

# Protecting IRAs for Heirs

By LIZ MOYER

Financial advisers are scrambling to set up trusts for retirement assets earmarked to be passed down to children or grandchildren. But for some families, such a move might prove to be overkill.

At issue: whether funds from an inherited individual retirement account are fair game for bankruptcy creditors. The U.S. Supreme Court ruled that they were.

The Supreme Court case called *Clark v. Rameker* concerned a woman who inherited \$450,000 from her mother's IRA in 2001 and filed for bankruptcy nine years later with \$300,000 of the funds remaining. The unanimous decision handed down in June set off a flurry of discussions among advisers and estate lawyers, who say it could have far-reaching implications about how to protect IRA inheritances.

Since then, there has been "a lot more discussion about using trusts," says Edwin Morrow III, senior wealth specialist at Key Private Bank, a division of Cleveland-based KeyCorp.

Generally, IRAs funded with annual contributions are protected from creditors up to \$1.2 million, an amount adjusted for inflation every three years. Roll-overs from qualified plans have unlimited protection. But in this case, the court focused on the fact that the money was inherited and not the woman's own assets.

There are differences in how a spouse and a nonspouse who inherit an IRA can access the money. A nonspouse can't mix the inherited money with his or her own account, for example. A spouse can roll over the funds into his or her own IRA, and that money is protected from creditors, lawyers say.

Trusts are another way to shield an inheritance, especially from creditors—including a former spouse or a litigious patient, when an heir is in a high-liability profession such as medicine.

Trusts also can be used to protect assets against a spendthrift heir, as a trustee can be given broad discretion over when, how and to whom to distribute the money.

To get those creditor protections, you must use a so-called see-through trust, in which the beneficiaries are individually identifiable, experts say.

Otherwise, the IRA funds would have to be withdrawn within five years of the last day of the year the IRA owner died, assuming the IRA owner was younger than 70½ years old. If the IRA owner dies at that age or older, the withdrawals are pegged to what would have been his remaining life expectancy.

If it isn't set up as a see-through trust, there could be tax implications, says Bob Charron, the head of the tax department at Friedman LLC, a New York accounting and advisory firm. In a non-see-through trust, annual income after the first \$12,149 is taxed at the top rate of 39.6%. Income generated in a see-through trust, though, is taxed at the beneficiaries' individual rates, which could be lower, he says.

Experts say the high fees that come with setting up a see-through trust—not to mention the added complexities—can outweigh the benefits, especially for

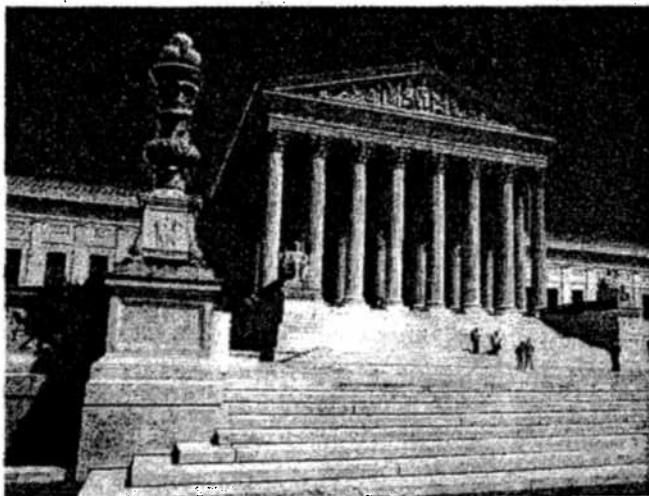
accounts with assets of less than \$500,000.

Costs can range from \$1,500 to \$5,000 in lawyer fees, depending on location. Once the IRA owner dies and the assets are passed along to heirs, there are annual fees for tax preparation and filing for the trust, plus fees for trustees and investment management. Such fees can be anywhere from \$1,500 to \$3,000 a year or more, Mr. Charron says.

One lower-cost option to setting up a trust: a "trusteed IRA." It offers the same creditor protections as a see-through trust, experts say, and it allows heirs to stretch mandatory withdrawals over time. A trustee, appointed by the bank, can prevent a spendthrift heir from depleting the assets.

Such an IRA costs a couple of hundred dollars to set up, plus an annual fee of 1% to 2% of assets after the owner dies and the heir inherits the assets. Only a few firms offer them, among them Bank of America Merrill Lynch, Northern Trust, Key Bank and USAA.

Mr. Charron says he recently met with his estate lawyer to talk about whether he should set up a trust for his own IRA. They decided not to set one up, at least for now. "For me, it would have been overkill," he says.



A Supreme Court ruling could make inherited IRAs more vulnerable.