TRUST STRATEGIES THAT BUILD TRUST

3 Essential Planning Stages

1. Should a trust be named?
2. Setting up IRA trust
3. Implementing IRA trust after death

#1 Should a Trust be Named?

Yes!

- The main reason to name a trust as IRA beneficiary is **CONTROL.**
- The IRA owner wants to control post-death IRA distributions to beneficiaries who are: minors, disabled, incapacitated, spendthrift, or vulnerable to financial predators.
- The IRA owner wants to preserve a large IRA or Roth IRA to ensure the stretch IRA.
- The IRA owner wants asset and creditor protection.
- The IRA owner wants divorce protection.
- **U.S. Supreme Court ruled inherited IRAs are *not*** protected in bankruptcy (*Clark et ux. v. Rameker, Trustee, et al., Supreme Court of United States, No. 13-299, June 12, 2014)*
    - Result ➥ more clients looking to name trusts as IRA beneficiaries to protect against bankruptcy, lawsuits, divorce, etc.

No!

- Too complex with too many tax laws to follow.
- Too costly to create and maintain.
- High trust tax rates for trust income retained in discretionary trusts (2015 trust tax rates hit top 39.6% rate after $12,300 taxable income).
- No separate account rules – required minimum distributions are based on shortest life expectancy (if all trust beneficiaries are individuals).

AMERICA'S IRA EXPERTS

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[#2] Setting up the IRA Trust

- IRA trusts should qualify as "see-through" or "look-through" trusts.
- *See-through trust benefits:*
  1. Allows oldest of individual trust beneficiaries to be treated as if he or she were named directly.
  2. The inherited IRA can be stretched over that person's life expectancy.
- If the trust does **not** qualify as a see-through trust, the IRA is treated as if there was no designated beneficiary – ***no stretch IRA!***
- If IRA qualifies as a see-through trust, the trust must meet the following IRS requirements:
  1. Trust is valid under state law.
  2. Trust is irrevocable or becomes irrevocable.
  3. Beneficiaries of the trust are identifiable.
  4. Trustee of the trust provides required trust documentation to the IRA custodian no later than October 31 of year following IRA owner's death.
- If any of trust beneficiaries are not individuals (ex: estate or charity), the trust will fail to qualify as a see-through trust.
- *Conduit and discretionary trust features:*
  1. Must distribute annual required minimum distributions (RMDs) from inherited IRA to the trust.
  2. Can qualify as see-through trusts if they meet IRS requirements.
  3. Depending on trust terms, distributions to trust beneficiaries can exceed the RMD (ex: health, education, maintenance, support, etc.).
- *Conduit Trust*
  1. Post-death annual RMDs flow through the trust-to-trust beneficiaries.
     - No IRA funds retained in the trust.
     - Eliminates income tax at trust tax rates.
  2. Post-death annual RMDs are based on the age of the oldest trust beneficiary, but only primary beneficiaries are counted.

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- *Discretionary Trust*
    1. Trustee has discretion – trustee does not have to pay out all IRA distributions to trust beneficiaries.
    2. Distributions from the inherited IRA to the trust that are not paid out to beneficiaries of the trust are subject to income tax at trust tax rates.
    3. Post-death RMDs are based on the age of the oldest of all trust beneficiaries – ***both*** primary and remainder beneficiaries.

- **Comparison of Trust Tax Rates**
    1. For 2015 trust tax returns, income over $12,300 is taxed at 39.6%.
    2. Married couple filing jointly would not reach 39.6% tax rate in 2015 until taxable income exceeded $464,850.
    3. Surtax on net investment income can add 3.8% for a total of 43.4% on net investment income retained in a trust.
    4. *Tradeoff:*
        - High trust taxes or beneficiary/creditor protection.
        - Clients are not usually told about the IRA trust tax problem when creating the trust.
        - High trust taxes connect with large IRA clients once they know about it!
    5. **3 Ways to Avoid High Trust Taxes**
        - *Use Conduit IRA Trusts:*
            - No inherited IRA funds are retained in the trust.
            - This eliminates IRA trust tax problem, but does pass a minor amount of IRA funds to your beneficiaries each year that cannot be protected.
        - *Roth Conversions:*
            - Beneficiaries cannot convert inherited IRA to a Roth, but IRA owners can!
            - Taxes will have to be paid on the Roth conversion, but then the Roth IRA is left to the trust and the trust tax problem is eliminated—forever.
            - Required distributions from the inherited Roth IRA paid to the trust will be tax free, even if retained in the trust for protection!

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- *Life Insurance:*
  - Instead of leaving IRA to a trust—turn it into life insurance.
  - Withdraw IRA funds, pay taxes and use the remaining funds to purchase life insurance.
  - Leave the life insurance proceeds to the trust.
  - This eliminates the trust tax problem even if funds were retained in the trust, since life insurance is income tax free.
  - Life insurance also eliminates all complicated IRA tax and trust rules.
  - Life insurance is a much more ***trust friendly*** asset than an IRA.

[#3] Implementing Trust After Death—When Big Mistakes Happen!

- After the account owner's death, the IRA is retitled as an inherited IRA.
  - **Ex: John Smith (deceased January 3, 2014) IRA F/B/O John Smith Trust**
- The IRA is not paid out to the trust.
- The RMD is paid from the inherited IRA to the trust.
- The trust pays income on the RMD to beneficiaries of the trust or accumulates funds in the trust.
- If the trust accumulates, then the trust pays the income tax on the accumulated funds at trust tax rates.

IRA Trust Horror Story – Don't Let This Happen to You!

Denied by IRS, PLR 200513032; Released by IRS April 1, 2005

An inherited IRA cannot be rolled over.

- The IRA beneficiary was a non-spouse beneficiary (a trust) so the IRA was ineligible for rollover in the first place.
- **PLR 201425023** (released by IRS June 20, 2014) – the trust benefits and the cost and effort of setting up the trust were negated due to disastrous implementation.
- Client's plan was never carried out – the distribution of the entire IRA to the trust triggered an unintended and substantial tax cost.

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IRA Trust Planning Points

1. Check to see that the trust is named as IRA beneficiary on IRA beneficiary form.
2. Review IRA beneficiary forms to see if naming a trust is still appropriate.
3. Check to see if the trust will qualify as a see-through trust. All trust beneficiaries must be individuals.
4. A testamentary trust (trust created under the will) is ok as long as this trust is specifically named as the IRA beneficiary – do not name the estate or "as per my wishes" as IRA beneficiary to get the funds into this trust.
5. Check to see if the IRA custodial agreement or plan document will accept the trust as beneficiary.
6. If naming a trust as IRA beneficiary, use a separate, stand alone, irrevocable trust.
7. The trust should inherit the IRA and only the IRA.
8. Don't mix non-IRA assets and IRAs in the same trust.
9. Who will be the trustee? Do they know what to do after death? Do they know which professionals to hire to help? Does the trustee know the client's wishes as to the level of discretion for payouts to beneficiaries? When will the trust end? Will the trust be assignable to the beneficiaries? Should the trust have a spendthrift clause to protect trust assets?
10. Explain taxation of payouts from the inherited IRA to avoid post-death trust tax surprises.

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