KAUFFMAN AND FORMAN, P.A.

406 W. PENNSYLVANIA AVENUE
TOWSON ▪ MARYLAND ▪ 21204
(410) 823-5700 ▪ (410) 296-7349 Fax
www.KauffmanAndForman.com

Inherited IRAs are not protected from creditors

©istockphoto.com

If you're planning to leave an IRA or other retirement account to your heirs, you might want to consider creating a trust to hold the account. That's the upshot of a recent ruling from the U.S. Supreme Court.

That's because IRAs that are inherited from anyone other than a spouse are no longer protected from creditors in a bankruptcy.

Heidi Heffron-Clark and her husband Brandon filed for bankruptcy after their pizza shop failed in 2009. They owed their landlord $74,000, but didn't have enough cash on hand to pay the debt.

Heidi did, however, have $293,000 in an IRA that she inherited from her mother.

In general, IRA funds are exempt from creditors in a bankruptcy. Congress created this rule in order to protect Americans' retirement savings and to prevent elderly people from not having enough to live on.

But the Supreme Court made an exception, and said this rule doesn't apply to *inherited* IRAs – at least if they were inherited from someone other than a spouse. Inherited IRAs are different, the court said, because the owner didn't actually contribute any funds to them, and simply received them as a kind of windfall.

Therefore, Heidi's IRA could be tapped to pay off the landlord.

As a result, if you're planning to leave an IRA to your children or other heirs, and you want to protect the funds in case your heirs rack up business or personal debts or get sued in a lawsuit, you might want to leave the IRA to a trust instead.

A trust might not be absolutely foolproof, but it provides much better protection than simply leaving an IRA to someone directly.

Although the Supreme Court case involved an IRA, the same principle might well apply to other sorts of retirement plans such as 401(k) and 403(b) plans.

page 2
New danger when doing IRA rollovers
Divorced couples need to update beneficiary designations
Maryland is easing its estate taxes in 2015

page 3
Estate planning is still important even if you're not super wealthy

page 4
Inherited IRAs are not protected from creditors

Legal Matters®

Estate Planning
winter 2015

How to help your trustee make good decisions for your family

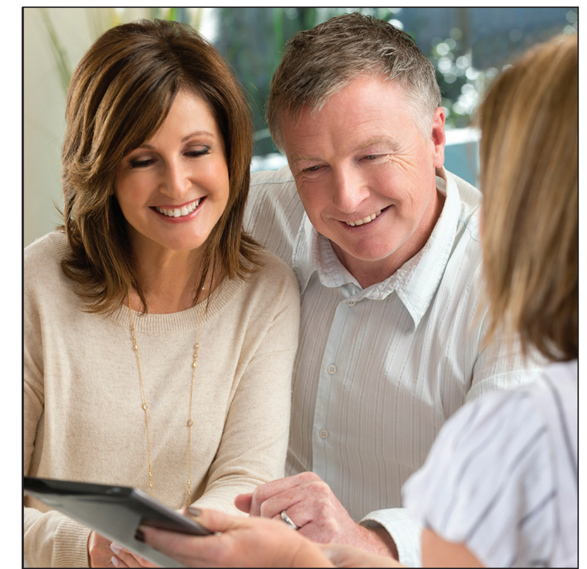
As Yogi Berra supposedly said, "It's hard to make predictions, especially about the future." Yet when you create a trust for your heirs, you have little choice but to make predictions about what their needs will be many years down the road.

Because circumstances change, it's a good idea to make your trust flexible enough to accommodate the unexpected. If you tell your trustee what to do in too much detail, the trust might end up being useless or counter-productive if something unforeseen happens.

That's why most trusts give trustees quite a lot of discretion. For instance, a trust might say that a trustee can make distributions to a spouse to help maintain his or her lifestyle, or to children for their health, education and support. But it's up to the trustee to decide when and in what amounts these distributions should be made.

On the other hand, vague terms like these can sometimes be a problem. For instance, if you're a trustee, how would you handle these dilemmas?

- A surviving spouse wants more funds from the trust to help maintain her lifestyle, but this would deplete the trust assets, and when she dies, there will be very little left for the remainder beneficiary (a child of a previous marriage).
- A college student wants you to pay his tuition bills, since they're for "education." But he also wants you to pay for an "enriching" trip to Europe to travel, take classes, and gain experiences related to his major.
- A child quits her job because she wants to switch careers. She wants you to send her $5,000 a month as "support" until she finds a job in her new field.
- Another child gets married to someone who develops cancer and requires expensive medical care. The child wants you to pay some of the spouse's medical bills. However, the spouse isn't one of the named beneficiaries of the trust.
- Yet another child claims that distributions for "health" should include not only medi-


©istockphoto.com

continued on page 3

KAUFFMAN AND FORMAN, P.A.

ATTORNEYS AND COUNSELORS AT LAW

406 W. PENNSYLVANIA AVENUE
TOWSON ▪ MARYLAND ▪ 21204
(410) 823-5700 ▪ (410) 296-7349 Fax

New danger when doing IRA rollovers

The new IRA problem has a simple solution – but you have to be very careful to handle it properly, or it could result in big tax penalties.

There's now a big danger if you're rolling money over from one IRA into another IRA, as a result of a decision from the U.S. Tax Court.

Under federal law, you can only do one IRA-to-IRA rollover per year. If you try to roll over more than one IRA in a 365-day period, it's considered a distribution, and you'll be subject to significant taxes and penalties.

©istockphoto.com

In the past, the IRS has told taxpayers that this means you can't roll over the *same* IRA within a year. So if you rolled your Fidelity IRA over to Schwab, and you later wanted to roll the same IRA over to Vanguard, you had to wait at least 365 days.

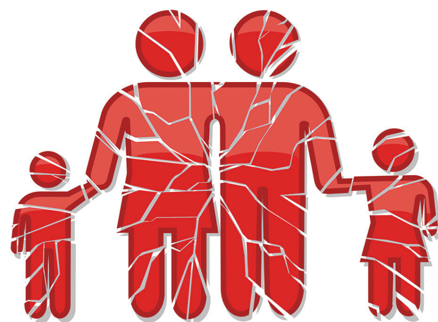
But the Tax Court says this is wrong, and in fact you can't roll over more than one IRA per year even if they're *different* IRAs.

So if you had two IRAs at Fidelity, and you wanted to roll them both over to Schwab, you'd have to roll one over, and then wait a whole year to roll over the second one.

There's an easy solution to this problem: Instead of rolling the funds over (having them made payable to you and then depositing them at the second institution), move them with a direct trustee-to-trustee transfer. As long as the funds move directly to the second institution, and you never touch them, it's not considered a rollover.

But you have to be very careful and make sure that the formalities are followed and the first institution doesn't actually send you any money. Otherwise, it could be a tax nightmare.

Divorced couples need to update beneficiary designations



One wof the most important things people can do after a divorce is to update their beneficiary designations, and indicate who should get the assets in various accounts if they should unexpectedly pass away.

Most married people name their spouse as the beneficiary of their accounts, but in the stress following a divorce, they often forget to update these designations.

And even when people make an effort, they might not remember every account. Pensions, 401(k) plans, life insurance policies, brokerage accounts, bank accounts, and more may all have listed beneficiaries.

Remember that if you die, who gets the money in these accounts usually depends on who is the listed beneficiary – not who is named in your will. Even if your will says that "everything" will go to a new spouse or a child or other relative, the will doesn't govern a separate account such as a 401(k) or an insurance policy.

Of course, even people who haven't been through a divorce should periodically review their beneficiary designations to make sure they're all current, because these designations are an important part of a well-constructed estate plan.

Maryland is easing its estate taxes in 2015

Maryland is reducing its estate tax burden in 2015, which is good news for anyone who lives here.

Maryland is increasing its exemption amount (the amount of assets an estate can have before any tax is due). For 2015, the limit goes from $1 million to $1.5 million.

In addition, the state will gradually raise its limit to the amount of the federal limit by 2019. The federal limit was $5.34 million in 2014, and is $5.43 million in 2015.

Maryland joins seven other states that are reducing their estate taxes this year – Delaware, Hawaii, Minnesota, New York, Rhode Island, Tennessee and Washington.

How to help your trustee make good decisions for your family

continued from page 1

cal care, but also a gym membership, yoga classes, acupuncture, spa treatments, a hiking trip, and a three-day meditation retreat.

You can see the problem: The trustee has become a de facto parent, acting as arbiter of the beneficiaries' needs and lifestyle choices. And the trustee must somehow do this while being "fair" to everyone and not spending so much that the trust runs out of assets.

One way to help with this situation is to give the trustee a lot of discretion in the trust document, but then write a separate "letter of intent" spelling out your hopes, dreams, goals, rules and limits regarding your family. This letter may not be legally binding, but it can be very useful to a trustee in making decisions.

For instance: If the trust will benefit one generation and then another generation, roughly how much money should be left for the second generation? Should the needs of one generation take precedence over the other? Are there circumstances where you'd make an exception – say, if someone develops an expensive illness?

If the trust will benefit several children, is it important to you that all the children ultimately receive a similar amount of the assets? Or can the trustee provide more to a child who has a greater need? And can distributions to children take into account the needs of their own family members?

Do you want your children to have relative comfort in their youth, and to take advantage of the experiences that comfort can provide? Or is it important to you that they earn their own way? And if one child is highly responsible and another is a spendthrift, is it okay for the trustee to treat them differently?

A "letter of intent" doesn't have to be written in legalese, and you can revise it from time to time. Obviously, it can't cover all possible issues – but it can at least give a trustee some clues as to what to do when he or she is asked to fund a new car or a backpacking trip across Italy.

A 'letter of intent' can't tell a trustee what to do in every case, but it can provide important guidance to keep your family on the right track.

Estate planning is still important even if you're not super-wealthy

Recently, Congress dramatically raised the federal estate tax exemption, which for 2015 is $5.43 million (or $10.86 million for a married couple). And that caused some people to mistakenly believe that they no longer need to think about estate planning if their assets are less than $5 or $10 million.

However, nothing could be further from the truth. And people who don't keep their estate plan up-to-date are making a big mistake that could still be very costly to them and their families.

There are a multitude of reasons for this, but here are just a few:

Protecting your heirs. Many of the techniques that people have used in the past to avoid estate taxes – such as trusts – have lots of other purposes in addition to saving taxes.

For instance, leaving assets to someone in a trust can protect them over the long term if they're not good at managing money. Trusts can also shield children from losses in the event they get divorced, face a lawsuit, or start their own business. And if you have children from a former marriage, a trust can be a way to care for your new spouse if something happens to you, while still protecting your children.

Trusts can also protect children and grandchildren if they should ever have a problem with gambling or other addictions, or if they have special needs.

All of these benefits still exist regardless of the level of the federal estate tax exemption.

Family issues. Estate planning has always been about more than just taxes, or even just financial assets. It's about family. What will happen to your family home, or a beloved vacation home? What will happen to a family business? If you have minor children, how will they be taken care of? Who will receive possessions that have sentimental value? Will your children feel that they've been treated fairly, and be encouraged to get along and use their legacy in accordance with your values? All these issues can (and should) be dealt with in a complete estate plan.

We welcome your referrals.

We value all our clients, and we welcome all referrals. If you refer someone to us, we promise to answer their questions and provide them with first-rate, attentive service. And if you've already referred someone to our firm, thank you!

This newsletter is designed to keep you up-to-date with changes in the law. For help with these or any other legal issues, please call our firm today. The information in this newsletter is intended solely for your information. It does not constitute legal advice, and it should not be relied on without a discussion of your specific situation with an attorney.