Benefits of Naming a Qualified Individual Conduit (QIC) Trust as the Beneficiary of Your Individual Retirement Accounts, Pensions, Profit Sharing Plans and Other Retirement Plans

WHAT IS A QUALIFIED INDIVIDUAL CONDUIT TRUST?

A Qualified Individual Conduit (QIC) Trust is a specially designed trust that satisfies the guidelines set forth by the Internal Revenue Service for naming a trust as the beneficiary of a qualified retirement account in place of naming an individual as the direct beneficiary. The first question that comes to mind is why bother with a trust, just name the child directly as the beneficiary. The following table summarizes the primary differences:

		Differences	
		Treatment if outright to Beneficiary	Treatment in QIC Trust for Beneficiary
1.	Beneficiary may stretch the payments over his or her life expectancy	yes[1]	yes
2.	Money available if beneficiary has real needs	yes	yes
3.	Beneficiary may cash IRA in and spend all the money unwisely	yes	no
4.	Spouse can get assets in a divorce	yes	no[2]
5.	Creditors of beneficiary can attach	yes	no[3]
6.	Beneficiary controls investments of IRA	yes	yes
7.	Beneficiary can waste principal, give it away	yes	no[4]

Notes

Note 1 Only if beneficiary chooses to stretch. A beneficiary may withdraw all or most of the IRA immediately and spend the money.

Note 2 Limited access to principal but spouse can attach once distributed to beneficiary.

Note 3 Limited access to principal but creditors can attach monies once distributed to beneficiary.

Note 4 You can limit the persons to whom the beneficiary leaves any IRA balance at the death of the beneficiary.

A QIC Trust will assure you that your beneficiaries will not just take the money out of your retirement account and spend it unwisely, finding themselves with a big income tax bill the next April 15th. Also, with a QIC Trust your hard earned retirement assets will not be subject to a predator in a frivolous lawsuit brought against your beneficiary. (This protection is **not** available if your beneficiary is directly named as a beneficiary.)

WHO CONTROLS THE QIC TRUST?

The QIC Trust has two trustees: the named successor trustee (most often this is the designated income beneficiary) who has almost all of the power over the trust, and the special trustee who authorizes distributions from the plan in excess of the minimum required distributions.

<u>What authority does the Successor Trustee have</u>?

- Controls the assets in the plan
- May make all investment decisions in the plan
- May buy or sell plan assets
- May invest in any investments that you as owner of the plan may make

<u>What authority does the Special Trustee have</u>?

The only authority the special trustee has is to request distributions from the plan in excess of the minimum required distribution (MRD). This is the amount the IRS requires the trust to withdraw from the plan and distribute to the beneficiary. You can give guidelines to the special trustee as to allocation of additional income or principal to the designated beneficiary in excess of the MRD.

WHAT ARE THE BENEFITS OF A QIC FOR YOUR BENEFICIARIES?

1. Beneficiary of a Stretch IRA

The "stretch option," or the ability to take distributions over the remaining life expectancy of a designated beneficiary, is available regardless of whether the designated beneficiary is a person or a QIC Trust. However, when a person is named the designated beneficiary, that person does not have to follow your wishes and may decide a new sports car or trip around the world is a better use of their inheritance. With a QIC Trust, the terms of the trust require that only the minimum required distribution can be taken each year unless there is a true need by the beneficiary for more funds.

In order to be sure that the QIC Trust is effective, it will be necessary for you to send a change of beneficiary form to the custodian or the plan administrator of each tax-favored retirement plan that you wish to be governed under the provisions of the QIC Trust.

As used in the QIC Trust, "tax-favored retirement plan" shall include a corporate or self-employed ("Keogh") pension, profit sharing and stock bonus plan that is "qualified" under Section 401(a), an individual retirement account (IRA) created under Section 408, a Roth IRA established under Section 408A, or a tax-sheltered annuity (or mutual fund) arrangement established under Section 403(b) and all such similar plans that may be available to persons presently or in the future. All of the aforesaid sections refer to sections of the Internal Revenue Code.

The QIC Trust can be designed to let the designated beneficiary or any other party named to manage the investments in the individual retirement account. This is a flexible option to give the beneficiary as much or as little control over the funds as you desire.

The major benefit of a QIC Trust is to provide a greater benefit to your heirs than they could obtain even with an outright cash bequest of a similar amount. This can be especially beneficial if the designated beneficiary is a very young person, such as a grandchild.

Illustration I

This illustration compares two bequests of $100,000 to a 45 year old individual. The results truly compare an apple to an apple. The figures illustrated represent the actual after tax dollars available to the beneficiary to spend over his life expectancy.

Outright bequest	$ 665,102
Stretch IRA	1,148,309

Thus a Stretch IRA will provide almost $500,000 in extra income.

Illustration II

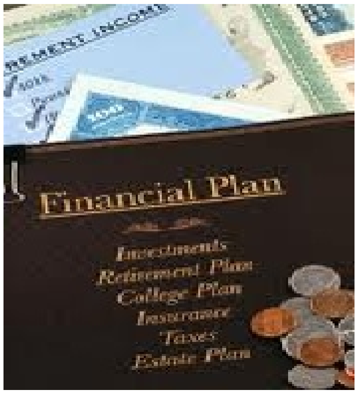
The same facts as Illustration I except the beneficiary is a four (4) year old child:

Outright bequest	$ 1,024,913
Stretch IRA	13,489,015

Yes, it is because of tax-deferred compounding of interest that twelve (12) times as much income will be available with a stretch IRA.

2. **<u>Provide Extra Retirement Income for Your Beneficiaries</u>**

Most clients feel their children or grandchildren are not saving for retirement and will later regret the lack of money in their retirement years. With a Stretch IRA the forty-five (45) year old beneficiary will have seventy-five percent (75%) more dollars in a retirement fund at age sixty-five (65) with a stretch IRA than if they had received an outright bequest. Our illustration shows that the forty-five (45) year old beneficiary will have the following "fund balance" at age sixty-five (65):



Outright bequest	$ 207,147
Stretch IRA	$ 345,797

3. <u>Protection from Creditors or Spouse in a Divorce</u>

A QIC Trust is designed to protect the principal of the trust fund from a spouse in the event of a divorce or from creditors if the beneficiary has creditor problems.

4. <u>What Happens if Designated Beneficiary Dies Prematurely</u>

If your designated beneficiary dies prematurely, if you wish you can limit the persons to whom the beneficiary can leave the remainder of your property held in the IRA account.

Please note all of the illustrations assume that the person receiving the outright bequest acts in a prudent manner and does not spend his or her inheritance but invests the money for the same return we used for the stretch IRA , and each year Person A (with the stretch IRA) and Person B (with the direct inheritance) paid all taxes required, spent the same dollar amount and reinvested the amount left over.

If instead of a regular IRA, a Roth IRA is given the beneficiary, the return results will blow your mind as the projected 30% tax bill will not happen and the after-tax dollar available to the beneficiary becomes huge with the Roth IRA. For a grandchild age 4 at 7% return on a $50,000 Roth IRA only, that grandchild will realize over $2,000,000 in tax free cash over his or her lifetime.

WHY NAMING YOUR REVOCABLE LIVING TRUST RATHER THAN A QIC IS NOT THE BEST CHOICE

You may ask why not just name my Revocable Living Trust or a subtrust within my revocable living trust as a beneficiary? The primary reason is that the revocable living trust and subtrusts do not generally have the required IRS provisions to qualify as a conduit trust. Furthermore, in order to provide flexibility in the revocable living trust and its subtrusts, provisions are often made for multiple beneficiaries or rights in the trustee to withhold distributions under certain circumstances, or accumulation of income and required distributions at certain ages, or many other provisions that may result in the trust having no "designated beneficiary" as defined by the IRS and, thus, such trusts will not qualify for stretching out of payments and may result in required distributions of retirement plan monies over a short time period.

GENERAL RULES FOR NAMING BENEFICIARIES OF RETIREMENT PLANS

As a general rule, if you are married your spouse would be the primary beneficiary and the QIC Trust the contingent beneficiary. Then when the plan owner dies, the surviving spouse names the QIC Trust as the primary beneficiary. There are times when this rule may not apply, such as:

- Second marriage or blended families
- Spouse who may not be responsible
- Children with special issues

These and many more situations require consultation with a professional to determine alternative courses of action.

SUMMARY

A QIC Trust is a specially designed trust to qualify under IRS Rules to permit the benefits to be paid over the life expectancy of the designated beneficiary. It also offers asset protection to the retirement account that are not available when an individual is named as the direct beneficiary. A QIC Trust offers many advantages as a method of leaving an individual retirement account balance to children, grandchildren, etc., and should be considered anytime a person has a substantial individual retirement account balance.

* * * * *

Contact Person:
Jodi Vosika
Telephone (480) 861-7743
Legal Assistant to
KNOLLMILLER & ARENOFSKY, LLP
e-mail: jodivosika@gmail.com

Presented By:
James G. Knollmiller
KNOLLMILLER & ARENOFSKY, LLP
1745 S. Alma School Rd., Suite 130
Mesa, Arizona 85210
e-mail: pts@aboutestateplanning.com