

THE RISELING REPORT

EXCLUSIVELY FOR THE ESTATE PLANNING PROFESSIONAL

IF YOU OWN AN IRA, DON'T DIE WITHOUT . . .

. . . reading this **Riseling Report** and obtaining an answer to each of the questions outlined below.

Problems with an inherited IRA are growing at an alarming rate. Apparently, not all IRA custodians are aware of what the Federal IRA rules permit and some IRA custodians have adopted policies that are technically within the law, but certainly create inconveniences for clients. This issue of *The Riseling Report* will address some of the problems that our client's children have encountered within the last several months. Here are examples of what we have discovered:

1. One life insurance company has a standard policy of allowing one withdrawal (only) when an IRA account is going to utilize the five year withdrawal period. If the client wishes to utilize the 5 year deferral period method, he must take all of the IRA account out at one time - - **not** once a year, but just once during the five year period. This creates a great inconvenience (and possibly greater income taxes) if money is needed throughout the five year period.

2. Some IRA custodians will not allow the beneficiary of an IRA to designate how the IRA is to be invested. A beneficiary is "locked in" to the investment decisions made by the decedent prior to death.

3. Some IRA custodians will not let a beneficiary change custodians and transfer the IRA to another custodian - - although this is permitted by Federal law. See Revenue Ruling 78-406, 1978-2 C.B. 157. Accordingly, some IRA custodians simply will not let the account be moved.

4. One life insurance company has a "standard" rule that if a beneficiary annuitizes the IRA (i.e., takes it out over their lifetime) then the **only** amount that can be taken out each year is the required minimum distribution ("RMD") – not anything in addition to that amount. This is not required by Federal law since the RMD is just that – a minimum amount that must be taken. Federal Tax law does not restrict the maximum amount that can be taken out in any particular year.

5. Some IRA custodians will not honor the Designated Beneficiary rules contained in Treasury Reg. 1.401(a)(9) which allows a Trust to be named as a beneficiary of an IRA and recognize the beneficiary of the Trust as Designated Beneficiary of the IRA. Although Federal law permits this [see Treasury Regulation §1.401(a)(9)-4 Q & A 5], we have encountered several IRA custodians who simply will not pay out in that fashion.

6. One IRA custodian told us that their “standard form” does not permit an IRA beneficiary to designate a successor beneficiary if the original beneficiary dies before all of the IRA is withdrawn. This would, of course, lead to a mandatory probate and conflicts with multi-generational estate planning. For example if Daughter inherits her Dad’s IRA and Daughter wants to elect to take the RMD over her remaining life, this custodian will not permit Daughter to name a successor beneficiary upon Daughter’s death.

7. Recently, a child of an IRA account owner who passed away was advised that she had two options. One, she could elect to take it out over her life expectancy. If she chose this method, the annuity payments would be equal every year. She would not be allowed to take additional distributions. She was advised that the reason she could not take additional distributions is because of the administrative cost of recalculating the RMD. This information is wrong because the RMDs as mandated by Treasury Regulations which require that the RMD be recalculated each year which would cause the annuity payments to actually change each year because of investment performance and the beneficiary’s life expectancy would be one year less each ensuing year. The other option was the five year payout method.

8. In January 2003, we had a client who passed away naming his Trust as the sole beneficiary of his IRA, to be distributed to the designated beneficiary of the Trust in accordance with the Trustee’s instructions. The Trust satisfies the requirements of Treasury Regulation §1.401(a)(9)-4 A-5(b). The client had two (2) children; a son and a daughter. The Trust Agreement provides that upon Dad’s death, the Trust was split into two (2) equal shares, one (1) for each child. The custodian was requested to bifurcate the IRA into two (2) separate, but equal, shares, one for each of the beneficiaries under the Trust. Thereafter, each beneficiary would take the RMD from that beneficiary’s separate IRA share in accordance with applicable Treasury Regulations. In other words, each child would commence to take RMDs over their respective life expectancy as permitted by the Treasury Regulations. *But, it is not that easy.* The custodian refused, citing no applicable law. The custodian stated that the IRA funds must be paid to the Trust all at one time and then the Trust could be split into two (2) shares; one (1) for each child. Of course, this is not the result that the IRA owner had in mind nor the result the children want because the entire IRA becomes immediately taxable one-half on each of the child’s personal income tax returns. This is the eighth time this has been issue with one of our clients during the last year. However, as with the seven (7) previous cases, we are hopeful that we will be able to educate the custodian and accomplish the client’s goal.

Not all news is bad, we have been successful in resolving many of the above problems.

Well, what should an IRA owner do? It is our strong recommendation that each and every IRA owner, regardless of age, send a letter to the owner's custodian (i.e., stock brokerage firm or financial institution holding the IRA as custodian) and ask for a written response to the following questions:

QUESTIONNAIRE FOR IRA CUSTODIANS

1. Do you honor the Designated Beneficiary rules contained in Treasury Regulations 1.401(a)(9)-4 (Q&A 5) when a Trust is named beneficiary of an IRA and allow the beneficiaries of the Trust to be considered Designated Beneficiaries of the IRA?

YES NO

2. Do you permit the beneficiary of an IRA to make investment decisions concerning that beneficiary's portion of the IRA?

YES NO

3. Will you permit the beneficiary of an IRA to name a successor beneficiary for any undistributed portion of the original beneficiary's share of the IRA?

YES NO

4. Will you let the IRA beneficiary move the IRA to another IRA custodian after my death as permitted by Revenue Ruling 78-406, 1978-2 C.B. 157?

YES NO

5. If an IRA beneficiary elects the five year payout method, will you permit multiple withdrawals during that five year period?

YES NO

6. If an IRA beneficiary elects to receive distributions over the beneficiary's lifetime, will you allow the beneficiary to take more than the required minimum distribution in any year?

YES NO

7. If: (1) I name my Trust as the beneficiary of the IRA, (2) my Trust qualifies as a beneficiary pursuant to the applicable Treasury Regulations, (3) my Trust agreement provides for separate shares to be created upon my death, and (4) the beneficiaries comply with all other Treasury Regulations and other tax laws; will you permit my beneficiaries to split my IRA into multiple IRAs in accordance with the Trust agreement governing my trust so as to create separate shares consistent with my Trust agreement?

YES

NO

Of course, the above enumerated questions are not intended to be an exhaustive list and other questions might be asked depending upon the particular client situation. It is extremely important that the IRA owner's attorney (who should be fully aware of all IRA distribution rules) be consulted if the custodian's response to any of the owner's questions is NO.

If you have any comments or questions regarding this Riseling Report, please contact us.

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