THE DESIGNATED BENEFICIARY TRUST

Federal law exempts qualified retirement plans created under the Employee Retirement and Income Security Act (ERISA) as exempt from the reach of creditors. Many state laws exempt individual retirement accounts, governed under tax code sections outside of ERISA rules, from the reach of creditors. What has been uncertain until recently has been the issue of whether inherited retirement plan assets are protected from the claim of creditors. In June of this year, the Supreme Court in *Clark v. Rameker*, (S. Ct 6/12/2014) 113 AFTR 2d 1P 2014-889, put any confusion to rest. In *Clark*, the Supreme Court ruled that the retirement plan benefit inherited by the IRA owner's daughter was not exempt from a creditor's claim in bankruptcy. The Supreme Court held that an inherited IRA did not meet the definition of "retirement fund" under federal bankruptcy laws because the beneficiary cannot make additional contributions to the account, must take the required minimum distributions even if the beneficiary has not reached the mandatory or permissible retirement ages (59 ½ or 70 ½), and can withdraw the retirement funds at any time without penalty other than payment of income tax on the withdrawn funds.

For many of our clients this leaves quite the dilemma: How do we protect our children, grandchildren or other beneficiaries from losing what are often substantial inherited retirement benefits in the event of divorce, bankruptcy or judgment?

In light of *Clark*, the concept of a Designated Beneficiary Trust ("DBT") should be considered. The DBT should contain the spendthrift provisions necessary under state law governing the DBT to prevent an involuntary attack on the trust assets by a beneficiary's creditors.

The DBT should also be designed to comply with the basic requirements that would allow the trust to be the beneficiary of a retirement plan. Those requirements are that the trust be valid under state law; that it identify the beneficiary or beneficiaries; that it be irrevocable at the time the benefits are to be paid to it; that a copy be provided to the plan administrator upon request.

The DBT could be a true conduit trust, that is paying out the required minimum distribution directly to the beneficiary or, for maximum protection, could give the trustee the discretion to accumulate the required minimum distribution within the trust.

The required minimum distribution is generally determined by the age of the oldest trust beneficiary. It is recommended that either a separate DBT be prepared for each beneficiary for maximum flexibility, or if a single trust is used, separate identifiable trust shares be established under the document and the corresponding beneficiary designation, so that each beneficiary may use his or her life expectancy to determine the maximum "stretch out" of the individual retirement account or qualified retirement plan payable to the DBT.

The *Clark* decision by the Supreme Court did not address the protection accorded an inherited IRA by a spouse. However, since there are analogous circumstances to retirement plans inherited by a child, spousal benefits might also be exposed to creditor claims. Payment of a qualified retirement plan to a QTIP trust may be the solution to protecting qualified retirement plans from the claims of the spouse's creditors while also maintaining the retirement plan assets within the family. Be mindful that a QTIP trust, as beneficiary of a qualified retirement plan, must provide for the surviving spouse to receive the maximum of the income produced or the required minimum distribution.

There are many other technical requirements that should be investigated fully before instituting this strategy. If your clients are concerned about protecting substantial retirement benefits from the claims of a beneficiary's creditors, consider using a Designated Beneficiary Trust.