How to Protect an IRA From Heirs' Creditors

When a person declares bankruptcy, an individual retirement account (IRA) is one of the assets that is beyond the reach of creditors, but what about an IRA that has been inherited? Resolving a conflict between lower courts, the U.S. Supreme Court recently (and unanimously) ruled that funds held in an inherited IRA are *not* exempt from creditors in a bankruptcy proceeding because they are not really retirement funds. *Clark v. Rameker* (U.S., No. 13-299, June 13, 2014).

This ruling has significant estate planning implications for those who intend to leave their IRAs to their children. If the child inherits the IRA and then declares bankruptcy sometime in the future, as a result of the Supreme Court ruling the child's creditors could take the IRA funds.

Fortunately, there is a way to still protect the IRA funds from a child's potential creditors. The way to do this is to leave the IRA not to the child but to a "spendthrift" trust for the child, under which an independent trustee makes decisions as to how the trust funds may be spent for the benefit of the beneficiary. However, the trust cannot be a traditional revocable living trust; it must be a properly drafted IRA trust set up by an attorney who is familiar with the issues specific to inherited IRAs.

The impact of the Supreme Court's ruling may be different in some states, such as Florida, that specifically exempt inherited IRAs from creditor claims. As Florida attorney Joseph S. Karp explains in a recent blog post, Florida's rule protecting inherited IRAs will bump up against federal bankruptcy law, and no one knows yet which set of rules will prevail. While a debtor who lives in Florida could keep a creditor from attaching her inherited IRA, it is unknown whether that debtor would succeed in having her debts discharged in bankruptcy while still retaining an inherited IRA. We will have to wait for the courts to rule on this issue. In the meantime, no matter what state you are in, the safest course if you want to protect a child's IRA from creditors is to leave it to a properly drafted trust.

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5 Questions To Ask Before Making Gifts for Tax Planning or Medicaid

Many seniors consider transferring assets for estate and long-term care planning purposes, or just to help out children and grandchildren. Gifts and transfers to a trust often make a lot of sense. They can save money in taxes and long-term care expenditures, and they can help out family members in need and serve as expressions of love and caring.

But some gifts can cause problems, for both the generous donor and the recipient. Following are a few questions to ask yourself before writing the check:

1. **Why are you making the gift?** Is it simply an expression of love on a birthday or big event, such as a graduation or wedding? Or is it for tax planning or long-term care planning purposes? If the latter, make sure that there's really a benefit to the transfer. If the value of your assets totals less than the estate tax threshold in your state, your estate will pay no tax in any case. For

federal purposes the threshold is $5.34 million (in 2014). Gifts can also cause up to five years of ineligibility for Medicaid, which you may need to help pay long-term care costs.

2. **Are you keeping enough money?** If you’re making small gifts, you might not need to worry about this question. But before making any large gifts, it makes sense to do some budgeting to make sure that you will not run short of funds for your basic needs, activities you enjoy – whether that’s traveling, taking courses or going out to eat – and emergencies such as the need for care for yourself or to assist someone in financial trouble.
3. **Is it really a gift (part one)?** Are you expecting the money to be paid back or for the recipient to perform some task for you? In either case, make sure that the beneficiary of your generosity is on the same page as you. The best way to do this is in writing, with a promissory note in the case of a loan or an agreement if you have an expectation that certain tasks will be performed.
4. **Is it really a gift (part two)?** Another way a gift may not really be a gift is if you expect the recipient to hold the funds for you (or for someone else, such as a disabled child) or to let you live in or use a house that you have transferred. These are gifts with strings attached, at least in theory. But if you don’t use a trust or, in the case of real estate, a life estate, legally there are no strings attached. Your expectations may not pan out if the recipient doesn’t do what you want or runs into circumstances – bankruptcy, a lawsuit, divorce, illness – that no one anticipated. If the idea is to make the gifts with strings attached, it’s best to attach those strings legally through a trust or life estate.
5. **Is the gift good for the recipient?** If the recipient has special needs, the funds could make her ineligible for various public benefits, such as Medicaid, Supplemental

Security Income or subsidized housing. If you make many gifts to the same person, you may help create a dependency that interferes with the recipient learning to stand on his own two feet. If the recipient has issues with drugs or alcohol, he may use the gifted funds to further the habit. You may need to permit the individual to hit bottom in order to learn to live on his own (i.e., don't be an "enabler").

If after you've answered all of these questions, you still want to make a gift, please go ahead. But unless the gift is for a nominal amount, it is advisable to check with your attorney to make sure you are aware of the Medicaid, tax and other possible implications of your generosity.

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How To Make Your Funeral Wishes Known

How can you make sure your funeral and burial wishes will be carried out after you die? It is important to let your family know your desires and to put them in writing. Just don't do it in your will.

To help your family or close friends follow your wishes after you are gone, you can write out detailed funeral preferences as well as the requested disposition of your remains. In addition to explaining where you want your funeral to be held, the document can include information about who should be invited, what you want to wear, who should speak, what music should be played, and who should be pallbearers, among other information. Making these decisions ahead of time can not only let everyone know what your wishes are, it can also help your family members during their time of grief.

It may be tempting to include this information in your will, but a will may not be opened until long after the funeral is over. A will is best used for explaining how to distribute your property, not for funeral instructions. You can write your funeral and burial directions in a separate document or you may be able to put your wishes in your health care directive. Whatever you do, make sure your family knows where to find the information.

If you don't make your wishes known, the responsibility for determining your funeral and burial rests with your loved ones. If you are married, your spouse is usually in charge of making the decisions. If you are not married, the responsibility will likely go to your children, parents, or next of kin. Disputes could arise between family members over what you would have wanted.

It is possible to make funeral arrangements ahead of time with a funeral home. However, be wary of pre-paid funeral plans. Consumers can lose money when pre-need funeral funds are misspent or misappropriated. A funeral provider could mishandle, mismanage or embezzle the funds. Some go out of business before the need for the pre-paid funeral arises. Others sell policies that are virtually worthless. For more on the dangers of pre-paid plans, click here.

For help with making your funeral wishes known, talk to your attorney.

Dangers of Creating A Will Without Legal Assistance

People sometimes try to save money by not consulting with a qualified attorney when executing their will, instead using a pre-printed form or online program. A recent court case offers yet another example of the hazards of doing this. Deciding the long-running case, the Florida Supreme Court has ruled that money acquired by a woman after she used a form to execute a will should be distributed as if she had never made a will at all. A justice hearing the case called it "a cautionary tale of the potential dangers of . . . drafting a will without legal assistance." *Aldrich v. Basile* (Fla., No. SC11-2147, March 27, 2014)

Ann Aldrich wrote her will on an "E-Z Legal Form." She listed several possessions and bank accounts that she intended to go to her sister unless her sister died before her, in which case they were to go to her brother. Ms. Aldrich's sister did indeed die before her, and Ms. Aldrich inherited additional money and property from the sister. However, Ms. Aldrich did not have a "residuary clause" in the original will and she never revised the will to account for this new property.

After Ms. Aldrich herself died, the court had to determine who would inherit the property Ms. Aldrich received after she wrote the will. Her brother argued that he was entitled to all her property, but Ms. Aldrich's nieces (the daughters of a second brother who had died) maintained that the property should pass through intestacy – according to state law for those who have no will. The case wound its way through the courts. A trial court ruled for Mr. Aldrich, but an appeals court reversed that ruling, and Mr. Aldrich appealed.

The Florida Supreme Court has determined that although the will made it clear that the property listed was to go to Ms. Aldrich's living brother, the will did not say anything about property acquired after the will was written. Because the will had no residuary clause or general bequests that could include the inherited property, the court held that the after-acquired property will have to pass under Florida's laws of intestacy.

A concurring judge noted that the case was "a cautionary tale of the potential dangers of utilizing pre-printed forms and drafting a will without legal assistance."

The irony is that using a boilerplate will form not only frustrated Ms. Aldrich's testamentary intent, but ultimately cost her estate far, far more than a simple consultation with an estate planning or elder law attorney would have.

To read the court's decision in the case, click here.

For Consumer Reports' conclusions on do-it-yourself wills, click here.

For an ElderLawAnswers White Paper on letting a computer plan your estate, click here.

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Redo Your Estate Plan Before You Remarry

If you are getting remarried, you obviously want to celebrate, but it is also important to focus on less exciting matters like redoing your estate plan. You may have created an estate plan during your first marriage, but this time it will probably be more complicated—especially if you have children from your first marriage or more assets. The following are some pointers for ensuring your interests are taken care of when you remarry:

- **Take an inventory**. The first thing you and your partner should do is each take an inventory of your assets and debts and share it with the other person. Don't forget to include life insurance policies and retirement plans in your inventories. It is important to be open and honest about money if you want to prevent bad feelings in the future.
- **Decide how you want to handle finances**. Once you know what you are dealing with, then you need to decide if you want to combine (or not combine) assets when you are married. For example, if one partner is selling a house and moving in with the other partner, will he or she contribute to the cost of the house? If one partner has significant debt, you may not want to combine finances or make any joint purchases. These decisions need to be made upfront so everyone is clear on what to expect.
- **Decide what you want to happen when you die**. You and your future spouse need to figure out where each of you wants your assets to go when you die. If you have children from a previous marriage, this can be a complicated discussion. There is no guarantee that if you leave your assets to your new spouse, he or she will

provide for your children after you are gone. There are a number of options to ensure your children are provided for, including creating a trust for your children, making your children beneficiaries of life insurance policies, or giving your children joint ownership of property. Even if you don't have children, there may be family heirlooms or mementos that you want to keep in your family. Again, open discussions can prevent problems in the future.

- **Consult an elder law or estate planning attorney**. Even if you don't have a lot of assets, you should consult an attorney, especially if you have children. You will definitely need to update your will. You may also need to update or create other estate planning documents such as a durable power of attorney and a health care proxy. If you have significant assets, a prenuptial agreement may be appropriate. In addition, the attorney can help you decide if a trust is necessary to protect your children's interests.
- **Change your beneficiaries**. You may want to change the beneficiaries on your life insurance policy, annuity, and/or retirement plan. If you are divorced, however, you may not be able to change some of the beneficiaries. Bring your divorce decree with you to the attorney so he or she can make sure you do not violate the decree. If you can't change your beneficiaries, you may want to buy additional life insurance or retirement plans that will include your new spouse.
- **Consider a prenuptial agreement**. While you are intending to stay married, things happen. Unlike a first marriage, you may be bringing property to this marriage that you spent decades accumulating and you may be merging two families. You need to decide together what your intentions are for the use of funds while you are living together, if you get divorced and when one of you dies

before the other. Failure to think and plan ahead can mean severe heartache and financial costs for you and your family.

- **Consider purchasing long-term care insurance.** The physical, emotional and financial cost of long-term care can deplete the savings of all but the most wealthy. While you may be willing to spend your lifetime of savings on the care of a spouse with whom you raised a family and accumulated the funds, you may not want to lose this to the care of a relatively new spouse. Long-term care insurance, while expensive, can permit you and your new spouse to get the care you need without impoverishing the other.

The most important thing to remember is to be open and honest with your future spouse and your family members about your wishes.

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