

IRAs REQUIRE SPECIAL CONSIDERATION IN ESTATE PLANNING

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Individual Retirement Accounts (IRAs) are a popular investment tool for retirement, but they also need to be taken into account when doing estate planning. Although IRAs can be used to provide for heirs either directly or through a trust, to what extent your heirs will benefit from the IRA and avoid unnecessary taxes depends on proper planning.

What Is an IRA?

IRAs are personal savings plans that allow you to set aside money for retirement and create tax savings. The advantage of IRAs is that you may be able to deduct some or all of your contributions to an IRA from your taxes and also be eligible for a tax credit equal to a percentage of your contribution. Earnings in a traditional IRA generally are not taxed until distributed to you. At age 70 1/2 you have to start taking distributions from a traditional IRA. Earnings in a Roth IRA are not taxed nor do you have to start taking distributions at any point, but contributions to a Roth IRA are not tax deductible. Any amount remaining in your IRA upon your death can be paid to your beneficiary or beneficiaries.

Rule Number One: Name Beneficiaries

From an estate planning perspective, the most important thing to remember with an IRA is to name a beneficiary. While a spouse is usually the logical choice for a beneficiary, you should be sure to name contingent beneficiaries as well. If you and your spouse died at the same time and there was no contingent beneficiary, then the IRA would go to your estate and be subject to probate (the legal process of administering the estate of a deceased person). When a spouse inherits an IRA, he or she can roll it over into his or her own IRA. When a non-spouse inherits an IRA, the heir will need to start taking distributions within a year after the IRA owner dies.

Stretching an IRA

If you don't need the funds in your IRA for retirement and want to use them to provide for your beneficiaries instead, you may be interested in "stretching out" your IRA. To do this, when you reach 70 1/2, take only the required minimum distributions, leaving more assets in your IRA. When you die, your beneficiary can also stretch distributions out over his or her lifetime and then

designate a second-generation beneficiary. It makes sense to name a young beneficiary because the younger the beneficiary, the smaller each distribution must be, which gives the funds in the IRA extra tax-deferred years to grow. If you are designating a younger, or minor, beneficiary, you should not name them directly as beneficiary but instead should have our office prepare a trust, for the benefit of said beneficiary, to be designated as beneficiary of the IRA.

Trusts as Beneficiaries

In some cases, it may make sense to name a trust as a beneficiary. This is particularly true if you have minor children, children with special needs, or a beneficiary with poor spending habits. But the trust must be properly drafted to avoid negative tax consequences. If the trust is a "see-through" trust or "conduit" trust, then the distributions from the IRA to the trust after the participant's death can be stretched out over the life expectancy of the oldest trust beneficiary. If you are planning to leave your IRA to a trust, you should have our office prepare a trust.

An IRA can be a valuable part of an estate plan, but the rules can be complicated. If you would like to discuss your IRA, and how your beneficiaries are designated (or how they should be), call our office to schedule an appointment to discuss the same.