MSBA MARYLAND STATE BAR ASSOCIATION, INC

Bar Bulletin

© 2017 Maryland State Bar Association, Inc.

The Stretch IRA Trust–from Conundrum to Opportunity

By Jeffrey D. Katz, Esq. and Meghan C. Lentscher, Esq.

Why does the Supreme Court's recent decision in Clark v. Rameker, 134 S. Ct. 2242 (2014) - which resulted in a good deal of disarray in the estate planning community - bode well for estate attorneys?

A 2015 study by the Investment Company Institute revealed that there are more than $7.6 trillion worth of assets placed in IRAs nationwide. Although less than 1 percent of estates nationally are subject to federal estate tax, more than 80 percent of Americans have some type of retirement plan. While many won't require sophisticated tax planning, almost all could benefit from counsel to preserve their assets for the benefit of their beneficiaries.

Retirement accounts of less than $1 million have long been exempt from claims of creditors in bankruptcy. Inherited IRA's, pre-Rameker, also held this exemption. The Rameker Court abrogated the long standing protections as described In re Chilton, 674 F.3d 486 (2012). It held that bankruptcy protections usually afforded to an Individual Retirement Account (the term "IRA" is used collectively herein to refer to all retirement accounts) do not also attach to a future beneficiaries interest in the account once the original account owner dies—unless that beneficiary is the original owner's spouse—with the successor non-spousal beneficiaries losing these special protections altogether.

How can estate planners ensure that their clients retain the full protections afforded to the IRA's original owner for successive beneficiaries? The answer – despite what many practitioners currently believe – is to name a specifically designated trust as the IRA's beneficiary.

When an attorney is skilled and careful, a "Stretch IRA Trust" that follows the IRS' strict rules regarding a trust's possession of an IRA can be set up. The beneficiaries of the trust can retain the IRA, along with the protections against claims that may arise in a bankruptcy, divorce and from other creditors in most lawsuits.

Stretch IRA trusts accrue additional value thanks to compound interest and investment growth, while deferring the requirement to pay federal or state income taxes over the lifetime of the beneficiary. In short, they may protect people who inherit the IRA from the potential "triple tax" threat – estate, federal, and state income tax.

As a planning opportunity, an evaluation of whether a Stretch IRA Trust is appropriate should be the new "normal" in the planning community. Unfortunately, while some estate planners have expressed concern in naming a Stretch IRA Trust, others remain oblivious to the issue at all, and do so at their peril.

Regardless of the outcome on the decision-making process, even many experienced estate attorneys have reservations on the beneficiary designation. Outright designation of beneficiaries could result in a failure of the beneficiary to exercise the stretch election.

Moreover, clients routinely hinder their beneficiary's ability to stretch the IRA by violating the naming conventions. An attorney also could unintentionally arrange the IRA and the beneficiary trust when drafted as a Revocable Trust in such a way that the trust's own beneficiaries are subject to higher taxes and/or a requirement that the beneficiaries take the IRA over the course of five years.

The best option may be a separate irrevocable "see-through" trust, which allows the IRS to "look through" the trust to see who are named as the trust's beneficiaries. The beneficiary's name and income will determine the actuarial life expectancy over which the IRA must be distributed, as well as calculate the required minimum distributions ("RMDs").

When properly drafted and implemented, the IRS will view the trust as a "see-through" so long as it meets the requirements laid out in Treas. Reg. 1.401(a)(9)-4, A-5, namely that: (1) the trust is valid under state law; (2) the trust is irrevocable or becomes irrevocable upon death; (3) the beneficiaries on the trust are identifiable, and (4) the trustee has provided the required trust documentation to the IRA custodian no later than Oct. 31 of the year following the death of the IRA's owner.

The Regulations further specify that the beneficiary of the IRA must be an individual rather than an entity, such as a business, estate or charity. When the trust meets these requirements, and the trust is named as a beneficiary of the trust, it will be possible to "stretch" the benefits of the IRA over years and even – possibly – decades.

The Stretch IRA trust provides a powerful tool for all individuals, regardless of estate size to ensure that whatever wealth they've accumulated in a retirement plan passes on and continues to benefit their family—and not their families' creditors. The Attorney's evaluation of the Trust relevance to their specific client's needs, design, and implementation of the Trust provides a new approach for the attorney to engage with their client, and allows for better positioning as the advisor of choice. While the ultimate recipient of the IRA's assets may sometime pay the piper, the careful attorney can ensure that this day is deferred as long as legally possible.

Jeffrey D. Katz, Esq. *is the founder and managing partner of Bethesda, MD based JDKatz, P.C., and focuses his practice on innovative tax and estate planning strategies.*

Meghan C. Lentscher, Esq. *is an associate at JDKatz, P.C. in the Estates and Trusts section, and the former articles editor of the Washington College of Law, Administrative Law Review.*

The information in this column is provided for discussion purposes and is not intended as legal advice.