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OFF THE CLOCK

Will Your Kids Blow Your IRA After Your Death?

Contributed by Michele Procino-Wells, Esquire

I see clients on a regular basis whose largest asset is their IRA (or other tax-deferred retirement account), yet they have given very little thought to what will happen to that account after their deaths. They simply put beneficiaries' names on a fill-in-the-blank style designation form and don't give any real thought to how the distribution of the account will actually occur when they pass away.

In general, the receipt of an inheritance is not subject to income tax. The major exception to this rule is retirement accounts because they consist of pre-tax income. After an IRA owner's death, the beneficiaries of the IRA must pay tax as they withdraw funds from the account. Ideally, the beneficiaries will defer paying that tax for as long as possible by postponing withdrawals from the account. Unfortunately, that often doesn't happen.

ALL THESE RISKS CAN BE AVOIDED BY DESIGNATING A CERTAIN TYPE OF TRUST AS THE IRA BENEFICIARY

Under current law, beneficiaries are permitted to "stretch" payments (known as "required minimum distributions" or "RMDs") over their life expectancy. The ability for IRA investments to compound, tax free, over a much longer period of time, makes IRAs one of the most valuable assets when planning for intergenerational transfers of property. For example, a $200,000 IRA, inherited by a 50-year old, could be worth $1.5 million or more over the lifetime of the beneficiary and the beneficiary's children.

This income tax "stretch" can be obtained by naming individuals as beneficiaries of IRAs or by naming a certain type of trust as beneficiary. Unfortunately, naming individuals as beneficiaries, with no safeguards in place to protect the IRA, often creates a host of problems, some of which are detailed below:

- The individual beneficiary may at any time decide to take out more than the RMDs because the beneficiary is unaware of the tax rules and available options, receives bad advice, or the beneficiary (or a person who may influence the beneficiary) wants to spend the money. As a result, significant income taxes are imposed much earlier than required, losing years of tax-free compounding.
- When an IRA is left outright to a primary beneficiary, the original IRA owner loses control of who will eventually inherit the IRA assets after the later death of that beneficiary.
- The IRA beneficiary may have poor money management skills, be a spendthrift, be too young, or suffer from an illness or incapacity which impairs the ability of the beneficiary to manage the IRA funds.
- The IRA is exposed to the beneficiary's spouse in a divorce.
- A disabled beneficiary could lose state and federal government benefits upon outright receipt of IRA funds.

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- Lawsuits filed against the beneficiary or bankruptcy (even if years later) would result in the loss of the IRA funds.

Without exception, all these risks can be avoided by designating a certain type of trust as the IRA beneficiary instead of an individual. When a trust is the beneficiary, the terms of the trust must adhere to certain requirements to obtain maximum "stretch" of the IRA over the lifetimes of the beneficiaries of the trust. A standard revocable trust generally does not meet these requirements. Instead, a separate trust called a "Retirement Account Trust" or a "RAT" is created and named as the IRA beneficiary.

A RAT is specially designed to meet all of the IRS requirements and offers the best of both worlds: it allows beneficiaries to still maximize the "stretch" but also provides protection against all the risks discussed above.

A properly drafted RAT offers unique flexibility after the IRA owner's death, permitting the trustee to adapt to the conditions existing at the time. If the beneficiary's share of the RAT is structured as a "conduit" trust, it will direct that all IRA distributions flow over into the trust and then are immediately distributed out to the beneficiary. In the alternative, for a variety of personal, family and financial reasons, many clients prefer the RAT to be originally established as an "accumulation" trust, where IRA distributions flowing into the trust are distributed to the beneficiary, but only at the discretion of the trustee based on the beneficiary's circumstances at the time.

Retirement Account Trusts offer a smart planning option for individuals with retirement accounts of significant value, especially when they have concerns about how those accounts will be managed after their deaths. Simply stated, the income tax savings and asset protection planning that this type of trust provides can typically save families hundreds of thousands of dollars.

Bella's Brief

The Office from a Dog's Perspective

Not one of you called to inquire about my whereabouts last quarter. I could have wandered off, never to be heard from again, for all you care! But, if you think that is going to make me cower, well, you have another thing coming. The motto I live by: "Don't let the bastards get you down." Anyway, it's hard to do here with the constant excitement and hint of salt in the air. Erin Dukes is expanding again and this time I was more astute in deducing the reason. Baby número tres is on the way! That really makes me think about a siesta, but who has time.

Over in our Lewes office Mindi just returned from a beach vacation with a spring in her step and a ring on her finger. What a surprise to everyone here, except for me, of course. With my Sherlock Holmes insight I tracked a pattern of activity after Meg Gem joined us for Live for Chocolate. That could only mean one thing: a diamond engagement ring. Ahh, young love.

So we are adding to the family again, and I am back to writing; I've missed you.

Cheers,

xoxo Bella

Time Out — Attorney Profile

Michele Procino-Wells, Esquire

Off the Clock: Coming from a family who owned their own successful business in Sussex County, Michele was thrilled to open her own office in Seaford in 2005, which is now known as Procino-Wells & Woodland, LLC. That same year she also married her husband, John, and served as the President of an all-female civic organization, Soroptimist International of Seaford, Delaware, Inc., in which she is still a board member. It's no wonder Michele was later recognized in 2014 as one of Delaware Today's Women in Business.

Michele is a mother of 4 active boys, ranging in ages from eight to nineteen. She spends her free time in a variety of ways. Most recently, it has either been supporting her boys at the pool or taking college tours.

Her fondest childhood memories are from times spent on the water. Now, she shares that tradition with her own family, whether it's in Crisfield, MD or St. John, USVI. In either place, you can find her enjoying a brisk walk outside or a book on the beach.

Upcoming Events

What is on our Calendar?

July 4 — Office Closed; Independence Day

July 6 — Elder Law Workshop II; 12:00 - 1:30 pm, Delaware State University

September 7 — Elder Law Workshop; 5:30 - 7:00 pm, Lewes Public Library

September 13 — Special Needs Planning Workshop; 5:30 - 7:00 pm, Easter Seals; Georgetown, Delaware

September 26 — Elder Law Workshop; 5:30 - 7:00 pm, Seaford Library & Cultural Center

For more information, visit www.pwwlaw.com.

Legal Mumbo Jumbo

Legal Language in Layman's Terms

Beneficiary

The person or entity named to receive assets or profits from an estate, a trust, an insurance policy or any other item in which there can be a distribution.

A note from the attorneys…

This year our team chose one word that we would collectively focus on in our day to day lives. It was a fun exercise that generated a lot of productive conversation about who we are, how we represent ourselves, and what we can do daily to have a positive impact on others. Our word is flourish. Here's the definition: grow or develop in a healthy or vigorous way, especially as the result of a particularly favorable environment. One word is a simple idea with meaningful results. You can learn more about this concept at www.getoneword.com.

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Planning today to protect your family's tomorrow.

OFF THE CLOCK

We would like to thank our featured referrer of the month:

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