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Upcoming Seminars:

WHEN:

Wednesday,
August 28, 2013
at 7:00 pm

WHERE:

Shoreline Library

WHEN:

Saturday,
September 21, 2013
at 10:30 am

WHERE:

Kirkland Library

PLANNING WITH PURPOSE, INC THE LAW OFFICE OF PAUL H. GRANT

Volume II, Issue 2

August 2013

IRA Creditor Protections - They May Surprise You

BY: PAUL H. GRANT, JD LL.M

The basic rule for IRAs and other retirement funds is that they are creditor protected. This protection is extended by Federal and State law. Washington law states that any "right of a person to a pension, annuity, or retirement allowance" is "exempt from execution, attachment, garnishment, or seizure by or under any legal process whatever." This means that as long as the IRA is not distributed the principal remains creditor protected. There are exceptions for child support and other social obligations, and if you make a MRD or other distribution, then those can also be attached. Also, Federal law only exempts up to one million dollars. But, for the most part, leaving your money in an IRA creates a protected asset.

Many advisors tout these protections as an IRA benefit in

addition to the traditional thoughts of tax deferment and compounded growth. However, what happens when the owner of an IRA dies?

IRAs have beneficiary designations to pass the remaining funds to whoever is named; typically a spouse, children, or other loved ones. The beneficiary can receive those funds in one of three ways: outright (and pay taxes!); a stretch-out (continues the fund as a retirement account), or through a qualified trust.

Once in the hands of a beneficiary, the question is "Do the creditor protections continue?" Most individuals say a resounding "Of course!" Well, let's take a look at some recent developments and trends in the law. Recently, the Seventh Cir-

cuit Court of Appeals ruled that an inherited IRA is *not* exempt from bankruptcy (Rameker v. Clark). In this case Mrs. Clark inherited her mother's IRA worth approximately \$300,000. Ten years later she filed for bankruptcy and claimed the inherited IRA was exempt (using Federal law to say it was creditor protected). The Wisconsin bankruptcy court disagreed. The Seventh Circuit Court Of Appeals upheld that decision making her IRA available to pay her creditors.

Other jurisdictions have ruled the opposite, that an inherited IRA is protected. So how do we prepare?

The first key issue to remember is that Washington law is not always used, it depends on where the beneficiary lives. If

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LEGAL TECHNICAL

A "power of appointment" is a right given to someone to make choices about your property after you are deceased. It is most commonly utilized in trusts and the power is given to a remaining spouse or another trusted relationship. For example, in a typical credit shelter trust, the deceased Trustmaker's assets are split from a remaining spouse. Let's call the deceased Trustmaker Bob (sorry to all the Bobs out there) and his wife Sherry. In our example, Bob has died. All of Bob's community property and individual property would be entitled to be protected in a credit shelter trust (amazing benefits, review past Newsletters). However, what if after Bob dies, Sherry determines (for reasons that we must accept are reasonable and we would also make the same choice) that one of her children's share needs to be adjusted. Sherry can make that choice over her property by simply amending her trust, but Bob's credit shelter trust is irrevocable after his death. Enter the power of appointment. If Bob gave permission to Sherry through the power of appointment, Sherry in her will (not her trust,) can adjust Bob's share to the same child. Now the consistency is in both Bob's plan and Sherry's even though Bob is no longer

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they live in a state under the Seventh Circuit's jurisdiction, then a beneficiary will not have creditor protections. Or, for example, in California, IRAs are only protected to the amount a court determines is "necessary" for the IRA owner and their dependent family. Or in Minnesota only up to \$60,000 is protected. Still others do not protect what was contributed in the past year, and the list goes on. In addition, with the introduction of states making adverse rulings that IRAs are not creditor protected for beneficiaries, the trend will be for other courts to follow. The point is that it is impossible to predict the moving landscape of IRA protections for your beneficiaries.

Another consideration is that IRA funds are not always protected in a divorce and definitely not for child or matrimony support. How about a failed business? What if a beneficiary needs life-saving medical treatment? These and many other concerns can be protected against.

Leaving an IRA with a beneficiary designation may have unforeseen consequences and may not be as protected as believed. The simple belief that IRAs are creditor protected is a general statement that has gaping holes.

However, the good news is that there are solutions to bridge the gap between IRA laws and creditor protections. A qualified trust or a Stand-Alone IRA trust is the solution.

A typical conversation with many advisors when discussing IRA beneficiaries is wrapped around two predominant topics: first, passing the IRA without encountering a tax, and second, not leaving it in a trust. However, a deeper look at the right type of trust resolves both tax consequences and protection issues.

Basic IRA rules allow an unlimited roll-over to a remaining spouse, but anyone else must be a "qualified beneficiary" in accordance with IRS regulations. As a general rule, a trust cannot qualify, and that's why most advisors insist on not listing a trust as a beneficiary. However, a "qualified trust" can meet the necessary IRS rules to be counted as a qualified beneficiary. When a trust meets those qualifications, then the stretch-out option can be retained, thereby not encountering the higher trust tax rates. In addition, a trust can add necessary creditor protections and create predictability for beneficiaries regardless of the courts.

IRAs constitute more than 25% of all retirees' wealth in America, and that number continues to grow. With proper planning, an IRA can be protected for your beneficiaries **and** meet IRS qualified beneficiary status. You do not need to settle for just one. But the proper trust and discussion of your estate planning goals must be evaluated so a valid design can be strategically instituted.

Power of Appointment - continued

alive! Washington requires that the power of appointment is exercised in a will and the power must be specifically mentioned. This is a very powerful option to assist Bob's intent and desires to be carried out after he has passed away. Since no one can see what changes our children and heirs may go through after we are deceased, leaving specific powers of appointment may assist in protecting them and fulfilling our goals to create an estate plan that works as we intended. However, great caution must be taken to ensure that the proper power is given, otherwise unfortunate tax consequences may be at stake. Make sure your plan has this powerful tool to protect your heirs and bring consistency to your plan. You can request a complimentary review of your current plan by mentioning this article!

PWP Legacy and Maintenance Program

Be sure to mark your calendars for the first Successor Trustee Training Program on Saturday, September 28, 2013 starting at 8:30am. More details will be mailed to you soon!

REMINDER: Have you experienced any personal or family changes that could influence your plan? Be sure to keep us informed - there is NEVER a charge for a phone call, so give us a call so we can keep your plan at it optimal level of service.
