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Retirement Plan Trust

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Many of your clients have accumulated tremendous wealth in an Individual Retirement Account (IRA) or in multiple IRAs. For some, the IRA may be the single largest asset in their portfolio. Because IRAs are such valuable assets, it is therefore vital to plan for their disposition at the death of the contributor. The realm of IRAs can be tricky, however, as retirement plans are governed by a set of complex regulations. Insufficient planning can lead to major tax consequences down the line for beneficiaries, or simply fail to meet the objectives of the client. When conducting IRA planning for those clients with large IRAs—typically $250,000 or greater—an excellent tool to consider is the Standalone Retirement Plan Trust (RPT). This article explores the advantages of the RPT over an outright distribution of the IRA, and provides suggestions as to the clients who stand to benefit most from this planning method.

Before starting the planning process, clients might first need a quick primer on certain key characteristics of IRAs. Many clients are unaware that the tax code permits beneficiaries of an inherited IRA to withdraw only a required minimum distribution (RMD) from the plan each year, thereby allowing the remainder of the principal to continue growing tax-deferred. Commonly referred to as the "stretch out," this option is far better for the beneficiary from a tax perspective in comparison to cashing out the IRA in a lump-sum distribution. Clients should know that RMDs for the beneficiary are calculated based on the beneficiary's age and life expectancy, so the younger the beneficiary, the longer the stretch out. One caveat for both advisors and clients to remember is that if the IRA pays out to a trust with multiple beneficiaries, the RMDs for **all** beneficiaries will be tied to the eldest beneficiary's age. In addition to the stretch-out, many clients also are unaware that IRAs are protected from creditors (up to an amount determined under federal bankruptcy laws and adjusted for inflation annually; for 2018 this number was just under $1.3 million). However, due to the Supreme Court's ruling, inherited IRAs received in an outright distribution do not enjoy the same protection.

To better appreciate the benefits of the RPT, it is important to contemplate the disadvantages of naming a beneficiary **outright** as the recipient of your client's IRA. With an outright distribution, the client has no control over the treatment of the IRA. A beneficiary could squander a significant portion of the IRA in taxes alone by choosing to cash out the IRA immediately or by withdrawing it over five years. Due to lack of guidance or financial immaturity (among other reasons) the beneficiary may sacrifice the stretch out without comprehending the consequences. Also an outright distribution leaves the IRA vulnerable to the beneficiary's creditors, which can include a spouse in divorce or a plaintiff in a lawsuit. Further, a distribution to a minor must be paid to a guardian, and if no guardian exists, the court will step in and manage the IRA from a custodial account. Upon reaching the age of majority the beneficiary takes full control of the IRA, opening the door for mismanagement of the account as a result of the beneficiary's age and financial irresponsibility. Additionally, if the beneficiary predeceases the client and no contingent beneficiary is named, the IRA becomes subject to the court's probate process—and a deleterious consequence of probate is that the IRA must be cashed out. If a beneficiary is incapacitated, there is the risk of court interference and loss of government benefits as a result of the outright distribution. Finally, if the beneficiary is your client's spouse, he or she can take the "spousal rollover" and name new beneficiaries in contravention of the client's original wishes—in a blended family this could mean disinheritance of your client's children from a prior relationship.

Thankfully, all the potential negative consequences of an outright distribution can be avoided with the RPT. By creating an RPT, your client can control the disposition of the IRA through the terms of the trust. The RPT can be set up to prevent the beneficiary from cashing out the IRA or taking distributions that exceed the annual RMD, thereby ensuring that the beneficiary receives the maximum stretch-out. Moreover, by naming a trust as the beneficiary of the IRA, the beneficiary receives the benefit of asset protection, which keeps the IRA out of the hands of creditors or a spouse in divorce. The trust also guarantees continuity in the event of the beneficiary's death, as the terms provide for successor beneficiaries as well as Trustees to manage the RPT—a significant benefit if the next beneficiary in line is a minor. By virtue of the IRA being held in trust, the asset cannot accidentally become subject to probate or court interference. The RPT also can be designed to provide for an incapacitated beneficiary or a beneficiary with special needs, and to prevent the beneficiary from losing or failing to qualify for government assistance. Importantly, the RPT can protect against accidental or intentional disinheritance in blended families; for example, the trust's terms could dictate that the surviving spouse receives RMDs for life, with the remainder of the IRA passing to the contributor's children from a prior relationship. Lastly, for clients who already have trust-based plans, such as a Revocable Living Trust, RPTs can be used to circumvent the rule that ties RMDs to the age of the eldest beneficiary. The IRA can be subdivided and designated to multiple RPTs, each with its own beneficiary, and the beneficiary of each separate trust then takes RMDs based on his or her own life expectancy. With this method, the IRA can be split between a client's child and a grandchild, for example, without the grandchild taking RMDs based on the life expectancy of the parent. Thus, RPTs are an excellent complement to an existing trust-based plan, as the client's specific goals for the IRA and general wishes for the disposition of the estate can all be achieved through the coordinated use of separate trusts.

When conducting IRA planning with your clients, the RPT can be a superb addition to your toolkit. Especially for the client with a large IRA who wishes to maximize the tax-deferred stretch-out and to provide asset protection, the Standalone Retirement Plan Trust is an ideal vehicle for meeting your client's needs.