



# SHEFFIELD

---

L A W O F F I C E

---

95 South Market Street, Suite 300

San Jose, CA 95113

Ph: 408-920-2500

[www.sheffieldestateplanning.com](http://www.sheffieldestateplanning.com)

# **RETIREMENT PLANS & TRUSTS:**

**They Go Together Like  
Peanut Butter & Jelly**

# GENERAL RULES

- Charity before Individuals
- Younger before Older
- Low Income before High Income

**STRETCH OUTS:  
MYTH vs. REALITY**

# STRETCH OUT: MYTH vs REALITY

- Plan Administrators – May destroy your planning!
  - They have a lot of legal requirements that they must comply with for each account.
  - If participant dies with 5 beneficiaries?
    - Cost go up 5 times
    - Revenue is unchanged

# STRETCH OUT: MYTH vs REALITY

- Beneficiaries – May destroy your planning!
  - How many beneficiaries ONLY take out their Minimum Required Distribution?
  - Accounts left outright are “found” money to the beneficiary
  - How long does it take the beneficiary to consume found money?

# CONTINGENT BENEFICIARIES

- General Rule
  - Oldest living individual who is an actual or contingent beneficiary will be the Designated Beneficiary
  - If any non-individual is actual or contingent beneficiary, then 5 year rule applies

# CONTINGENT BENEFICIARIES

- Trust Rule
  - Accumulation Trust
    - Look to see who the actual and contingent beneficiaries of the Trust are.
    - Generally, 5 year rule applies
  - Conduit Trust
    - Look to see who the actual beneficiary of the Trust is.
    - **IGNORE CONTINGENT BENEFICIARIES**

# CONDUIT TRUST

All distributions from the Retirement Plan to the Trust **MUST** immediately be paid to the beneficiary of the Trust. The Trust may not accumulate any of the Retirement Plan

## CONDUIT TRUST

# CONTROL!

# CONTROL

- Stretch Out
  - The Trustee makes the decision on HOW MUCH will be withdrawn from the Retirement Plan (not the beneficiary)
  - Keeps the Beneficiary from Destroying the Plan
  - Keeps the Plan Administrator from Destroying the Plan
  - Makes sure the Plan is Consistent
  - Trust may be drafted in many ways
    - May require stretch out (only pay MRD)
    - May allow trustees discretion
    - May specify specific situations (i.e. wedding, house, school, etc.)

# CONTROL

- **Stretch Out**
  - **Contingent Beneficiaries don't count**
    - Allows more flexible planning including naming other family members or charities as contingent beneficiaries
  - **Advisor's can coordinate the entire estate plan to ensure it complies with clients objectives**

# CONTROL

- Dealing with the Spouse
  - Preserving the Exemption Amount
    - MUST use a Trust!!!
    - Make CST beneficiary of the plan, OR
    - Allow spouse to DISCLAIM into CST
  - Marital Deduction w/ Control
    - Make QTIP Trust the beneficiary of the plan

# CONTROL

- Dealing with Special Needs Children
  - Outright to child may remove child from SSI and MediCal benefits
  - Conduit Trust may do the same if MRD's are over \$18,000 a year
  - Must use an Accumulation Trust (which is designed as a Special Needs Trust) to protect benefits

# BENEFITS OF A STAND-ALONE RETIREMENT PLAN TRUST

- Increases likelihood that the trust will survive planning by another attorney who doesn't understand retirement planning.
- Easier for successor trustees and plan administrators to manage and work with the trust.
- Trustee is not likely to miss an issue because the trust completely spells them out.
- Debts, taxes and expenses will not be paid out of the retirement plans.
- Living Trust can be simpler and less confusing to the client.
- Allows Living Trust to name other older beneficiaries, contingent beneficiaries, charitable beneficiaries, and not worry about stretch out rules.

# BENEFITS OF A STAND-ALONE RETIREMENT PLAN TRUST

- Living Trust can have broadest spendthrift, no contest, incentive/disincentive or other clauses that act to restrict or eliminate income payouts to a beneficiary.
- Simplifies fiduciary accounting issues after death involving division between income & principal.
- Simplifies tracing of the immediate payout of RMDs out to the beneficiary that is required in the conduit trust.
- Simplifies income tax filing and planning regarding IRD and the §691(c) deduction.
- Might prevent the trustee from commingling retirement plan assets in a conduit trust from making a §645 election to treat the trust as an estate – jeopardizing DB status.
- Separates the retirement plan assets so GST can be allocated appropriately.

# BENEFITS OF A STAND-ALONE RETIREMENT PLAN TRUST

- Segregates Roth IRA/401(k) assets for appropriate planning – like GST.
- Greater flexibility to use powers of appointment in the Living Trust and Retirement Trust (but have the powers be different).
- Allows clearer directions to trustees regarding exhausting assets in order of tax preferred priority without worrying about diversification rules overriding tax preferences.
- Avoids tremendous danger of having a pecuniary bequest in a Living Trust trigger IRD in the retirement plans.
- Provides more flexibility for amending the trust as tax law changes.

# IRA ANNUITIZATION

- For Clients with Taxable Estates
- Goal
  - Remove Taxable Assets From the Estate
  - Replace With Assets Not Subject to Estate Tax

# IRA ANNUITIZATION

- Place all assets in the IRA into a Life Annuity
  - Creates a fixed income stream for the rest of the Client's life
  - No worries about failing to withdraw MRD's
- Use the Annuity payments to:
  - Pay Income Tax
  - Fund an Irrevocable Life Insurance Trust (ILIT)
  - Increase client's standard of living
- Have ILIT Trustee purchase life insurance on Client's life

# IRA ANNUITIZATION

- On Client's death...
  - Nothing is left in IRA
    - No Estate Tax
  - Life Insurance Proceeds inside ILIT are not included in the Client's estate
    - No Estate Tax
  - Children get more money than if inheriting the IRA
    - IRA is IRD
    - You pay estate tax on the income tax inherent in the plan
    - In some cases, children may receive 15% of the value of the plan after taxes

# IRA ANNUITIZATION

- Advantages
  - Creates spendable income, guaranteed for life (not subject to market fluctuations)
  - Eliminates Income Tax to children on inherited asset
  - Eliminates Estate Taxes
  - Guaranteed Death Benefit
- Disadvantages
  - Client must be insurable



95 South Market Street, Suite 300

San Jose, CA 95113

Ph: 408-920-2500

[www.sheffieldestateplanning.com](http://www.sheffieldestateplanning.com)