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IRA Disbursements Post-Mortem; Trusts Can Verify

The ins-and-outs of inherited IRAs.

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As with many silver linings, good fortunes often come with a cloud. The cloud in this case arose with an early June 2014 decision by the US Supreme Court stating that inherited IRAs are not considered “retirement funds” for the recipient with typical creditor protection and, therefore, are not eligible for exemption under federal bankruptcy regulations.

So, if your will designates a financially troubled relative as the beneficiary of your unspent IRA, that individual might find the fund suddenly used to satisfy creditors.

The court reviewed a case in which a couple petitioning for bankruptcy under Chapter 7 wanted the proceeds of an inherited IRA declared exempt, meaning they could not be forced to use it to pay creditors. The court ruled against the couple, asserting that the funds in the IRA are to be treated as any other inherited asset.

But, as with any cloud, there also is a silver lining for inherited IRAs. This Supreme Court ruling could motivate people to think about innovative ways to protect their assets and secure the distribution to their heirs as originally intended.

For instance, the IRA could be passed on to a beneficiary in the form of a properly-established trust that will designate how the funds in the IRA will be distributed, while also helping the beneficiaries avoid some income taxes that could eat into their net worth. Of course, a competent accountant, attorney or similar professional advisor should be consulted.

Perhaps you have beneficiaries who are experiencing financial difficulties. Or, in the case of a second marriage, perhaps you want to ensure that the children from the first marriage receive the money you intended for them. If multiple beneficiaries are involved, it could be advisable to set up different trusts for, say, each grandchild, designating the money to be taken out for health and/or education or even distributed over the heir's lifetime.

As with any trust, you will need a trustee for oversight – someone you designate, such as a capable family member, attorney, an accountant or a financial institution.

For many workers, the IRA is their major asset outside the home. Ensuring that it provides sufficient funds to not only accommodate the needs of a retirement lifestyle, but is sufficient to benefit your heirs as well, is of paramount importance.

There may yet be dark clouds on the horizon. It is possible, perhaps even likely, that Congress will further alter the rules regarding inherited IRAs – making it even more important to stay abreast of changes that could significantly affect your financial fortunes and those of your future beneficiaries. It will require extra vigilance to ensure that your money works as you intended and goes where you intended.

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