

## IMPORTANT TO READ IRA CUSTODIAL AGREEMENT

Reading the fine print of a custodial agreement for an individual retirement account is about as exciting as the idea of having blood drawn. You're probably more focused on the IRA's investment options or rolling your 401(k) plan account into the IRA without running afoul of tax rules. Those are worthy issues, to be sure, but don't ignore that custodial agreement.

One reason to thoroughly read your custodial agreement – or have your financial planner read it and explain it to you – is that custodial agreements don't necessarily have to match the Internal Revenue Service rules and regulations. Custodial agreements can be more restrictive.

For example, IRS rules allow the beneficiary or beneficiaries who inherit an IRA to name their own beneficiaries. Commonly a parent will name a child the beneficiary on an IRA inherited from the parent's parent. If Joe inherits his dad's IRA, he can "stretch out" the tax deferral by making minimum distributions over his life. By naming his daughter Sally as his beneficiary, she can do the same thing after Joe dies, thus continuing tax deferral.

But the custodian of the IRA, such as a bank, brokerage firm, or mutual fund, doesn't have to permit the beneficiary to name a successor beneficiary. When the owner dies, some custodians require the IRA assets to be paid out to the owner's estate in a lump sum, causing the loss of deferral and an immediate, and potentially large, tax bill. Fortunately, most custodians allow such stretch IRAs, but not all do, so read the agreement carefully.

Another provision to check for is what happens if you have multiple beneficiaries named to an IRA, such as your adult children, and one of them dies before you do. The standard language of custodial agreements call for IRA assets to pass to the remaining beneficiary or beneficiaries upon the owner's death "per capita." That means the assets are divided only among the *surviving* beneficiaries.

But what if a prematurely deceased beneficiary had children? Under the per capita default, no IRA assets would pass to those children. The assets would pass only to the surviving beneficiaries. Essentially, you disinherited some of your grandchildren.

This oversight can be avoided if the language of the agreement says “per stirpes” instead of per capita. Per stirpes allows the share that would have gone to the deceased beneficiary to be passed to the deceased’s children (or other designated heirs of the deceased).

Some custodial agreements that have the per capita provision as a default allow you to check a box on the agreement form changing it to per stirpes. In other cases, you may have to draft a signed and witnessed custom addendum instructing the custodian to distribute on a per stirpes basis. It is a good idea to have the custodian sign the addendum acknowledging receipt. If the custodian won’t accept addendums, you may want to consider a different custodian.

Does the custodial agreement allow multiple beneficiaries to your IRA? The default language of some agreements limits owners to a single primary beneficiary or is simply silent on the issue. Furthermore, custodial agreements that allow multiple beneficiaries may prescribe equal distribution of the assets, but you may prefer different percentages for different beneficiaries. Again, if allowed by the custodian, you may need to attach separate language detailing multiple beneficiaries by name and how you want the assets distributed among them.

What is the agreement’s default language regarding a divorce or legal separation in which you forget to remove the name of your former spouse as beneficiary? Agreements typically are silent, though a few will automatically revoke the divorced spouse as beneficiary unless otherwise directed by a divorce decree.

Does the agreement allow the custodian to discuss the IRA with the owner’s estate executor or successor trustee who isn’t a named IRA beneficiary? If not, you may have to write that provision into an addendum.

Does the agreement allow the beneficiaries to make a trustee-to-trustee transfer of the IRA assets to another financial institution after the owner dies (thus avoiding the payment of income taxes)? If the custodian does not permit the transfer, beneficiaries either are stuck with that custodian or would have to cash in the IRA and pay potentially substantial taxes on the lump sum.

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