The Estate Update

A newsletter provided for the benefit of the clients and friends of
The Peninsula Center for Estate Planning and Elder Law

A message from the Firm:

Hello and Happy Spring! I know we are all excited to see the warm weather return (at least on some days). The crocuses are in bloom – a sign that the beauty of spring is just around the corner. After this winter, it is very welcome indeed. I hope you are all well and enjoying 2015. It plans to be a busy year for us here at TPC. We have added two new staff members. Mary Fountain is a paralegal who has joined our Estate and Trust Administration Department. Jessica Rhodes is an administrative assistant who will be working directly with Barbara to ensure that every client's needs are addressed promptly. They are both delightful ladies, and I know you will enjoy talking to and working with them. I also hope to add a new attorney before the end of the year. The key, as always, is finding the right person who will fit in with our very unique practice. I am confident this person exists and am very excited about where we are headed in 2015.

In this issue we will review the rules regarding inherited IRAs. When your IRA passes down to your children, the rules change, and because of that, the IRA may not be protected as it was before. Because of this, trusts are often used to provide that creditor protection. If you have any questions after reading the article, or if you are interested in discussing whether such a trust, commonly referred to as a Retirement Preservation Trust, is right for you, please call.

As a reminder for those of you having children or grandchildren going off to college in 2015, the College Power Pack is a must! My son will be headed to Virginia Tech in the fall, and his documents are already in place. If we can help in getting your child or grandchild ready for this big transition, please let us know. Best wishes for a healthy and prosperous 2015 from all of us here at TPC.

Helena

Are Inherited IRAs Protected From Creditors?

By Helena S. Mock, Esq.

What is an "inherited IRA?" If you name as a beneficiary a person who is not your spouse, the IRA passes to your beneficiary as an "inherited IRA." Why does this matter? There are very specific rules governing the tax treatment of IRAs at different periods of time – before the IRA owner attains age 59 ½, between the ages of 59 ½ and 70 ½, after age 70 ½, and upon death. In addition, there are different rules which apply to the tax treatment of an IRA depending on whom the beneficiary is. For example, if the beneficiary is a trust, the trust must contain special language which will qualify the trust as a "designated beneficiary." If a charity is named as beneficiary, the charity doesn't pay any tax on the IRA, but the funds must be distributed out to the charity before September 30th of the year following the account owner's year of death. If a spouse is named as beneficiary, the spouse can make an election to treat the IRA as his own, and even comingle with an existing IRA of the spouse, thus affording the spouse the same level of access, control, and creditor protection as he enjoys with his own IRA. This election is referred to as a "spousal rollover," and it is only available to spouses. When a child or other individual is named as beneficiary, the IRA is treated as an

"inherited IRA" and very different rules apply regarding distribution and taxation. With an inherited IRA, the deceased owner's name remains on the account which is set up "for the benefit of" or "fbo" the beneficiary. A traditional account designation for an inherited IRA would read something like: "John J. Smith Inherited IRA fbo Susie Smith Jones." This account designation tells the world that this is an inherited IRA and thus subject to a different set of rules.

There are some notable characteristics of inherited IRAs which distinguish them from an individual's own retirement fund. First of all, the beneficiary of an inherited IRA must begin taking the required minimum distribution (RMD) from the IRA by December 31st of the year following the year of death. In other words, the beneficiary does not get to wait until attaining age 70 ½, and there is no penalty for making withdrawals prior to the age of 59 ½. Second, no additional money can be added to an inherited IRA and an inherited IRA cannot be combined with any other IRA of the beneficiary. Third, and this is one of the more positive features of inherited IRAs, although the beneficiary must begin taking distributions, the RMD is based on the *beneficiary's* life expectancy, not that of the deceased account owner. This means that if the beneficiary is younger than the account owner, the IRA will be paid out over a longer period of time, thus providing the opportunity for maximum deferral on the payment of income tax. This is commonly referred to as a "stretch IRA."

A beneficiary of an inherited IRA can still name her own beneficiary of any funds remaining in the IRA at her death. However, once the beneficiary of the inherited IRA dies, the required minimum distributions do not re-calculate, and the new beneficiary must continue to receive distributions based on the prior beneficiary's remaining life expectancy.

But is an inherited IRA protected from creditors of the beneficiary? Over the past ten years or so, this issue has been the subject of numerous cases. The issue has primarily been addressed within the context of a beneficiary's request for protection under federal bankruptcy laws.

In 2014, the U.S. Supreme Court finally settled the issue for purposes of federal bankruptcy law by holding in Clark v. Rameker, 573 U.S. ___ (2014) that retirement funds lose their character after the death of the original owner and become merely inherited assets which are not permitted any special protection under the Bankruptcy Code. In rendering its decision, the Supreme Court reviewed the legal characteristics of regular versus inherited IRAs and found inherited IRAs to be distinct from "retirement funds" based on the unique characteristics defined above. Based on these characteristics, the Court held that an inherited IRA is no more than any other inherited account which is intended for "current consumption" rather than retirement savings.

The follow-up question, however, is whether an inherited IRA is protected from creditors in non-bankruptcy situations? Obviously if the case is brought under federal law, the Supreme Court's holding in Clark will apply and permit the plaintiff to reach the inherited IRA. In a state court, however, the answer must be found under state law.

Virginia Code Section 34-34B provides in part "the interest of an individual under a retirement plan shall be exempt from creditor process to the same extent permitted under federal bankruptcy law for such a plan." Since the statute references federal bankruptcy law, which now definitively does not exclude inherited IRAs, it would seem the matter is settled. However, the provision goes on to state "[t]he exemption provided by this section shall be available whether such individual has an interest in the retirement plan as a participant, *beneficiary*, contingent annuitant, alternate payee, or otherwise." (Emphasis added).

The statute has not been amended since the Clark decision was handed down by the Supreme Court, so we really have no answer to the question. So how can you be sure the retirement plan assets you leave to your

children are protected from lawsuits and other creditors (including spouses in a divorce proceeding)? The only way to be sure is to name a trust for the child as beneficiary rather than naming the child as a direct beneficiary. There are many options available, and of course there are tax consequences to be considered, but today this is the only sure way to ensure that the funds will be protected.

As a trust cannot "own" or hold title to an IRA, the only way to ensure the protection afforded by a trust is to name the trust as beneficiary. A stand-alone trust, commonly referred to as a Retirement Preservation Trust, can qualify as a designated beneficiary of IRA proceeds, but it is not necessary to use a stand-alone trust in order to obtain creditor protection. As with everything else within the realm of what we refer to as "estate planning," there is no "one-size-fits-all" plan.

Keeping Your Medical Documents Confidential, Yet Close at Hand

By Helena S. Mock, Esq.

Did you know Virginia residents can safely store their medical documents (health care power of attorney, living will, HIPAA authorization, declaration of anatomical gift form, etc.) so that first responders and medical personnel can quickly and easily obtain necessary information regarding special medical conditions, medications, and personal wishes regarding preferred hospital and/or physician(s) as well as who to call in case of an emergency and who has authority to make health care decisions on your behalf. And the best part – the service is provided free of charge through the Virginia Department of Health. The information is kept safe and confidential through a secure website which is protected by the most up-to-date security software available.

To register, simply go to www.virginiaregistry.org and set up an account. The system will walk you through uploading your personal documents. Once registered, you will receive a personal identification card to carry in your wallet which indicates that your medical documents are on file with the Virginia Advance Health Care Directive Registry.

In addition to the registry, the Virginia Department of Health website provides a link to Microsoft's Healthvault, which provides a secure location to store all of your family's health information and records in one place with easy access. With Healthvault, you can always be prepared for doctors' visits and unexpected emergencies by having the entire family's health records at your fingertips. And yes, there's an app for that!

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from his or her tax advisor based on the taxpayer's particular circumstances.

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