

# USING TRUSTS FOR INHERITED IRAs



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# Biographical Information

**Anna Katherine Moody** graduated from the University of Georgia, Henry W. Grady College of Journalism and Mass Communications, with an A.B.J. in Public Relations in 2006, and received her J.D. from Washington and Lee University School of Law in 2011. She was admitted to the Maryland Bar in December of 2011.

Ms. Moody currently serves on the MSBA Estate and Trust Section Council, having been elected to a two-year term from 2014-2016, and is a member of the Maryland State Bar Association, the Anne Arundel County Bar Association, and the National Academy of Elder Law Attorneys. She has published articles on various estate planning topics in the MSBA Estate and Trust Newsletter and the Anne Arundel County Barrister.

**Frederick R. Franke, Jr.** received his A.B. from Kenyon College in 1969; his J.D. from Washington and Lee University in 1973; his L.L.M. (Taxation) from George Washington University in 1983. He was admitted to the Maryland Bar in 1974 and has practiced in Annapolis since 1976.

Mr. Franke is past-chair of the Council of the Estates and Trusts Law Section of the Maryland Bar Association. He is a Fellow of the American College of Trust and Estate Counsel and has served as an Adjunct Professor of Law at the University of Baltimore, School of Law. He has been, and is included in THE BEST LAWYERS IN AMERICA (Trusts and Estates) consistently since 2001, listed in the MARYLAND SUPER LAWYERS (Estate Planning and Probate) consistently since 2007 being named "Top 50" or "Top 100" lawyers statewide for the last four years, and named the Top Annapolis estate and trust lawyer by WHAT'SUP ANNAPOLIS in a survey of Anne Arundel County lawyers since 2009. He has received an AV rating from Martindale-Hubbell for over 20 years. The law firm has been listed as a Tier 1 Estates and Trusts firm by US News since 2011. He is a member of various local and national bar associations.

He has published articles on tax and other topics related to his professional interests, including: *"Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract,"* ACTEC JOURNAL, Winter 2010; *"Asset Protection and Tenancy by the Entirety,"* ACTEC JOURNAL, Spring 2009; *"Perfect Ambiguity: The Role of the Attorney in Maryland Guardianships,"* MARYLAND JOURNAL OF CONTEMPORARY LEGAL ISSUES, 1996.

Mr. Franke also has participated, as a lecturer, in various continuing education programs for lawyers, including: *"Maryland Trust Act,"* (MSBA 2014); *"Heirs, Legatees and Related Issues,"* (Judicial Institute of Maryland 2013); *"Asset Protection, An Overview for Maryland Estate and Trust Lawyers,"* (MSBA 2013); *"A Beneficiary's Right to Information,"* (MSBA 2012); *"Trust Litigation: The Enforcement of Beneficiary Rights,"* (MSBA 2011); *"Asset Protection: An Overview for Maryland Estate and Trust Lawyers,"* (MSBA 2010); *"Back to the Future, Schoukroun and the Spousal Election,"* Hot Topics in Elder Law, (MICPEL 2009); *"A Match Made In Heaven – Using Tenancy by the Entirety for Creditor Protection Without Sacrificing Estate Planning,"* (MSBA 2009); *"Asset Protection – A Guide for Maryland Estate and Trust Lawyers,"* (MICPEL Advance Estate Planning Institute 2006); *"Revocable Inter Vivos Trusts,"* (MICPEL 2004 and 2006); *"Valuation Discounting,"* (MICPEL 2003; MSBA 2002 and 2003); *"Business Valuation,"* (MICPEL 1998); *"Family Partnerships,"* (MICPEL 1996); *"Avoiding Probate - Will Substitutes,"* 1996; *"Basic Estate Planning,"* (MICPEL 1993).

# OVERVIEW



- Impact of recent US Supreme Court case: *Clark v. Rameker* (134 S.Ct. 2242 (2014))
- Structuring trusts to “Save the Stretch”
- Storm clouds on the horizon for Inherited IRAs?



Impact of recent US Supreme Court  
case: *Clark v. Rameker*  
(134 S.Ct. 2242 (2014))

# Background: Federal Bankruptcy Code §522



- §522 exempts certain assets from inclusion in the bankruptcy estate.
- Pre-2005: Exempts “a payment under a stock bonus, pension, profit-sharing, annuity or similar plan or contract on account of illness, disability, death, age or length of service.” §522(d)(10)(E).

# Background: Federal Bankruptcy Code §522



- **Post-2005: Specific exemption for Traditional and Roth IRAs added in §522(b)(3)(C).**
  - “retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.”
- **Caps exempt amount at \$1,000,000 (indexed). §522(n).**
  - April 2013: \$1,245,475.
  - Cap does not include amounts rolled over from other qualified plans.

# Background: State Exemption Statutes



- States have the option to “opt-out” of the federal exemption statute.
  - Debtors in these states must use the state specific exemption statute.
  - Most states have opted out (Maryland included).
  - Some states statutes specifically exempt Inherited IRAs.
    - ✦ Texas, Florida, Ohio, Arizona, Missouri, Alaska, North Carolina
- Debtors in states that have not opted out may choose either the federal or state exemption statute.

# Background: Maryland Statute



- Md. Code Ann., Cts. & Jud. Proc. § 11-504(g) = a debtor is not entitled to federal exemptions.
- Md. Code Ann., Cts. & Jud. Proc. § 11-504(h)(1) = exempts “any money or other assets payable to a participant or beneficiary from, or any interest of any participant or beneficiary in, a retirement plan qualified under . . . § § 408, 408A.”



# Background: Case Law on Inherited IRAs – State



- The general trend on the interpretation of state exemption statutes is to deny the exemption of an inherited IRA.
  - California, Illinois, Indiana, Wisconsin, Alabama, Oklahoma.
- Courts have exempted inherited IRAs in two notable cases:
  - *In re McClelland*, 2008 WL 89902 (Bankr. D. Idaho 2008).
  - *In re Theim*, 443 B.R. 832 (D. Ariz. 2011). Arizona statute exempts any “assets payable to a participant in or beneficiary of, or any interest of any participant or beneficiary in, a retirement plan under . . . § § 408, 408A.”

# Background: Case Law on Inherited IRAs – Federal



- Unlike trend of cases interpreting state statutes, Federal Bankruptcy Code § 522 has traditionally been interpreted to exempt Inherited IRAs:
  - *In re Nessa*, 426 B.R. 312 (8<sup>th</sup> Cir. BAP 2010);
  - *In re Tabor*, 105 A.F.T.R.2d 2010-2964 (Bankr. M.D. Pa. 2010);
  - *In re Wielhammer*, 2010 WL 3431465 (Bankr. S.D. Cal. 2010);
  - *In re Chilton*, 674 F.3d 486 (5<sup>th</sup> Cir. 2012).

# Clark v. Rameker: History



- Heidi Heffron-Clark and her husband filed for bankruptcy in 2010. Is the inherited IRA Ms. Heffron-Clark received at her mother's death included in bankruptcy estate?
  - Bankruptcy Court says yes (not exempt). 450 B.R. 858 (Bankr. W.D. Wis. 2011)
  - Federal District Court says no (exempt) -- reverses and remands. 466 B.R. 135 (W.D. Wis. 2012)
  - Seventh Circuit says yes (not exempt) -- reverses. 714 F.3d 559 (7<sup>th</sup> Cir. 2013).
    - ✦ Easterbrook opinion acknowledges decision is in conflict with *In re Chilton* (5<sup>th</sup> Circuit case).

# *Clark v. Rameker*: Opinion



- Unanimous; Authored by Justice Sotomayor.
- To fall under §522 exemption, asset must be:
  - 1. A “retirement fund”; and
  - 2. Created under certain Internal Revenue Code sections, as enumerated in §522.
- “Retirement fund” = sums of money set aside for the day an individual stops working.

# Clark v. Rameker: Opinion



	Traditional/Roth IRAs	Inherited IRAs
Additions to Account	→ Tax incentives for owner to make additions to account.	→ Beneficiary may never make additions to account.
Required Withdrawals	→ Traditional IRA: Mandatory withdrawals begin at 70 1/2. → Roth IRA: No mandatory withdrawals.	→ Mandatory withdrawals generally begin 1 year from owner's death.
Allowable Withdrawals	→ 10% penalty on any amounts withdrawn before owner is 59 1/2.	→ Beneficiary may withdraw 100% at any time without incurring penalty.

# *Clark v. Rameker*: Holding



**Inherited IRAs are not  
“retirement funds” under  
federal bankruptcy code §522.**

Planning consideration: Leave retirement funds to beneficiaries in spendthrift trusts!



# Structuring Trusts to “SAVE THE STRETCH”

# Planning Basics: Designated Beneficiaries



- **Designated Beneficiary (DB):**
  - Spouse
  - Non-spouse individual
  - See-through trust
  
- **Non-Designated Beneficiary**
  - Estate
  - Non-see-through trust
  - Charity/organization/other non-individual



# Planning Basics: Required Distributions



- For DBs, generally required minimum distributions (RMDs) must start year after owner's death.
  - Spousal inherited IRAs (NOT spousal rollovers): generally RMDs are based on spouse's life expectancy, recalculated annually.
  - Non-spouse individual: generally RMDs are based on individual's life expectancy, but fixed term.
  - See-through trusts: generally RMDs are based on oldest beneficiary's life expectancy.
- For Non-DBs, 100% of account must be paid out 5 years from owner's death.

# Planning Basics: Single Life Table



## Single Lifetime Table

For use by beneficiaries.

Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
0	82.4	32	51.4	64	21.8
1	81.6	33	50.4	65	21.0
2	80.6	34	49.4	66	20.2
3	79.7	35	48.5	67	19.4
4	78.7	36	47.5	68	18.6
5	77.7	37	46.5	69	17.8
6	76.7	38	45.6	70	17.0
7	75.8	39	44.6	71	16.3
8	74.8	40	43.6	72	15.5
9	73.8	41	42.7	73	14.8
10	72.8	42	41.7	74	14.1
11	71.8	43	40.7	75	13.4
12	70.8	44	39.8	76	12.7
13	69.9	45	38.8	77	12.1
14	68.9	46	37.9	78	11.4
15	67.9	47	37.0	79	10.8
16	66.9	48	36.0	80	10.2
17	66.0	49	35.1	81	9.7
18	65.0	50	34.2	82	9.1
19	64.0	51	33.3	83	8.6
20	63.0	52	32.3	84	8.1
21	62.1	53	31.4	85	7.6
22	61.1	54	30.5	86	7.1
23	60.1	55	29.6	87	6.7
24	59.1	56	28.7	88	6.3
25	58.2	57	27.9	89	5.9
26	57.2	58	27.0	90	5.5
27	56.2	59	26.1	91	5.2
28	55.3	60	25.2	92	4.9
29	54.3	61	24.4	93	4.6
30	53.3	62	23.5	94	4.3
31	52.4	63	22.7	95	4.1

For ages not listed in this table, see IRS Pub. 590 for the complete table. See *Required Minimum Distribution (RMD)*, 13.21.

# Planning Basics: See-Through Trusts



- **Requirements:**
  - Valid under state law; Irrevocable; and Beneficiaries are individuals and are identifiable.
  
- **Conduit Trusts vs. Accumulation Trusts:**
  - **Conduit:**
    - ✦ All distributions from account must be paid outright to beneficiaries.
    - ✦ Allows for Non-DBs to be remaindermen.
  - **Accumulation:**
    - ✦ Distributions accumulate in trust.
    - ✦ Non-DBs (including unidentifiable individuals) will disqualify trust from accumulating.

# Conduit Trust: Drafting



Unless a contrary intent appears in the appropriate beneficiary designation form, if any trust to which any qualified employee benefit plans, individual retirement accounts, or other property from sources specified in Section 2039 of the Internal Revenue Code (collectively referred to as the “Accounts”) are payable is held primarily for a child or remote descendant of mine, I direct that trust be administered as a "Conduit Trust" for that person, as permitted under applicable IRS guidance. To this end, the Trustee of that beneficiary's trust must distribute to that beneficiary, immediately upon receipt, all amounts paid to that trust from the Accounts, net of expenses directly attributable to that trust or Account, even if that distribution is in excess of the trust's fiduciary accounting income. Although I prefer that the assets in the Accounts remain intact for the longest period allowed by law so as to permit the beneficiary to receive them under the minimum distribution rules, the Trustee may withdraw additional assets from the Accounts as needed for the beneficiary's support, as may be specified in the beneficiary's trust, provided those assets are then distributed to, or used for the benefit of, that beneficiary.

# Accumulation Trust: Drafting



I wish to allow the maximum deferral of distributions from the Accounts. Therefore, unless a contrary intent appears in the appropriate beneficiary designation form, I intend and direct a trust for the benefit of one of my descendants, to which one or more of the Accounts are payable, qualify as an accumulation trust and its beneficiaries be treated as "designated beneficiaries" within the meaning of the minimum distribution rules under Section 401(a)(9) of the Internal Revenue Code and applicable regulations.

**Restrictions on Accounts.** No portion of the Accounts payable to such Trust may be used, paid, or appointed in such a way as to disqualify the trust beneficiaries as designated beneficiaries. By way of example and not in limitation:

- No portion of the Accounts may be used to pay, directly or indirectly, any debts or expenses of mine or of my estate, including any share of estate taxes payable from this Will or chargeable to my estate.
- No portion of the Accounts may be used to satisfy a gift to a beneficiary other than a qualified recipient.
- Upon the death of the beneficiary whose measuring life was used for calculating minimum required distributions after my death, further payments from the Accounts (including payments pursuant to the exercise of a power of appointment) may be made only to qualified recipients who are younger than that beneficiary, despite any other provision of this Will.

# Beneficiary Designations



- 100% to the Trustee of the Jane Doe Trust, created under the John Doe Living Trust dated 2/19/15.
- 100% to the Trustee of the Jane Doe Trust, created under the will of John Doe.
  
- Common issues:
  - No Tax ID number for trust until participant's death.
  - Identity of trustee unknown until participant's death.
  - Date of last will & testament unknown until participant's death.



# Storm Clouds on the Horizon for Inherited IRAs?

# Revenue Proposal



- Revenue proposal issued at the end of 2014 suggests that “stretch” inherited IRAs may be a thing of the past.
- Proposal would require all inherited IRAs to be completely paid out within 5 years of participant’s death.
  - Exceptions: Chronically Ill, Disabled, Beneficiaries less than 10 years younger than participant.
  - Exception: Minor children; however, account would be paid out within 5 years of reaching age of majority.