

Are You Sure Your Estate Plan Is In Order?

IS YOUR IRA IN YOUR TRUST?

This Estate Planning Mistake Could Cost Your Beneficiaries Thousands



LEE & Associates
HYDER

Brought to you by
Lee Hyder



Is Your IRA in Your Trust? **Beware of These Costly Tax Implications!**

Jim liked the idea of leaving a generous inheritance for his kids someday. After researching his options, he decided putting a trust in place made the most sense to ensure his wishes were carried out after he was gone. Jim met with an estate planning attorney who drafted his trust and then asked him to prepare a list of all the assets he'd like to place in the trust. Jim listed his primary home, his vacation home, his coin collection, and his \$500,000 IRA. He also named the trust as the beneficiary of his IRA to ensure it was paid out according to the trust. All was good in Jim's mind. He was relieved to know his affairs were in order. However, six years later, when Jim passed away, his children were shocked to learn how much of their inheritance they would be forced to handover to Uncle Sam. They knew they may have to pay some taxes, but they never dreamed it would be so much.

Five Common IRA Planning Mistakes:

How You May Unknowingly Give the Government a Big Chunk of Your Kid's Inheritance...

Mistake #1: Designating a Trust as the IRA beneficiary.

You should name your children as the beneficiaries of your IRA instead of naming a trust. When an IRA beneficiary is a trust, the proceeds are taxed at trust tax rates. Passing IRA assets to a “non-living” entity puts your beneficiaries at a significant disadvantage as they lose the option to be taxed at their individual income tax rates, as well as the option to defer the inheritance and stretch the distributions out over their lifetimes.

Mistake #2: Not Providing a Copy of Your Beneficiary Designation Form to Your IRA Plan Administor For Review and Acceptance Prior to Your Death.

If your beneficiary designation form isn't approved by the account custodian prior to your death you run the risk of it not being approved. This robs you of the opportunity to make any changes needed to allow your children to minimize potential taxes and maximize the value of the inheritance.



Mistake #3: Not Ensuring That Your Trust is Irrevocable.

This is an important point to discuss with your attorney up-front because it is a necessary characteristic of a valid pass-through trust.

Mistake #4: Failing to Verify That the Trust Agreement is Valid Under Your State Law.

This is another question that must be asked – especially if you’re using an online legal service or had your trust drafted in another state. Using a “do-it-yourself” online legal service may be acceptable in some states but not for others. Your trust should be verified as a legal and valid trust under your state’s law.

Mistake #5: Not Naming Individual IRA Beneficiaries.

In Jim’s case, his beneficiary was the trust. Ideally, his beneficiaries should have been specifically named. Using non-specific terms like “kids” or “grandkids” isn’t recommended. Clearly-defined beneficiaries are an important element of a valid trust agreement for IRA inheritance purposes.

Individual Vs. Trust Tax Rates

Below is the 2012 Tax Rate Schedule for Estates and Trusts. Did you notice? Any distributions over \$11,650 have a base tax rate of \$3,011.50, plus a 35 percent tax rate on every dollar over and above the first \$11,650! This is a huge disadvantage to a beneficiary, as under today's ordinary income tax rates they would have to earn \$388,350 before reaching the 35% tax bracket. Simply stated, any money inherited from the IRA, paid out through the trust will be taxed at an unnecessarily high rate. By naming specific beneficiaries, they will instead be taxed according to their individual ordinary income tax rates, which in this case, is much more advantageous.

Individual Tax Rates

Tax Bracket	Married Filing Jointly	Single
10%	\$0 - \$17,400	\$0 - \$8,700
15%	\$17,400 - \$70,700	\$8,700 - \$35,350
25%	\$70,700 - \$142,700	\$35,350 - \$85,650
28%	\$142,700 - \$217,450	\$85,650 - \$178,650
33%	\$217,450 - \$388,350	\$178,650 - \$388,350
35%	Over \$388,350	Over \$388,350

2012 Tax Rate Schedule for Estates and Trusts

Taxable Income is over:	But not over:	Base tax rate is:	Plus the tax rate for the amount over is:
\$0.00	\$2,400	15%	\$0.00
\$2,400	\$5,600	\$360 +	25% over \$2,400
\$5,600	\$8,500	\$1,160 +	28% over \$5,600
\$8,500	\$11,650	\$1,972 +	33% over \$8,500
\$11,650	-----	\$3,011.50 +	35% over \$11,650

Let's Do the Math:

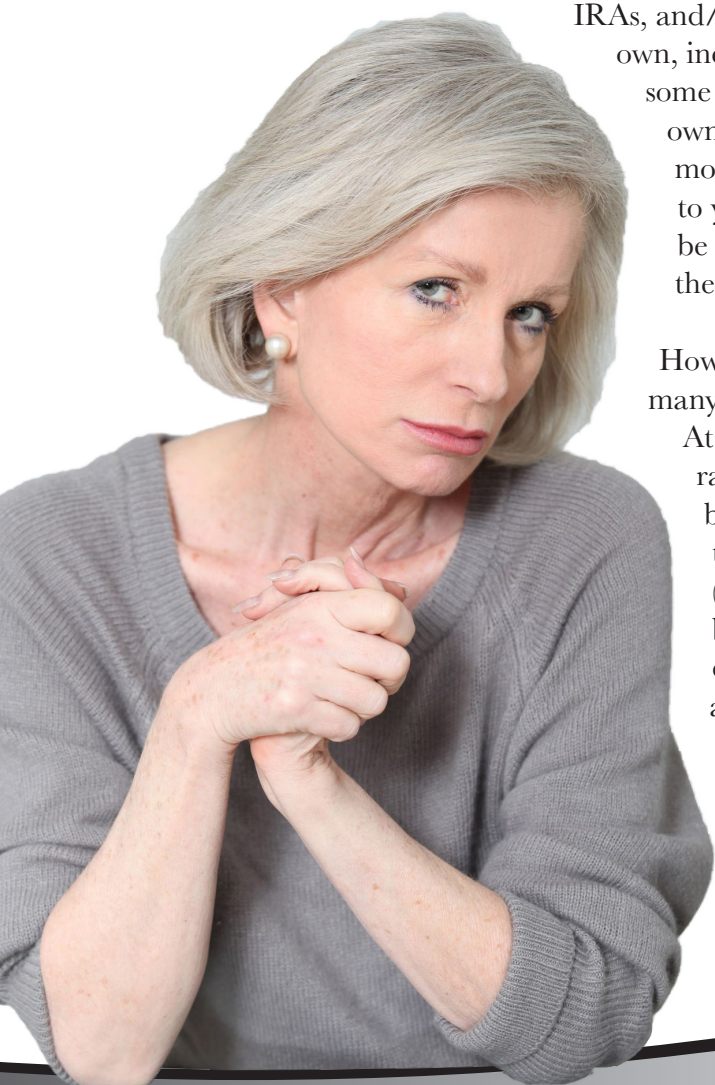
Taxes owed on the first \$11,650	\$3,011.50
Additional tax owed at 35%: (\$759,153 - 11,650 = 747,503 x .35 = \$261,626)	\$261,626.00
Total income tax due on the IRA:	\$264,627.50

As you can see, Jim's kids, who were expecting to receive \$759,000 were forced to pay over \$264,000 in income taxes. Not only was this a blow to them and something Jim never would have wanted, they also lost the ability to let that \$264,000 continue to grow and compound in the IRA, an option they would have had, had Jim named them as individual beneficiaries. As you can see, this was probably the largest taxable event that Jim's kids will ever face in their lives!

What Does This Mean for You?

None of us can escape the fact that every dollar in your traditional IRAs, and/or any other tax qualified retirement plans you may own, including any 401(k), 403(b), or 457 plans will be taxed at some point. The question is, at what rate? Most likely if you own any of these types of retirement plans they are worth more than \$11,650, meaning that if passed these accounts to your beneficiaries through a trust your beneficiaries will be forced to pay federal income taxes on the inheritance at the top tax rate of 35%!

However, by naming individual beneficiaries you give them many more options when it comes time to inherit the money. At a minimum you can save them from paying such a high rate of income tax, but it doesn't stop there. Individual beneficiaries also have the option of "stretching" out their inheritance using required minimum distribution (RMDs) tables, which both extend the tax-deferred benefits of the IRA and help minimize the income tax consequences in a given year. If you set up your IRA and trust appropriately, your heirs can continue to benefit from the IRA's tax-deferred status by taking only RMDs each year, paying tax on only that amount, while allowing the IRA to continue to compound on a tax-deferred basis as the IRA grows over their lifetimes and for their own retirement.



In Summary

If you don't want to give away a big chunk of your loved ones' inheritance to Uncle Sam, contact an estate planning specialist who is experienced with trusts, and then contact a financial advisor that understands IRA distribution rules **BEFORE** putting your IRA into a trust. The reality is, IRA distribution planning is a very specialized practice, and one that many attorneys and/or CPAs do not understand. You need an advisor who has extensive experience in this area. The end goal is to set up an estate plan that carries out your final wishes while also providing the best tax advantages and wealth accumulation opportunities for you and your heirs.



Need Assistance?

If you currently have an IRA or other work related retirement plan and you want to make sure that the beneficiary designations are set up in the most tax advantageous manner, please give us a call to schedule a complimentary IRA distribution planning strategy session. We're here to help! You can schedule this strategy session by clicking on the calendar on our site, or by simply calling or emailing our office.

LEE & Associates
HYDER

1655 West Market St. #445 Akron, OH 44313
330.836.7800 • lee@leehyder.com

Lee Hyder & Associates is registered as an investment adviser with the state of Ohio and only transacts business in states where it is properly registered, or is excluded or exempted from registration requirements. This report is a publication of Lee Hyder & Associates. Information presented is believed to be factual and up-to-date, but we do not guarantee its accuracy and it should not be regarded as a complete analysis of the subjects discussed. All expressions of opinion reflect the judgment of the authors as of the date of publication and are subject to change.

Are You Sure Your Estate Plan is in Order? - Is Your IRA In Your Trust?