SPECIAL REPORT #3

THE IRA INHERITANCE TRUST®
The Way To Stretch Out And Protect Your IRA Funds

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"for your peace of mind"

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Most people don't realize that their IRA is their ***biggest problem asset***. That is because under the new income tax rules, after your IRA's are inherited, they may be the ***largest*** asset that your loved ones receive from you.

When you put your money into the IRA, it was tax deductible. Money in that account compounds tax free until you reach age 70 ½. After that, you ***must*** start taking required minimum distributions (RMD) which are taxable. We're talking about your traditional IRA's, not your Roth IRA's.

The reason that IRA's create a problem is because of the ***triple tax*** charged on them. If your estate is large enough (over $4 million) your family will pay an Illinois death tax of 8% to 16%. If your estate is large enough (over $5.45 million, as of 2016), they will also pay a Federal death tax of 40% or more. (The estate tax was repealed for the year 2010 but it returned on January 1, 2011 with a Federal Credit amount of $5 million Indexed to inflation annually and an Illinois credit amount of $4 million, as of January 1, 2016). Then of course, there is ordinary income tax on the amount that is withdrawn. You may be in the 28% income tax bracket or even as high as the 39% bracket. Don't forget that those minimum distributions you take from your IRA may cause your income to go high enough to cause your Social Security income to be taxed. Fortunately, some of these taxes can be taken as deductions against others, ***but you could end up with an effective total tax rate over 70%!***

Good news arrived when the ***IRS came out with new minimum distribution rules***. This is really a ***key point*** in this report. There is now a ***smaller required minimum distribution amount*** and it's much easier to calculate. Before, you had 6 different formulas to choose from, causing confusion and complications. Once your choice was made, it was irrevocable. Today, we have a ***uniform table*** that's easier to use and understand. For example if you're age 73, you will take your account balance as of December 31st of last year and you will divide the balance by 24.7. This is the number provided in the table. You'll take out about 4% per year. Now you take out less and you're allowed to compound on a tax-free basis for a much longer time. That's ***good news***. But the really good news is the ***much longer payout period for your non-spouse beneficiaries after you're gone.***

Let's look at the old law. If dad died and mom rolled over his IRA into her own IRA and she died at age 76, her children were required to use her remaining life expectancy. The old table said there was 6 remaining years. The children would have been required to take the IRA proceeds in 6 years or less, pay all the taxes, and would lose the tax-free compounding that was allowed by deferring the distribution.

Much Longer Pay-Out Periods

Now let's look at the new Tables! Let's say that I'm age 37 and I inherit the IRA from my 76-year-old mother. How many years do I have to take out that IRA? Not the 6 years we saw before. Now I have 46 ½ years under the new rules. ***This is a huge difference!*** This means that over time, that account is going to be worth much, much more if I can stretch it out for 40 additional years. Keep in mind, there is a simple rule that says that if money grows at 6%, it will double every twelve years. Think of what can happen to that account by the time I reach 80. If you plan properly, ***you can now pass that IRA down for several generations of beneficiaries.*** Each generation can compound their growth, tax-free. Now we have the **"stretch-out" IRA** (sometimes called "eternal IRA," multi-generational IRA," or "Inherited IRA"). Basically, what we mean is that your non-spouse beneficiaries can ***stretch out*** their minimum distributions over a much longer period of time.

Most People Spend Their IRA's Conservatively

Let me illustrate how great the impact of a proper stretch out can be. Let's say dad dies and leaves an IRA to mom and she rolls it over and adds it to her own IRA. The total is $250,000. Let's assume it's growing at 8%. If you think that is not realistic, we'll look at an example with 6% growth later. If it is a $250,000 account, growing tax deferred at 8% from mom's 65th birthday until she is age 70 ½, that account will increase to $400,000. At age 71, mom's RMD under the current life table, is only about 4%. So it still continues to grow because the growth exceeds the RMD. Some client's say "were going to spend out our whole IRA." But we have found that most of our clients don't really do that. They treat the IRA as "rainy day" money and take out only the minimum because they don't want to increase their income tax. If they need additional funds to live on, they usually spend other non-taxable assets.

If mom took only her RMD, the account is growing faster than it's being withdrawn. ***If she lives until age 80, that account will be worth about $540,000 at her death.*** That is the amount that will be inherited by her 45 year-old son.

If the estate is large enough to pay an estate tax, the son will not use the IRA to pay the estate tax. Why? Because the first money to come out of the IRA would be taxable income and create an additional income tax for the son. That would be silly. We would pay the estate tax (if there was one) from other non-taxable assets. In our example, the age 45 son would inherit an IRA worth $540,000. That 45 year old can now use ***his own life expectancy*** to take the minimum distribution. This is a major benefit of the new rules. By the time he reaches his 80th birthday, he would be taking a required distribution (RMD) of $250,000.

Growth Potential In A Properly Stretched IRA Is Amazing

Between age 45 and age 80, he would have withdrawn total RMD's of $2.9 million. And believe it or not, there will still be a balance in this account (at age 80) of over ***$700,000***, to pass to the next generation. All of this from just a $250,000 IRA! These calculations have been checked and re-checked by one of the most respected IRA authorities in the country (Robert Keebler, CPA). Did you ever think this could happen with your IRA? It can, ***with proper planning.*** This is very powerful for those who take advantage of this technique.

INHERITED IRA TO A 45 YEAR OLD CHILD

AGE	REQUIRED MINIMUM DISTRIBUTION	TOTAL DISTRIBUTIONS TO DATE	REMAINING BALANCE
50	20,694	102,825	734,729
60	45,873	431,645	1,133,251
70	103,226	1,166,518	1,435,258
80	246,881	2,867,955	765,319

Let's look at *another example* to see how truly powerful this concept is. Let's assume the 45-year old child we previously talked about had a 20 year old grandchild and you named the grandchild the beneficiary of the IRA instead of the child . That grandchild has a life expectancy of 63 years according to the current IRS tables. ***That's 63 years to defer the tax from that IRA.*** At age 80, the grandchild would take an RMD of $1.1 million. From what was originally $250,000 that grandchild would have taken out a total of $13 million and would still have $2.5 million left at age 80. These are remarkable numbers. ***All of this happens because your non-spouse beneficiary can now stretch distributions over their lifetime.***

INHERITED IRA DIRECTLY TO GRANDCHILD AGE 20

Age	Required Minimum Distribution	Total Distribution to Date	Remaining Balance
30	18,775	143,941	1,055,861
40	41,172	446,432	1,870,845
50	90,669	1,092,206	3,140,767
80	1,101,860	13,280,662	2,467,719

Let's review a few important facts:

1) You can now stretch out and take smaller IRA minimum distributions under the new table;

2) Your IRA is exposed to less estate tax when you pass away because the estate tax exemption has gone up;

3) Your beneficiaries can now stretch out and take smaller minimum distributions and that is the key point I'm making;

4) Your IRA now can represent a huge asset in your estate; and

5) The IRS is your friend?? Well, we may not want to go that far, but they've given us all these great new rules so let's at least say the IRS is a little friendlier.

The Problems With Paying IRA's Directly To Beneficiaries

I've told you about all these great benefits, but of course, like most things in life, ***it does not happen automatically.*** It requires planning. Remember, you wanted to avoid Probate, so you ***planned*** and created a Living Trust. There is planning needed to ensure the maximum stretch for your beneficiaries. You could simply name your children or grandchildren as your direct beneficiaries of your IRA's but unfortunately, that creates some large problems.

First, If I'm your son and I inherit your IRA, do I ***have to*** take only the minimum distribution or can I yank it ***all*** out the day after you die? If I yank it all out, I void the stretch out. I call this a ***"blow-out."*** A large number of people tell me they don't think this will be a problem. They say to me, "my kids are responsible and all of them will make the right choices." Unfortunately, many people don't understand the IRA rules. In a very common scenario, mom dies and the daughter finds out that she is the beneficiary of mom's $300,000 IRA. She goes to the bank or mutual fund and ***cashes it out.*** They gave her a check with her name on it. She then deposits it in her bank account or investment account. ***The moment she deposits that check, she has triggered all the income tax.*** Unlike you, she does not have that 60-day rule that allows her to replace it and defer the tax. So, if she takes the IRA money out only for 1 day, she cannot reverse that tax by putting it back in the IRA. ***She didn't understand the rules***.

Second, let's say your beneficiary is a little smarter. She calls the IRA Custodian (a bank or mutual fund). She asks them what to do and they say, "send us the death certificate." She does what they told her to do, and they send her the check. Again, it may be in the amount of three hundred thousand dollars. She banks the money in March or April and over the next 8 or 9 months she spends it on home repairs, or a new house, a car, vacation, or the grandchild's education. Then she sees her accountant in February or March of the next year and he tells her, ***"you have over $100,000 of income tax due here."*** And she says, "I don't have the money, I spent it."

Third, a possible problem is your child (or grandchild) inherits your 401(k) or profit-sharing plan, rather than your IRA. There are different stretch-out rules. ***Those plans have their own rules that supercede the stretch out rules.*** Nearly all of the corporate retirement plans I have seen, require that a non-spouse beneficiary must withdraw the corporate retirement assets in one to five years and pay all the taxes. For this reason, I recommend to my clients that if they are retired, they look seriously at rolling over those corporate retirement funds into their own IRA. If the client does that (the child can also do this after parent's death, under a 2006 tax provision of the Pension Protection Act), the IRA stretch out rules are available to the non-spouse beneficiaries rather than the more restrictive corporate plan requirements.

Fourth, many children think they can simply roll-over Mom or Dad's 401(k) or IRA and just put it in his or her own IRA. ***That is not permitted***. Only you or your spouse can make a tax-free rollover. Non-spouse beneficiaries cannot do that.

In my other "Special Reports", I talked about creating creditor and divorce protection for your children with a special **Personal Asset Trust℠ (a PAT).** Many of our clients have done this. The reasons for creating a PAT were:

1) Prevent the wrong people from eventually inheriting your assets (in most cases, clients want their inheritances to eventually pass to grandchildren and not in-laws) ;

2) Poor spending habits of beneficiaries, their spouses, and children;

3) Your beneficiary's spouse may take part of the inheritance in a divorce;

4) Poor money management skills of beneficiaries;

5) Young, elderly, or disabled beneficiary unable to properly manage his affairs;

6) A beneficiary losing entitlement to government benefits;

7) Your beneficiaries' lawsuits, creditors, or bankruptcy proceedings, grabbing their inheritance; and

8) Estate taxes when the money passes to the next generation.

Safety and Protection For The Inherited IRA

If ***any one*** of those 8 problems might affect your beneficiaries, you would want to not only make sure that the beneficiary took advantage of the ***maximum stretch out*** but also be sure you ***protected the IRA*** from the possibility of divorce, creditors, lawsuits, estate taxes, and lastly, to make sure the balance of the IRA passed to your grandchildren or whomever ***you*** want.

If you pass the IRA directly to your beneficiaries, ***without proper planning***, you cannot protect against any of these possibilities nor can you maximize the stretch-out. There are a lot of reasons to get a headache here. I sincerely wanted you to understand the magnitude of the problems with an IRA before I told you more about these issues. Can't you get all of that protection by naming your Living Trust as the beneficiary after you're gone? The answer is "maybe." Most Living Trusts don't provide asset protection, divorce, lawsuit, or creditor protection unless they include a "Personal Asset Trust℠" However, with most Living Trusts, you end up with the beneficiaries having to withdraw the IRA and pay all the taxes in as little as ***five years***. There won't be a full stretch out because the Trust does not "qualify" for it. The ***solution*** to these headaches, and to provide the "stretch out and protection" is a new breakthrough strategy called the IRA Inheritance Trust®.

The IRA Inheritance Trust® Solution

What kind of Trust is it? It is revocable. You can change it any time you wish. Just like your Living Trust. The difference between the IRA Inheritance Trust® and your Living Trust is that you put your assets into your Living Trust while you were alive. But you did ***not*** put your IRA into your existing Living Trust while you are living. ***You*** remained the owner of your IRA but named your Living Trust as the ***beneficiary*** after your death. ***We don't change the ownership*** of the IRA to your Living Trust because it would cause it to be immediately taxable, just like a withdrawal.

The same procedure applies to your IRA Inheritance Trust®. It will be the ***beneficiary*** of your IRA after your gone. While you are living, you remain in control of your IRA, just like you are now. You decide on the investments, when you take the money out, etc. This IRA Inheritance Trust® is totally separate from your Living Trust.

Some clients ask "why do I need a separate Trust?" There are both technical and practical reasons for it. The required IRA Trust provisions that permit maximum stretch out, contradict many provisions contained in a standard Living Trust. If we try to build those provisions into a standard Living Trust, we expose it to a great risk that the ***5-year required payout rule*** will apply, will cause it to be prematurely taxed, and lose the stretch-out benefit.

For practical reasons, we also want the separate Trust. The existence of the IRA Inheritance Trust® alerts the beneficiary to the different income tax treatment of the IRA. It also removes the possibility that the beneficiary can go in to the bank the next day after you're gone and take all the money out. If the beneficiary goes to the bank, mutual fund, etc. and says "I want to close the account", the custodian says "wait a minute, this goes to the Trust. You must be the Trustee and only the Trustee can make that decision." It makes it easier for the custodian at the bank or mutual fund to properly administer it. ***This is very important***. Imagine if you put a provision in your Living Trust that says "I want each child to stretch out the distribution of my IRA" and it's buried in 40 or 50 other pages somewhere. Your child will take it to your legal counsel and it will sit for a while until it's read and meanwhile, the IRA is withdrawn, contrary to your wishes. This is why we establish a separate IRA Trust.

Approved By The IRS

So, why haven't you heard about this before? Because the IRS issued a complex ruling on September 16, 2005 that approved these types of Trusts. This is a relatively new concept. ***We are one of the very few law firms who have implemented this technique and most financial advisors don't know about it*** or if they do, they are not familiar with its operation and technical requirements. This is a very narrow area of the law. The actual Trust document that ***we are using***, was submitted to the IRS for approval and they have issued a written published ruling which has approved its use (called a Private Letter Ruling) that is referred to above. We ***know*** that it will work when set up properly, because the IRS has approved it. Since the first ruling, the IRS has issued at least 6 subsequent rulings in the last few years, all approving this trust concept.

What do you do that's different than before? You must file a ***new beneficiary designation*** form with the custodian. You may recall that when you first set up your IRA, you filled out a form that named your beneficiary. The new one we will file, names your children's (or other benficiaries' shares) of the IRA Inheritance Trust® as beneficiaries. You are still the owner of your IRA and can change the IRA Trust, tear it up, or do whatever you want with the beneficiary designations during your life. It's completely flexible while you are alive.

What happens when you pass away? First of all, we must have proper retitling of the beneficiary on your IRA account. If John Doe has an IRA and he dies, his daughter Mary, is not going to roll over John Doe's IRA to her name or even to the name of the IRA Inheritance Trust®, because that would be taxable. Because of the new beneficiary form we have prepared for you that is filed with the bank, mutual fund, etc., the beneficiary of the IRA will be: ***"for the benefit of the Mary Doe share of the John Doe IRA Inheritance Trust®."*** If John Doe has two children, Mary and Jane, the beneficiary of his IRA will be: "50% for the benefit of the Mary Doe share of the John Doe IRA Inheritance Trust®" and "50% for the benefit of the Jane Doe share of the John Doe IRA Inheritance Trust®." What happens to the required minimum distribution (RMD)? They will be poured into the IRA Inheritance Trust®, where ***the terms of your Trust will determine what is paid out to whom and when.*** Based upon your children's income tax brackets, in some cases we want the RMD to stay in the Trust. In other cases we want the Trust to distribute the RMD to the child. In many cases, Mom and/or Dad want the distributions to be paid out to the beneficiary while the remainder of the IRA remains ***sheltered*** by the Trust. In some cases, we want those distributions to stay in the Trust, under the ***safety and protection*** of the Trust because the child is a spendthrift, has a bad marriage, has creditor problems, is involved in a lawsuit, or suffers from an illness/disability. If there was a disability and the child was receiving government benefits, the distributions from the IRA to the IRA Inheritance Trust®, would not disqualify him, could be used to supplement those government benefits and the government could not attack the Trust or IRA to get reimbursed.

Bob And Betty Example

We have a husband and wife, Bob and Betty. Bob has $250,000 in his IRA. He dies and Betty is the primary beneficiary. She can roll-it-over, like I said before, and use the liberal "uniform table". If she is under age 70 ½, she does not even need to make any withdrawals. In some cases, like 2nd marriages, Bob may not want Betty to be the primary beneficiary. He may want his IRA Inheritance Trust® to be the primary beneficiary so that his children from his 1st marriage will receive some or all of the IRA. If Bob was single, the IRA Inheritance Trust® will definitely be the primary beneficiary. If Bob wanted Betty to be the primary beneficiary and he died first, Betty would then name ***her*** IRA Inheritance Trust® as the primary beneficiary after her death.

When the IRA pays to the IRA Inheritance Trust® at the last spouse's death, it has all the protection of the Personal Asset Trust (PAT)℠ we discussed before. Because of the walls of legal protection that are built into the PAT Trust, the children's IRA distributions and the IRA itself, are protected from spouses, divorces, creditors, lawsuits, government claims, bankruptcy and even estate tax at the time of the children's deaths (You might be thinking, Federal and state law protect <u>my</u> IRA from creditor's claims. You are correct, but that protection disappears at the moment of your death and does <u>not</u> pass to your children). Even with all of these protections, each child can act as Trustee over their own share of the IRA Inheritance Trust®, control the investments, decide how it is used, and how it is spent. And at your child's death, ***the remaining balance in the IRA Trust will pass to your grandchildren (or other beneficiary selected by you) and not to a spouse or other 3rd party.***

By the way, in the beginning of this discussion, we were using an 8% rate of return, and I told you that if your children paid the tax in one year after taking all of the IRA proceeds at once, versus stretching the IRA over their lifetimes, the difference would have been over $3 million dollars. That is the difference between having the IRA Inheritance Trust® or having paid all the tax up front. Plus, as a huge extra benefit, the Personal Asset Trust (PAT) provisions, avoid losing the IRA to any 3rd parties.

Earlier I promised you that I would show you an example using a 6% rate of return for those of you who don't believe 8% is realistic. If you started out with a $200,000 IRA growing at 6% and it passed to a 40 year old child, at age 80, that beneficiary would have received total distributions of $760,000 and still had another $200,000 left to pass down to his children. The results aren't quite as dramatic as if it was a 8% return, but you would still increase the value of the IRA 4 ½ to 5 times and can still provide the creditor, divorce, lawsuit, protection and insulate against those who have poor spending habits, bad management skills or a disability. It is still a very effective stretch out.

Let's Review The Benefits Of An IRA Inheritance Trust®

1) ***Maximize income tax deferral*** of accumulated wealth by taking advantage of stretch out - even for Roth IRA's, (so that they can remain in a tax free environment);

2) ***Protect*** the undistributed balance of the IRA **(even Roth IRA's)**:

a) proper distribution to your intended beneficiaries (probably your grandchildren);

b) protection against spendthrift habits;

c) professional money management (if desired);

d) divorce protection;

e) protection from controlling or greedy in-laws;

f) protection for minors;

g) protection for elderly or disabled;

h) government benefit program eligibility with no claims for reimbursement;

i) lawsuit, creditor, and bankruptcy protection; and

j) reduce or eliminate estate taxes at children's deaths.

3) ***Leaving a legacy in your name!*** Remember, every single distribution check that goes to your child or grandchild has your name on it. Why? Because we kept John Doe's name on his IRA even after he died and paid it to his IRA Inheritance Trust®. ***There is a hidden value to this***, that most people don't ever anticipate, and that is, when people know who set aside the inheritance for them, your name is on the check and they know where it came from. ***They value it far more and in most cases, take better care if it.*** This is a subtle but important benefit from the IRA Inheritance Trust®.

Should you get an Inheritance Trust®? If you have over $200,000 in combined husband and wife IRA and employment retirement benefits, you should be giving serious consideration to the IRA Inheritance Trust®. This is a general rule of thumb. We might set up an IRA Inheritance Trust® for a client with a $150,000 IRA and has a disabled daughter who is receiving government benefits.

Think it about it this way: you already have a Living Trust to properly distribute and protect all your other non-IRA assets. Think of this new Trust as ***a "Living Trust" for your IRA"***. If this sounds like the technique for you, call us today at ***847-670-8200*** to set up a consultation.