used to provide for a special needs beneficiary and protect government benefits.

A trust protector can be given the power to change from a conduit to an accumulation trust. This can be valuable if there is a change in the beneficiary's circumstances (due to disability, divorce, dependency issues, etc.) that would make it desirable to keep the distributions in the trust.

Can I name a charity as beneficiary?

A tax-deferred account can be an excellent asset to leave to a charity because there will be no income or estate taxes on the account after you die. If you name a charitable remainder trust as beneficiary, your spouse, children or others can receive an income for a set number of years or for as long as they live. You can also set up your own foundation that can pay your children a salary to run it.

Just be aware that a charity has a life expectancy of zero. This will not affect your distributions while you are living, but it could affect your planning after you die.

What if I name multiple beneficiaries?

If you name several beneficiaries for one IRA, then you must use the life expectancy of the oldest beneficiary for the entire IRA, just as if you were to name a trust as beneficiary. If you include a charity as a beneficiary, it would be considered the oldest beneficiary because it has a life expectancy of zero. This could cause the entire IRA to be paid out in just five years.

What if I divide my IRA into smaller ones?

With separate IRAs, one for each beneficiary, you can use each one's life expectancy. That would give you the maximum stretch out over all their ages. It would also be more fair to your beneficiaries, especially if there is a wide difference in their ages or if you want to include a charity.

But, remember, anytime you name an individual, you lose control. The person can cash out the account at anytime, plus it would be exposed to creditors, predators, ex-spouses and irresponsible spending. For these reasons, the stand alone retirement trust is gaining in popularity.

Benefits of a Stand Alone Retirement Trust

- Ensures continued tax-deferred growth over the life expectancy of each beneficiary.
- Prevents a beneficiary from cashing out the account and destroying your plans for long-term tax-deferred growth.
- Protects your tax-deferred plan from the beneficiary's creditors and predators.
- Lets you keep plan distributions in the trust, preserving a special needs beneficiary's government benefits.
- With a trust protector, gives you the option of keeping distributions in the trust if your beneficiary becomes incapacitated, divorces, develops dependency issues or is irresponsible.
- Gives you maximum control and peace of mind.

What happens if I die without a beneficiary?

If you die before your required beginning date, your account must be paid out within five years. If you die after your required beginning date, distributions will be paid over the remaining years of your "fixed life expectancy," based on your age when you die. In either case, the proceeds would have to go through probate to determine who is entitled to receive these benefits.

Do I need to use an attorney?

Yes, you absolutely need expert advice for your tax-deferred plans. There is often a lot of money in these accounts and the rules are still complicated. A small mistake can have devastating results and may be irreversible. You will want to discuss your options with your attorney.

This information is from the bestselling book, *Understanding Living Trusts®* by Vickie Schumacher. It is available from Amazon and most bookstores.

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Understanding CHOOSING YOUR IRA BENEFICIARY

WHY A STAND ALONE RETIREMENT TRUST MAY BE THE BEST OPTION FOR YOUR IRAS AND OTHER TAX-DEFERRED PLANS

Your information here

Name
Title
Firm/Company Name

Street Address
City, State, Zip
Phone: 123-456-7890
Email address
www.my-website.com