Kiplinger's Retirement Report

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Control Your IRA After You Die

By Rachel L. Sheedy

Some IRA owners worry about leaving a big pot of money to heirs with no strings attached. Perhaps the son is a spendthrift, or the daughter's husband is somewhat of a gold-digger. And obviously, a young grandchild can't have unfettered access to all this money.

If you want to dictate how your IRA will be handled post-death, you could consider leaving the IRA to a trust. "Naming a trust as a beneficiary comes down to one word - control," says Jeff Levine, IRA technical consultant for Ed Slott and Co., a firm of IRA experts in Rockville Centre, N.Y.

The trust terms can be as restrictive or as flexible as you want. "It's your own personal playbook," Levine says. One client set up a trust, he says, because he wanted his adult children to receive only $20,000 a year.

You could use a trust to force an heir to "stretch" an IRA - that is, take distributions over his or her life expectancy. An IRA might also be left to a special needs trust to help provide for a disabled child's care. Such a move "could prevent the child from losing [government] disability benefits," says Jean Dorrell, founder of Senior Financial Security, in Summerfield, Fla.

Or and IRA owner might want more control because of a family issue. Perhaps the owner doesn't like a child's spouse, says David Peterson, president of Peak Capital Investment Services, in Denver. A trust could protect the money in case the child divorces, he says.

You could also leave IRA money outright to one child but through a trust for a second child. The best way to accomplish this, says Levine, is for you to split you IRA into two separate accounts.

You could be tying an heir's hands for life, so forgo a trust if you don't want to exercise tight control. "About 95% of the time, an IRA trust is not worth it," Dorrell says. Initial costs can run several thousand dollars, so a trust won't make much sense for small IRA's.

Follow the Rules

If you're leaving your IRA to your spouse, a trust could impose unintended restrictions. A surviving wife, say, would generally be unable to roll the IRA into her own IRA, and thus be prevented from allowing the money to grow tax-deferred until she turns 70 ½ (with a Roth IRA, the money could grow tax-free until her death). With a trust as a beneficiary, distributions, based on the wife's life expectancy, would have to begin the year after the IRA owner's death. Also, if the children are trust beneficiaries along with the wife, they would have to take IRA payouts based on her shorter life expectancy rather than on their own longer life expectancies.

A trust doesn't provide tax benefits that you couldn't get using other estate-planning methods, and it could actually cause some heirs to pony up more to Uncle Sam. Beneficiaries who receive payouts straight from a trust will be taxed at their individual income rate. But if there is a delay in distributions - perhaps you don't want your 25-year-old daughter to get money until she's 35 - earnings in the intervening years will be taxed annually at the higher rates that apply to trusts. One way around this is to convert your IRA to a Roth IRA, leaving tax-free distributions to the trust.

A mistake could blow up your carefully laid plans, so it's essential to see a lawyer who knows the intricacies of IRA rules. "One word can make or break an IRA trust," says Levine. The trust must be the beneficiary of the IRA; the IRA cannot actually be placed inside a trust. As with any beneficiary, the inherited IRA must be properly retitled - in this case, with the deceased's name for the benefit of the trust.

If instead the IRA is placed into a trust before or after the owner dies, the account would be considered liquidated. The entire account would be taxed.

To qualify as a beneficiary, an IRA trust must meet several requirements. For example, a copy of the trust must be given to the IRA custodian by October 31 following the year of the death of the IRA owner. Levine notes that heirs often fail to deliver the copy on time.

If the requirements aren't met, the IRA must be emptied within five years or over the owner's life expectancy if the owner died after age 70 ½.

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