Affluent

"Honey, the Kids Shrunk Our IRA!"

By Neal Frankle, CFP®

If only it was a nightmare, and I could just wake up! I'd loved Doris and Robert. They had been two of my favorite clients. They were a fun couple who'd loved their family and worked hard to provide for them.

Robert had died 10 years ago after working 35 years in his successful, small architectural firm. Doris had retired 5 years ago after working 20 years at the middle school as a librarian. They'd saved and invested well, and by the time Doris died last year, they'd amassed more than $5 million in retirement savings alone. They'd named their son and daughter the sole beneficiaries on the account, so I invited their heirs to visit me and discuss options.

That's when the trouble started. You see, Doris and Robert's children weren't nearly as industrious as their parents. As they stepped jovially into my office, I sensed there would be trouble ahead. "Mr. Frankle," said James, their son, "you mentioned options. What are they?"

"Well, James, you have a choice. You can withdraw all the money right now. If you do that, you'll have to pay taxes, of course. So, if you withdraw the entire account now, you'll pay about $2.3 million in tax and have $2.7 million to spend any way you like.

"The other option is to take advantage of the Inherited IRA provisions that your parents made sure to set up for you. With this option, you won't pay much tax at all. You can allow the money to grow tax-deferred for many years to come. You'll be forced to take a small distribution each year, but it won't be much and, therefore, the tax will be minimal. Because you're so young, if you choose this option and take only the minimum distributions each year, you'll be able to stretch the IRA and take out over $20 million over your lifetimes. This is a far better option. It's the option your parents were most interested in for you, and it's what I recommend."

The moment of truth came. A crushing silence fell over the room. Then James spoke. "Mr. Frankle. Thank you very much. That really is very good and thoughtful advice and we appreciate it. But GIVE US THE MONEY NOW. We want it immediately. We don't care about the taxes."

All Doris and Robert's planning had been for naught. The big tax payoff was thrown away. The kids turned a hard-earned $5 million into $2.7 million with the stroke of a pen, and then they threw away over $17 million without batting an eye.

How can you make sure this doesn't happen to you and your kids?

Plan A. Educate your beneficiaries. Explain to them the benefits of taking advantage of the Inherited IRA and continuing tax deferral. Since your kids listen to everything you say, this should work (in about 1 percent of the cases).

Plan B. If you know deep in your heart (and wallet) that your kids are going to spend that money no matter what you say, here's your fool-proof plan: Set up an Inherited IRA Beneficiary Trust.

You might be saying, "Hey, Frankle, I've already got a living trust, that will handle it!"

Well, yes and no. If you name your living trust as the beneficiary of your retirement account, it may keep the kids from getting their grubby little hands on your cash, but in most cases, it will also trigger immediate taxation of the entire account. That's something you want to avoid like the bird flu. Sorry, if you want to make sure your kids don't decimate your hard-earned retirement savings, and you also want to avoid immediate taxation on your IRA, in most cases, the only way to do that is to set up a special Inherited IRA Beneficiary Trust.

In summary, your IRA is probably one of your largest financial assets for two reasons:

1. **Big Brother would have slapped your hands if you'd touched the money**, so you haven't.

2. **You grew that money tax-deferred**. The best legacy you can give your family is the ability to continue to grow that money tax-deferred, which the government allows. For many people, the Inherited IRA Beneficiary Trust is the best way to make sure that happens.

If you'd like a list of questions to ask your attorney before you set up your Inherited IRA Beneficiary Trust, send me e-mail at *neal@wealthresorcesgroup.com.*

The necessary disclaimer: This article isn't intended to substitute for professional legal and financial advice. As each individual situation is unique, questions relevant to personal finances and specific to the individual should be addressed to an appropriate professional to ensure that the situation has been carefully and appropriately evaluated.

Neal Frankle is the author of Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity. *He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. To receive a free report on how to find the best funds, contact him by sending e-mail to Neal@WealthResourcesGroup.com.*