Seven Reasons to Use an IRT Instead of an IRCA

"Individual retirement arrangements" (IRAs) can be established in either of two legal forms, a custodial account (IRC § 408(h)) or a trust (§ 408(a)). They are treated identically for tax purposes. Here are reasons to consider using a "trusteed IRA" (also called "individual retirement trust," or "IRT") instead of the more common custodial IRA (called "IRCA" in this report).

An IRT can combine the *substantive terms* of a trust and the *tax deferral* of an IRA. The client (IRA owner) puts the trust terms and conditions into the IRT document. The document must comply with the minimum distribution rules and other requirements of § 408, but otherwise there's no limit on what it may provide, other than what the IRT provider is willing to accept. Keep in mind that not every provider's IRT necessarily provides all these advantages:

1. **Disability**: The IRT agreement can authorize the Trustee to use the assets for the participant's benefit during disability. An IRCA custodian will not perform those duties.
2. **State Probate Laws**: In some states, an IRCA may be considered a probate asset which can pass only by will. An IRT avoids that problem; assets pass according to the trust agreement.
3. **Limit Beneficiary's Access**: An IRCA beneficiary can withdraw the entire account at will. An IRT can limit the beneficiary's access to minimum required distributions (MRDs), or MRDs plus additional payments (such as for health or support).
4. **Limit Beneficiary's Control at Death**: If the beneficiary survives the participant, but then dies before having withdrawn all the money, who gets what's left? Under an IRT, but not an IRCA, the *participant* can specify the successor beneficiary.
5. **Avoid Complications of IRS "Minimum Distribution Trust Rules":** The only way to limit the beneficiary's access to an IRCA is to leave it to a trust. However, a trust named as beneficiary must meet tough IRS requirements to qualify as a "see-through trust" (i.e., a trust under which the oldest trust beneficiary's life expectancy is the Applicable Distribution Period for MRDs). An IRT does not have to jump through these hoops.
6. **Better creditor protection.** An IRT may have better protection from the owner's creditors, because it may be treated as a spendthrift trust under some states' laws.
7. **Reduce Legal Fees**. An IRT typically offers the participant a limited menu of the most popular post-death payout options, such as: outright to the beneficiary; beneficiary limited to MRDs (or spouse-beneficiary limited to greater of income or MRDs), with or without additional payments in Trustee's discretion. Please don't tell the Bar Association I'm writing this, but if the participant's estate planning goal is met by one of these "canned" options, the participant can avoid paying a legal fee to draft a trust agreement, because the trust terms are pre-drafted and included in the IRT document.

An IRT has some drawbacks: The provider's fee (or minimum account size) is typically higher for an IRT than for an IRCA because more services are provided. Also, since the IRT must pass all MRDs out to the IRT beneficiary, the IRT is not suitable for a client who wants MRDs accumulated and held in the trust for future distribution to the same or another beneficiary. Finally, the IRT cannot be a trust substitute for a client who seeks highly customized trust provisions.