INTRODUCTION

Larry, a 56-year-old man with two children from a previous marriage was remarried to Laura, a 48-year-old divorcee with two children of her own. In order to ensure that Laura would be financially secure in the event of his untimely passing, Larry made Laura the primary beneficiary of his only significant asset, a $1.5 million IRA and listed his own two children as contingent beneficiaries. Sadly, Larry passed away suddenly and his entire IRA was inherited by Laura who rolled it into her own IRA which had a modest balance of $60,000. While he was alive, Larry and Laura had agreed that they both wished to leave their respective assets to their own biological children. However, Larry's children were both financially successful while Laura's own children struggled to meet their basic needs. Fearing the hardship her children may face after her passing, Laura made her two children the primary beneficiaries of her IRA. Several years later, Laura passed away and her children inherited Laura's IRA which had grown to a value of over $2 million. Larry's own children received *nothing*.

ESTATE PLANNING STRATEGIES

What could Larry have done to ensure that Laura would have financial security while also ensuring an inheritance for his own two children?

APPORTIONMENT

A rudimentary approach that requires no special tax planning is to apportion your IRA in a way that takes care of your wife and kids simultaneously. If you have two kids, you might give each of them 25% of your IRA and then give 50% of your IRA to your second spouse.

Upside:
It is simple, quick, clear, and allows each of the parties to go on their separate ways.

Downside:
May prove inadequate. It most likely involves allotment guesswork that forces you to err on the side of giving your new spouse either more or less than is adequate to meet living expenses.

QTIP TRUST

The QTIP is also known as the marital trust, and it is also the "A" in an A/B trust. The trust provides the second spouse with an income for life, but at his or her death the principal reverts to the children of the first marriage. Set up an irrevocable trust that is named as the exclusive beneficiary of the IRA. This way, you can provide written instructions for the irrevocable trust to provide, for example, $60,000 per year for the second spouse for the rest of his/her life and then the kids from the prior marriage can split what remains thereafter.

Upside:

- Provides a guaranteed income stream to your spouse for life while leaving the remainder to your children.

Downside:

- Costs of setting up a trust fund and may carry high income tax rates.
- Cannot be used to create a multi-generational IRA that, say, would pay out earnings to the prior kids or subsequent grandchildren after the death of the second spouse.
- Accelerates income taxes by forcing both the surviving spouse and the children of the first marriage (generally the ones who inherit the remainder of the trust at the second death) to take required minimum distributions based on the surviving spouse's age. Furthermore, the life expectancy table that is used to calculate the spouse's remaining life expectancy is less favorable than the table used to calculate an IRA owner's life expectancy. Consequently, while the surviving spouse is alive, minimum distributions *are greater* than if the surviving spouse had been named outright. When the surviving spouse dies, the children will also have an accelerated minimum required distribution schedule based on the life expectancy of their *stepparent, not their own life expectancy.*

TRUSTEED IRA

Instead of using a trust document to limit and direct distributions to the ultimate beneficiaries, the IRA distributions are controlled by a contractual agreement with the financial institution.

Upside:

- They are a less expensive way to achieve control over your IRA assets after your death than if you hire an attorney to draft your own trust.
- The agreement may provide for dividing the account into separate accounts for multiple beneficiaries after the owner's death. This ensures that required minimum distributions are based on each beneficiary's life expectancy.

Downside:

- Charge a 1 to 2 percent annual fee to create and manage the accounts and require a minimum account balance of $250,000 to $500,000.
- The provisions in the trusteed IRA may not achieve exactly what you want. To have the ultimate level of control and the ability to customize provision to achieve exactly what the you want, your own trust would be needed.
- The lack of ability to move the inherited IRA assets. While there is no reason that a trusteed IRA could not allow the movement of inherited IRA funds after the death of the IRA owner, these documents are generally drafted in such a way that if this is not outright prohibited it is certainly not guaranteed.