Leaving Retirement Benefits to Beneficiaries

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1 PLAN PARTICIPANT NAMES THE BENEFICIARY DIRECTLY. This is the least effective and the most restrictive to the beneficiary. The problem with this is if the beneficiary takes the money in a lump sum, the entire amount is taxable to the beneficiary as income. Only if the beneficiary can be convinced to convert it to an Inherited IRA and if the retirement plan administrator allows it (most do), then you will have the benefits of an Inherited IRA.

2 PLAN PARTICIPANT NAMES THE INHERITED IRA AS BENEFICIARY. This approach is better but still is potentially troublesome and possibly costly in taxes. This method converts the retirement assets into an Inherited IRA per the decedent's wishes and the beneficiary does not need to be convinced to convert it. The benefit is that the Required Minimum Distributions (RMD) will be based on the beneficiary's life expectancy, not the decedents. The beneficiary, however, may demand the entire amount as a lump sum at any time after age 18, triggering a host of punitive taxes to be paid by the beneficiary. Also, Inherited IRAs do not offer asset protection. A divorce or lawsuit could force the beneficiary to cash out the account. Inherited IRAs do not have the IRS's asset protection characteristics of the participant's own retirement account.

3 PLAN PARTICIPANT NAMES THE RETIREMENT TRUST AS BENEFICIARY. This is the standard for leaving retirement assets to beneficiaries. A trust can be a stand-alone Retirement Trust, or can be the decedent's Living Trust. The former is generally better because the person that drafts the trust has to be extremely careful with the language in the Living Trust. A Retirement Trust has all the benefits of an Inherited IRA but the beneficiary cannot take the entire amount as a lump sum without approval by the Trustee. This aspect gives very strong asset protection on the retirement account, except, of course, for the annual required minimum distribution (RMDs). RMDs will be based on the life expectancy of the oldest beneficiary in the trust, so the stretch-out is accomplished. If it is a single Trust document, that document can create separate Retirement Trusts and achieve the stretch-out over each beneficiary's lifetime rather than the oldest beneficiary. The standard Retirement Trusts described above (IRS approved) are called Conduit Trusts. There is also a way to create an Accumulation Trust, which would keep the funds in the Trust until the Trustee decides to pay out amounts to the beneficiary and this would NOT require a pay-out of RMDs every year, triggering income tax every year. Accumulation Trusts are extremely tricky and not advisable except from an expert attorney in Retirement Trusts.

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