Lynn Asinof

Tackling a question on IRA *September 30, 2002 W.S.J.*

By LYNN ASINOF

Q: *An attorney suggests putting my IRA into a trust for my 15-year-old son. Since IRAs must be owned by individuals, I am wondering how that might work.*

Alex Rhodes
Houston

A: Let's start with the basics. You can't put an IRA into a trust without triggering major tax consequences. Individual retirement accounts, as you state, must be owned by individuals, and a trust isn't an individual. That means if you transfer your IRA to a trust, the IRS will view the transfer as a distribution and collect income taxes on the entire amount.

You can, however, name a trust as beneficiary of your IRA, with your son as beneficiary of that trust. And that's exactly what you should do if you want to leave IRA assets to a minor child, says Barry Picker, a Brooklyn, N.Y., accountant who specializes in IRA issues. Without such a trust in place, your son would need a guardian to administer any inherited IRA assets until he comes of age. But upon becoming a legal adult, he would be free to do whatever he wanted with the money.

"If you are sitting on a half-million [dollar] IRA, do you want your 22-year-old son to get this all at one time?" asks Mr. Picker. "I don't think so."

IRA trusts, however, aren't like regular trusts. They must be "artfully" worded to make sure the IRA retains its tax-deferred status, says Marvin Rotenberg, national director of retirement services for the private-client group at Fleet Bank, Boston. A properly constructed IRA trust allows distributions to flow into the trust, but leaves the IRA itself outside the trust, he says. And under no circumstances should the trust name your estate as a co-beneficiary. If you do, you will lose the ability to spread distributions over your son's lifetime.

The IRA trust should also specify how much money your son should get and at what age he should get it. You could, for example, provide annual distributions and then allow him access to all IRA funds at the age of 25. Or you might want to continue the trust an additional 10 or 15 years, perhaps giving the trustee the authority to make larger distributions from the IRA to pay for, let's say, college or a down payment on a house.

Remember, the protection provided by such a trust comes at a cost. There are fees for drawing up the trust, trustee fees for managing the trust, and income-tax returns due every year. Moreover, trust income-tax rates are extremely high, hitting the top rate of 38.6% once annual earnings are above $9,200. So be sure you've made provisions for those expenses in your planning. When your child is old enough to responsibly handle the money himself, you can simply name him beneficiary and tear up the trust.