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8/23/2012

Using an IRA Trust as the Beneficiary of your IRA

From time to time, I like to post current planning ideas. Here is one that requires the beneficiary to keep your PST/IRA as a tax deferred vehicle as long as possible.

We all have countless examples where a P&G retiree dies and his/her child wipes out the PST/IRA in short order. I had a client who spent $1,600,000 in three years. Here is a planning idea that will preserve the IRA as long as possible.

IRA Trust

If you die with a large IRA (or the PST is rolled into an IRA at your death) and you leave it directly to a child, that child may take a lump sum distribution or may withdraw the money over his or her life expectancy. Income taxes are paid as the money is withdrawn from the IRA. If you leave $1,000,000 in an IRA, there is nothing to stop a child from taking all of the money out of the IRA. The federal and state income taxes would be about 42% for a loss of principal of $420,000. If, however, the IRA beneficiary is an IRA Trust, the IRA would be payable to the Trust and then to the child over the child's life expectancy. An IRA Trust is designed to be the recipient of the IRA distributions. Two things are accomplished by an IRA Trust. First, you eliminate the right for a child to take a lump sum distribution and force him/her to delay the income taxes as long as possible. Second, if the child dies before the IRA is depleted, you dictate the remainder beneficiary not your child. The Trust would read something like, "*minimum distribution to my child for life and the remainder to his/her children*." Thus, the balance in the IRA at the child's death will go to your grandchildren or other named beneficiary. A nursing home, second spouse, creditor, or the government will have no claim to the IRA balance.

An example of how the minimum distributions would work for a 48 year old beneficiary is as follows:

Example of IRA Trust distributions to a 48 year old child

Age	Divisor	Minimum Distribution	Return 8%	IRA Balance
				$1,000,000
48	36	$27,778	$80,000	$1,052,222
49	35	$30,063	$84,178	$1,106,337
50	34	$32,539	$88,507	$1,162,304

51	33	$35,221	$92,984	$1,220,067
52	32	$38,127	$97,605	$1,279,545
53	31	$41,276	$102,364	$1,340,633
54	30	$44,688	$107,251	$1,403,196
55	29	$48,386	$112,256	$1,467,066
56	28	$52,395	$117,365	$1,532,036
57	27	$56,742	$122,563	$1,597,857
58	26	$61,456	$127,829	$1,664,229
59	25	$66,569	$133,138	$1,730,798
60	24	$72,117	$138,464	$1,797,146
61	23	$78,137	$143,772	$1,862,781
62	22	$84,672	$149,022	$1,927,131
63	21	$91,768	$154,170	$1,989,534
64	20	$99,477	$159,163	$2,049,220
65	19	$107,854	$163,938	$2,105,303
66	18	$116,961	$168,424	$2,156,766
67	17	$126,869	$172,541	$2,202,439
68	16	$137,652	$176,195	$2,240,982
69	15	$149,399	$179,279	$2,270,862
70	14	$162,204	$181,669	$2,290,326
71	13	$176,179	$183,226	$2,297,373
72	12	$191,448	$183,790	$2,289,715
73	11	$208,156	$183,177	$2,264,737
74	10	$226,474	$181,179	$2,219,442
75	9	$246,605	$177,555	$2,150,393
76	8	$268,799	$172,031	$2,053,625
77	7	$293,375	$164,290	$1,924,540
78	6	$320,757	$153,963	$1,757,746
79	5	$351,549	$140,620	$1,546,817
80	4	$386,704	$123,745	$1,283,858
81	3	$427,953	$102,709	$958,614
82	2	$479,307	$76,689	$555,996
83	1	$555,996	$0	$0

The child or other beneficiary receives a nice cash flow from the IRA. That cash flow grows each year. In the early years when your child is working, the cash flow is smaller. Once the child retires, the cash flow increases. The Trust could also provide for the child to take out more than the minimum distribution in the event of a medical emergency or financial crisis. Further, if this child died at age 65, the $2,105,303 IRA balance passes to your selected remainder beneficiary under the same distribution terms. The principal of the IRA grows tax deferred. Additionally, because the Trust has a spendthrift clause, the IRA is protected from the child's creditors in the event of divorce, law suits, and nursing homes. The IRA balance is not included in the child's estate for estate tax purposes.

Your child could be the Trustee of his or her IRA Trust or you could have a corporate Trustee to manage the IRA.

As long as the IRA Trust is a conduit Trust, meaning that the minimum distributions are distributed to the child each year as they are received by the Trust, the child's life expectancy may be used to determine the measuring life for purposes of calculating the minimum distribution. You could have more than one IRA Trust. If a portion of your IRA was payable to the child's IRA Trust, the child would use his or her life expectancy. If a portion was payable to a grandchild's IRA Trust, the grandchild's life expectancy would be used for that portion.

I hope this helps you with your retirement planning, estate planning, tax planning, and financial planning journey. Let me know if I can be of assistance. I welcome the opportunity to be a part of your team.

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