



5 Planning Opportunities with a Trusteed IRA

by Deb Erdmann & Mariam Hall


PEAK TRUST COMPANY
Elevated Trust & Wealth Management Solutions

www.PeakTrust.com

A trustee IRA is simply an IRA governed by a trust agreement.

What is a Trusteed IRA?

A trustee IRA is a tool that combines the tax planning advantages of a “regular” or custodial IRA with the flexibility and control of a trust. A custodial IRA is an investment account that is designed to offer a tax advantage for your retirement savings, either tax-deferred or tax-free growth. A trust is a legal agreement that assigns a person or corporation as trustee who holds the responsibility of carrying out the terms of the trust for the benefit of the designated beneficiaries. A trustee IRA is exactly the same as a “regular” IRA, with the single exception that the account assets are held in trust rather than a “custodial” account. Under Tax Code, both types of IRAs are considered identical. The IRA provider (financial institution that administers the IRA) serves as the trustee of a trustee IRA rather than as “custodian” of a custodial IRA. A trustee IRA is simply an IRA governed by a trust agreement.

A trustee IRA offers all the advantages of naming a trust as the IRA beneficiary, but eliminates the expense and risk of drafting a complicated and specific IRA beneficiary trust.

Planning Opportunities with a Trusteed IRA

Those with a substantial portfolio of retirement assets may want to consider a trustee IRA. The trustee IRA was designed as a tool to gain greater flexibility to customize the timeframe, tax strategies, and protections surrounding the IRA assets in the years following the IRA owner’s passing or incapacitation. A trustee IRA offers all the advantages of naming a trust as the IRA beneficiary, but eliminates the expense and risk of drafting a complicated and specific IRA beneficiary trust.

1. Control of Distributions in Blended Family Situations

For individuals with blended family situations, a trustee IRA can be designed to support a primary beneficiary, such as a surviving spouse, as well as successor beneficiaries, such as children from a previous marriage. In these cases, some IRA owners want to ensure that any remaining assets are passed to their chosen successor beneficiaries, rather than to any new beneficiaries chosen by the primary beneficiary after the owner’s passing. With a trustee IRA, the surviving spouse may be named as the primary beneficiary and distributions can be limited in some way, such as being restricted to income and/or the required minimum distributions (RMD). The trustee IRA document may also allow the trustee to make additional discretionary distributions for the primary beneficiary’s benefit at the trustee’s discretion, in accordance with the health, education, maintenance and support (HEMS) standard or a predetermined amount or percentage.¹ Children from previous marriages may be named as successor beneficiaries by the original account owner. Upon the passing of the IRA owner, the remainder beneficiary designations become irrevocable so they cannot be retroactively changed by the primary beneficiary, such as a surviving spouse. Essentially, a trustee IRA can act like a marital trust, ensuring that remaining balances in the trustee IRA go to the IRA owner’s intended remainder and/or contingent beneficiaries, after the primary beneficiary’s passing.

2. Disability Protections & Avoid Guardianship and Probate

One of the distinct differences between a regular custodial IRA and a trustee IRA is how they function if the IRA owner becomes incapacitated while still living. With a custodial IRA, in the event of the owner’s incapacitation, family members or others would have to petition a court for a guardianship appointment, unless an appropriate

By design, a trustee IRA allows the IRA owner to put safeguards in place to plan for these potential issues.

If an IRA owner is concerned about potential creditors of his or her chosen beneficiary, the IRA owner should consider leaving the IRA in a protected spendthrift trust arrangement.

power of appointment was in place in advance. In contrast, with a trustee IRA, the trustee can be empowered to act on the account owner's behalf, as it relates to the IRA assets. This may include the management of investments, ensuring RMDs are made, or even paying routine bills for the owner's continued support. This avoids the expense of obtaining a guardianship or the risks that is often manifest with a power of attorney, such as abuse of power or lack of acceptance.

3. Protection from Spendthrift or Unwary Beneficiaries

One of the most common instances where a trustee IRA can be used is a potential spendthrift beneficiary. With a custodial IRA, upon the passing of the IRA owner, the beneficiary has complete and unlimited access to the IRA. With a significant IRA portfolio, it is likely that the IRA owner will want to implement some safeguards to ensure that their life savings will be distributed according to their wishes. There may be the concern that the beneficiary will unwisely spend through the entire sum of their inheritance with an unhealthy result, such as in cases involving substance abuse. Another common issue is that the beneficiary can unintentionally trigger potentially significant tax consequences with a lump sum distribution. By design, a trustee IRA allows the IRA owner to put safeguards in place to plan for these potential issues. This enables the owner to determine the rules and timeframe by which distributions may be made to the beneficiary. Simply put, in many of the same ways a trust can, a trustee IRA can be used to not only protect assets, but also to protect beneficiaries.

4. Greater Creditor Protection

During the IRA owner's lifetime, the IRA may have the protection of applicable federal and state bankruptcy and creditor protection laws. Once the IRA owner dies, and the beneficiary owns the inherited account, this protection may be reduced or lost. For example, the Supreme Court case *Clark v. Rameker*² ruled that the bankruptcy exemption allowed for "individual retirement accounts" protects the IRA during the original owner's life but expires upon his or her death. Therefore, an inherited custodial IRA is an asset available to the beneficiary's creditors if the beneficiary suffers bankruptcy or any other type of creditor exposure³ such as a lawsuit or divorce.

When thinking about creditor protection, we often think about the instances of bankruptcy or lawsuits. However, in reality, the most likely creditor any beneficiary will face is that of a divorcing spouse. When thinking about protecting the assets that the IRA owner intends to pass down to beneficiaries, an important aspect to consider is how much of the IRA do they want to go to a future ex son or daughter in-law if they part ways with the intended beneficiary?

If an IRA owner is concerned about potential creditors of his or her chosen beneficiary, the IRA owner should consider leaving the IRA in a protected spendthrift trust arrangement. Assets in a well-designed "spendthrift trust" cannot, in theory, be taken by the creditors of the trust beneficiary. There are two ways to accomplish this protection. The first is for the IRA owner to have an attorney draft a spendthrift trust for the benefit of the intended beneficiary, then name that trust (rather than the individual) as beneficiary of the IRA. The second, and likely more efficient option, is to use a trustee IRA with a payout determined by a third party. If the trustee IRA

With a trustee IRA there is no need to draft and maintain a separate trust, because the trustee IRA is the trust.

contains a “spendthrift clause,” which is a common provision,⁴ in most instances the beneficiary’s creditors cannot access the IRA. Creditors could try to seize IRA distributions as they are received by the beneficiary, but they cannot (under existing laws as operated in most states) go after the IRA directly.

5. Simplify Administrative Process

Prior to the inception of the trustee IRA, trusts were (and still are) used alongside custodial IRAs to accomplish many of the same objectives of a trustee IRA. One strategy that is commonly used with estate planning for IRAs is a see-through trust as the primary beneficiary of a custodial IRA. Since a custodial IRA cannot include a payout schedule or any of the other controls that a trust or trustee IRA can, a separate trust instrument can be used in conjunction with the custodial IRA to provide the desired controls at the trust level. With a trustee IRA there is no need to draft and maintain a separate trust, because the trustee IRA is the trust. This common approach (custodial IRA payable to a separate trust as beneficiary of the custodial IRA) by combining these two pieces accomplishes the same thing as a trustee IRA, but with some complications.

The first complication is the level of involvement that is required by skilled legal counsel to create the separate “see-through” trust. While the IRA owner should still expect to use legal counsel for estate planning advice surrounding the use of a trustee IRA, it is probable that the time and effort involved in drafting a separate trust will be much greater, and by extension, more costly for the IRA owner.

The second complication is the risk of a separate trust failing to qualify as “see-through” by IRS requirements. Not all estate planning advisors are experienced in drafting trusts to meet these requirements. If the trust named as beneficiary of a custodial IRA fails to qualify as a see-through trust, the IRA will potentially have to be paid out much more rapidly after the owner’s death depending on the classification of beneficiary that is to receive distributions.⁵ Typically, a trustee IRA is a document preapproved by the IRS,⁶ so this risk is eliminated.

Potential Caveats

Most financial organizations who offer trustee IRAs do not allow the IRA assets to be transferred to another organization (trustee transfer).⁷ This could become an issue if the beneficiary wants to work with a different IRA provider down the road. Some IRA owners may simply not like the idea of getting “locked in” with a single provider and want to maintain the freedom of choice to move their assets to another provider, should the need arise. Be sure to check the language of the trustee IRA document if you have a concern with this issue.

Another concern when choosing a trustee IRA provider, is whether that financial institution will allow you to maintain control over who is named as investment advisor for the assets in the trustee IRA portfolio. Many financial institutions⁸ only allow the option to use their investment advisors, platform, and investment strategies. This may be a concern if the IRA owner has had previous success and wishes to maintain an established relationship with their current investment advisor whom they trust or

A trustee IRA blends a custodial IRA account with a trust into a single mechanism that can be used to leverage the tax advantages of an IRA alongside the planning flexibility of a trust.

wish to self-direct the investment of their IRA portfolio.

Conclusion

As its name implies, a trustee IRA is simply, the marriage of a trust and an IRA. A trustee IRA is a single tool that takes advantage of the best of both the trust and IRA worlds. A trustee IRA blends a custodial IRA account (traditional or Roth) with a trust into a single mechanism that can be used to leverage the tax advantages of an IRA alongside the planning flexibility a trust can provide. A trustee IRA can offer greater protection for the IRA during the owner’s life (for example in case of their disability), an increased ability to control disposition of the IRA and the simplicity of incorporating all aspects into one document.

NOTE: Any IRA owner who is considering a trustee IRA as a way to accomplish greater control over the distribution of their IRA assets after their passing or the event of their incapacitation, should consult skilled legal and tax counsel on the best planning techniques to make sure that their plan and the tools they choose successfully accomplish their unique goals. Many of the options that are touched on in the paragraphs above, are quite complex and nature and should be executed under the guidance of a skilled advisor. If you are concerned about potential exposure to creditors’ claims for either yourself or your chosen beneficiary, you should consult an attorney who is expert in “asset protection planning.” The brief general statements here cannot cover the many complexities of this subject. This information is not legal advice and may not be relied upon as such. Every situation is unique, and individuals should consult with competent legal counsel for specific advice.

Endnotes

1. The Peak Advantage Trustee IRA allows for the following:
 - While the owner is living, in the event of incapacitation, the trustee may have full discretion over management of IRA.
 - Once assets are held in trust after owner’s passing there is the option for the trustee to have full discretion over distributions, be limited to the HEMS standard, or abide by a set amount or percentage for distributions.
2. In a landmark, unanimous 9-0 decision handed down on June 12, 2014, the United States Supreme Court held in that inherited IRAs are not “retirement funds” for beneficiaries within the meaning of federal bankruptcy law. This means that once IRAs are passed to beneficiaries available to satisfy the claims of the beneficiaries’ creditors. (See Clark, et ux v. Rameker, 573 U.S. (2014)).
3. Bankruptcy protections of retirement funds are governed by federal law; however, non-bankruptcy creditors are generally governed by state law, during and after the lifetime of the original IRA owner. As always, there are exceptions and this should be considered a general statement, not legal advice.

Creditor Protection Applicable Law		
	Bankruptcy	Non-Bankruptcy
IRA	Federal Protection that is limited. 2016 limit \$1,283,025 (only applies to contributions & earnings)	Follow State Law
Rollover \$ from QRP	2005 Federal Law Provides QRP ROLLOVER \$ Unlimited Protection for Bankruptcy	Does not apply to non-bankruptcy creditor protection. Follow State Law
Inherited IRA	Not protected under Federal law.	Follow State Law

4. The Peak Advantage Trustee IRA was designed to include necessary spendthrift protection language to provide protections from potential creditors of beneficiaries.
5. In light of the SECURE Act, there is ambiguity regarding the rules of conduit and accumulation trusts.
6. The Peak Advantage IRA uses a trust agreement that satisfies the requirements to qualify as a “see-through” trust.
7. Peak Trust Company designed the Peak Advantage Trustee IRA to be transferable to any other qualified trustee.
8. Peak Trust Company’s Peak Advantage Trustee IRA is unique among many competitor’s products in that the choice of investment advisor for the Peak Advantage Trustee IRA is determined by the IRA owner, and can be changed by the IRA owner throughout the life of the account.