MARCH 2016

CURRENT ISSUES IN THE AREAS OF ESTATE, TAX AND PERSONAL AND BUSINESS PLANNING

The information that follows summarizes some of the current issues in the areas of estate, tax and personal and business planning which may be of interest to you. Although this information is accurate and authoritative, it is general in nature and not intended to constitute specific professional advice. For professional advice or more specific information, please contact my office.

IRS Allows Spousal Rollover For Trust. A 60-day rollover requirement exists for a spouse of an IRA participant to rollover the IRA proceeds received by the spouse following the death of the IRA participant. In Private Letter Ruling (PLR) 201606032, the IRS waived the failure to meet the 60-day limit due to emotional distress even though the proceeds were initially to be received by a trust. In general, a tax free rollover by a spouse requires that the amount received be recontributed to a spousal IRA or another eligible retirement plan within 60 days after the taxpayer receives the IRA withdrawal. A rollover which occurs after the 60-day limit is generally taxable and also may be subject to a ten percent premature withdrawal penalty. The IRS considers several factors in determining whether to waive the 60-day requirement, which include events beyond the taxpayer's control or when failing to waive the 60-day rule would be contrary to equity or good conscience (sometimes referred to as a hardship waiver). In this case the taxpayer was the trustee of a trust that was the sole beneficiary of the IRA, and as the trustee and beneficiary, the taxpayer had full authority under governing law to distribute the assets of the IRA to herself. In this case the lump sum payment was paid to the estate of the deceased husband, and more than 60 days later, the amount was transferred to the taxpayer-spouse's IRA. If the proceeds of an IRA are paid to the trustee of the trust who then pays the assets to the surviving spouse as beneficiary of the trust, the surviving spouse may be treated as having received the IRA proceeds from the trust and not from the decedent and may not be eligible for the rollover. However, the IRS determined in this case that this rule should not apply in the circumstances of the present ruling because the surviving spouse was the sole trustee of the trust and had sole authority under the trust to pay the proceeds to herself. The IRS found that the information and documentation submitted were consistent with the taxpayer's argument that the failure to accomplish the rollover into her own IRA was due to emotional distress. The IRA allowed the late rollover even though it involved a payment that would have been made to a trust. The IRA has been relatively lenient in granting special exceptions in the case of a trust when it is relatively clear that the spouse was the trustee and had sole control over the trust as well as the right to distribute the IRA proceeds to himself or herself.

What Is A "Spendthrift" Trust? Trusts have been referred to as the Holy Grail of planning for asset protection. They have been used since the feudal era. Virtually every trust includes a spendthrift clause, which generally prohibits a trust beneficiary from transferring or otherwise alienating his or her interest in the trust, particularly for the benefit of creditors. States universally give a degree of asset protection to a so-called "spendthrift" trust, which is a trust which includes spendthrift provisions. Although many clauses are broad, it is generally a good idea in the case of a special needs trust that is specifically intended to preserve eligibility for public benefits to provide that the trust assets cannot be used in any way which would adversely affect government assistance (or to provide that any such use must be specifically contemplated and determined to be more important than protecting the particular income or principal that was being distributed). Many people establish a revocable trust, but a revocable trust does not protect assets and is only useful for probate avoidance. However, assets in the revocable trust can fund an irrevocable trust for the benefit of a beneficiary followed by the trust creator's death, which includes appropriate spendthrift and other protective provisions. Such a trust would be protected against claims by general creditors of the beneficiary. If a person establishes an irrevocable trust for himself or herself (sometimes referred to as a "self-settled" trust), the assets in the trust would only be protected to the extent that the grantor does not retain an interest. For example, if the creator retained an interest in only the income (which would be referred to as an "income-only" trust), then only the principal would be protected. An "irrevocable income-only" trust ("IIOT") is a frequently used device specifically designed to protect assets transferred by the creator of the trust, particularly if the creator or the creator's spouse may later require long term care. I have written literally thousands of IIOTs and have been through the entire gamut of the trust creation and settlement process, including dealing with Medicaid issues, and have found IIOTs to be virtually 100 percent effective as an asset protection vehicle.

Another Beneficiary Designation Issue. Numerous items have been written in this Newsletter regarding the issue of beneficiary designations. The principal reason for frequently including such comments is the fact that many, and perhaps most, beneficiary designations are completed incorrectly. A very common problem is to designate a group of persons as primary beneficiaries, such as "my children equally." Rarely does the beneficiary designation specify what happens if one of the children should predecease the IRA participant or life insurance policy holder. Many people assume that, by signing a contingent beneficiary designation, they have addressed that issue. However, naming a class of beneficiaries will generally result in the surviving members of that class receiving all of the proceeds so that the contingent beneficiary designation does not come into play. It is extremely important to be sure that your beneficiary designations are written correctly, particularly in the case of an IRA, because of the tax consequences involved. Also, it is a good idea to anticipate the fact that there could be younger beneficiaries, and to include, perhaps, a custodial provision under a Uniform Transfers or Gifts to Minors Act in the case of a beneficiary under 21 years of age. If a trust has been established for a beneficiary, and the beneficiary's trust will receive the proceeds until the beneficiary attains a certain age, it is also very important for the trust to be written properly in order to avoid unanticipated tax consequences, particularly in the case of an IRA distribution. It cannot be stressed too much or too frequently that beneficiary designations are extremely important and that most beneficiary designations are not completed correctly.

Additional Information. Future issues of this Newsletter will address other issues of current interest. Please contact my office with any questions that you might have.