



Will Power

Craig R. Hersch *Florida Bar, Board Certified, Wills, Trusts & Estates Attorney; CPA*

CAN YOUR IRA BE STRETCHED?

Last week I wrote about Individual Retirement Account (IRA) Legacy Trusts™ that are used to maximize the amount of tax deferred growth for your beneficiaries while providing a protective shield from the reach of creditors, divorcing spouses and other people who may try to get to an IRA inheritance.

I relayed how the stretch IRA strategy, combined with the power and direction of the Legacy Trust can turn a child's inheritance of a modest IRA from their parent whose date of death value was only \$100,000 into a \$1.3 million fortune over the child's lifetime instead of a \$65,000 after tax withdrawal upon the parent's death.

But in order to achieve these objectives, one's IRA must be able to accommodate a stretch. This isn't always the case.

In nearly all IRA accounts, the account will accommodate a stretch along with an IRA trust that can be used to protect the IRA distributions from the reach of a child's creditors. The reason I say "nearly all" instead of "every" IRA account is because, believe it or not, some financial institutions and banks are ignorant of the stretch IRA – or are so ignorant of the new tax laws that they do not allow it within their custodial agreements.

If your IRA cannot be stretched, your beneficiaries will be forced to withdraw the IRA funds soon after your death – sometimes in lump sum resulting in monstrous income tax bills. Not only are income taxes due right away, the long term potential for tax deferred growth remaining for your child's life vanishes into thin air. Even though the tax law encourages the stretch IRA provisions, such long term growth and tax deferral is not automatic unless the IRA plan document itself allows for the stretch.

So what do I mean when I say that a financial institution's custodial agreement may not allow a stretch? You must first understand that each financial institution has its own custodial agreement that governs their IRA accounts. It is like a rule book, written by the institution, so that the IRA meets the federal tax law standards in order to qualify for the benefits under the law.

Problem is, some of the financial institutions have not updated their rule books for several years. If yours hasn't, then you ought to move the money NOW to a custodian that does allow for the new stretch IRA distributions. And don't trust your broker. Have your estate planning attorney

read the rules to give you an opinion. Something else you may not know, is that many estate planning attorneys aren't familiar themselves with these complicated rules that carry estate, income and benefits laws. Make sure that you are using an attorney is so qualified.

Your attorney should also be able to counsel you as to several other provisions found in most custodial agreements:

Is a customized beneficiary form/trust permitted? Some custodians don't want to be bothered by complex planning. If you are interested in providing stretch with protection, then you need a custodial agreement that will allow customized beneficiary designations.

What are the default provisions? Many custodial agreements provide that if the primary beneficiary predeceases the IRA account holder, then the IRA account reverts to the account holder's estate. This is disastrous that for your loved ones in that the income taxes are payable within a very short time period following the account holder's death.

Can your beneficiary name a beneficiary? This is important if your beneficiary is younger when he or she inherits your IRA, and happens to predecease his or her life expectancy. Here, the stretch that may be remaining for his or her beneficiaries may be lost if he or she doesn't have the ability to name their successors.

What happens if you get divorced? Under most state laws governing wills and trusts, a divorce treats your ex-spouse as predeceasing you for purposes of your will or trust. In other words, they wouldn't inherit. But this often is not the case with IRAs. Since IRA have beneficiary designations, the person named is presumed to be your intended beneficiary unless the custodial agreement provides otherwise.

There are other factors too numerous to mention within a column here. I may get to them in future columns, but suffice it to say that you should treat your IRA beneficiary form with the same care that you take in constructing the provisions of your will or revocable living trust.

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Craig at hersch@sbshlaw.com