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Legal Matters®

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What you need to know about required distributions from your IRA or 401(k)

The oldest of America's 75 million baby boomers are turning 70 this year. That means the IRS will soon be requiring them to start cashing out their tax-deferred retirement savings accounts. How you handle these withdrawals can have a profound effect on your own retirement and on what you leave to your heirs.

As a general rule, if you don't need the money in these accounts to live on, it can be wise to keep as much as possible in them, rather than withdrawing it. This can reduce your income taxes, plus there can be significant tax advantages in leaving money to your heirs in a tax-sheltered account rather than giving it to them outright.

Here's a look at the rules: Once you turn age 70½, the IRS requires you to take "required minimum distributions," or RMDs, from your IRA and 401(k) accounts. You'll also have to pay income tax on these withdrawals.

If you don't take these distributions, you can be hit with a 50% penalty on whatever amount you were required to withdraw but didn't.

The exact amount that must be withdrawn is based on an IRS worksheet. The worksheets are available on the IRS website. (There's one for most people, and a separate one if your spouse is your sole beneficiary and is more than 10 years younger than you are.)

Generally, your first required distribution will be a fairly small percentage of the assets in your account, but the percentage increases each year after that.

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Not everyone with a retirement account has to take RMDs, however. For instance:

► Roth IRAs don't require you to take minimum distributions – although if you leave the account to an heir, your heir might have to start taking them fairly quickly after you pass away.

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How Medicaid's look-back period works

Medicaid's look-back period can be confusing, but it's important because it can have a very significant effect on your ability to pay for long-term care.

Unlike Medicare, Medicaid is a system that's available only to people who have very few assets. As a result, the government is concerned that people will "game the system" by giving away all their assets to family members and then applying for Medicaid shortly afterward. That's obviously not fair to the taxpayers who support the system.

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So Medicaid imposes a penalty on people who transfer assets without receiving fair value in return.

Typically, states require a person applying for Medicaid to disclose all financial transactions during the past five years. This five-year period is known as the "look-back period." The state Medicaid agency then determines whether the applicant transferred any assets for less than fair market value during this time. If Medicaid decides that an applicant made such a transfer, it will impose a penalty period – a period of time during which the person will be ineligible for benefits. This period is determined by dividing the amount transferred by the average private-pay nursing home cost in the state.

Any transfer can be scrutinized, no matter how small. There is no exception for charitable donations or gifts to grandchildren. Informal payments to a caregiver may be considered an improper transfer if they weren't made according to a written agreement. Similarly, loans to family members can trigger a penalty period if there is no written documentation.

The burden of proof is on the Medicaid applicant to show that the transfer wasn't made in order to qualify for Medicaid.

However, there are some types of asset transfers that won't trigger a penalty period. These include transfers to:

- A spouse (or to anyone else for the spouse's benefit),
- A blind or disabled child,
- A trust for the benefit of a blind or disabled child, and
- A trust for the sole benefit of a disabled person under age 65 (even a trust for the benefit of the Medicaid applicant, under certain circumstances).

In addition, special rules apply to the transfer of a home. A Medicaid applicant can transfer his or her home to the following without a penalty:

- A spouse,
- A child who is under age 21 or who is blind or disabled,
- A trust for the sole benefit of a disabled person under age 65 (again, even a trust for the benefit of the Medicaid applicant, under certain circumstances),
- A sibling who has lived in the home during the past year and already has an equity interest in the home, or
- A child who lived in the home for at least the past two years and provided care that allowed the applicant to avoid a nursing home stay.

As you can see, the rules are complex, and if you're thinking of applying for Medicaid – even if you're thinking of applying for it five years from now – you'll want to speak with an expert first.

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Guardianship abuse is leading to calls for reform

The growing problem of adult guardianship abuse is giving rise to calls for reform, as vulnerable elderly people caught up in this system sometimes end up being harmed and exploited by the very process that's supposed to protect them.

A guardian is someone appointed by a court to make decisions on behalf of an incapacitated person, known as a "ward." The process usually starts when a family member or social worker notifies the court that someone can no longer take care of himself or herself. If the court decides that the person is incapacitated, it often appoints a family member as guardian. However, if the family can't agree on a guardian, or there's no family member to serve, the court may appoint a public guardian. Public guardians are supposed to be neutral individuals hired to act in the ward's best interest.

Unfortunately, lax laws, a lack of oversight, and poor guardian training sometimes lead to abuse.

Once the court appoints a guardian, that guardian has complete control over the ward's property and finances. Guardians can block family visits, determine where the ward will live, and sell property. In addition, guardians can charge fees for their services that are payable from the elderly person's bank account, which

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What you need to know about required distributions from your IRA or 401(k)

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► If you're still working, and if your company's retirement plan allows it, you can often wait until April 1 of the year after you retire to start receiving distributions. (This is not true for SEP or SIMPLE plans, though, and it's also not true if you own at least five percent of the company.)

► If you've invested in a "qualifying longevity annuity contract," you may be able to shelter up to $125,000 of your investment and not have to take distributions until age 85.

Typically, you must take any RMDs by December 31 of each year. However, you're allowed to wait to take your first year's RMD until April 1 of the year following the year in which you turn 70½. So if you turn 70½ in January 2017, you can wait until April 1, 2018 to take your first distribution.

This might or might not be a good idea. For instance, if you wait, you might have to take two distributions in one calendar year. This could push you into a higher tax bracket for the year, and could also affect how much tax is due on your Social Security benefits.

If you want to avoid or minimize your required distributions, there are some strategies you can consider.

For instance, you can convert some of your regular IRA funds into a Roth IRA. The downside to this is that you'll have to pay income tax on the amount you convert, but there will be no more RMDs, you'll pay no tax on any amounts you decide to withdraw in the future, and if your heirs inherit the IRA, they'll also pay no tax on their withdrawals.

The ideal time to make such a conversion is usually after you retire, when you'll presumably be in a lower tax bracket.

If you're charitably minded, another technique is to make a charitable contribution directly from your IRA. You can contribute up to $100,000 a year from an IRA, and any amount you contribute reduces the amount of your RMD for that year.

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You won't get a charitable deduction for the contribution, but you'll reduce your adjusted gross income, which can have many other tax advantages. And giving to a charity from an IRA is far better than giving assets from a taxable account if you can't take a charitable deduction (for instance, because you don't itemize deductions).

What if you're over 70½ and you didn't realize you were supposed to take RMDs? You might be able to avoid the 50% penalty by filing Form 5329 with the IRS and attaching an explanation of how you were confused about the law.

In general, navigating RMDs and getting the best tax results for you and your family can be very tricky, and if you're approaching age 70 or older, it can be good to talk to an elder law attorney about how best to handle the issue.

If you don't need the money in a retirement account to live on, it can be wise to leave it there. This may reduce your income tax, plus there are significant tax advantages in leaving money to your heirs in a tax-sheltered account.

Guardianship (continued)

can invite corruption.

When a senior gets caught up in the guardianship system, it can be very difficult to get out. Seniors can be confused and overwhelmed after losing control of their lives to a guardian they don't know.

Florida recently passed a law making changes to its public guardian system. The law creates an Office of Public and Professional Guardians that is required to create standard practices and rules, and has the power to revoke a guardianship.

Other states are starting to pass new laws and strengthen or better enforce existing ones.

One force for change has been the late actor Peter Falk's daughter, Catherine, who gained the right to visit her father only after an expensive court battle. Several states have passed so-called "Peter Falk Laws" that protect the rights of children, especially when a current spouse acting as guardian cuts off access by children of an earlier marriage.

If you think a loved one needs a guardian, consult with your attorney to determine the best steps. There may be less restrictive alternatives to guardianship. In addition, if your family can't agree on the best course of action, you might benefit from elder law mediation.

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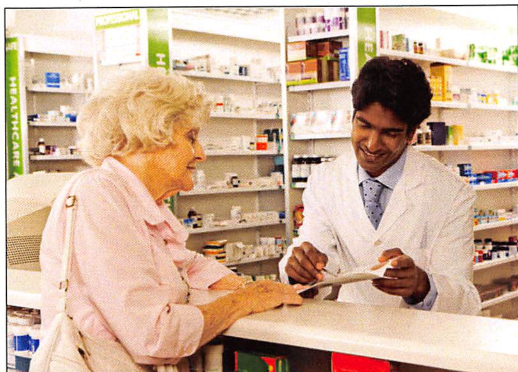
Has Medicare dropped coverage of your drugs?

Medicare prescription drug plans can change which drugs they cover, possibly leaving you without coverage for a drug you need. Or you might switch plans, and find that your new plan doesn't cover your medication at all. In these circumstances, it's good to know that Medicare drug plans are required to offer you a 30-day transition supply of the drug you're taking.



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All Medicare Part D plans must offer these transition refills, including Medicare Advantage plans with prescription drug coverage. Plans must provide a 30-day supply of an ongoing medication (unless a lesser amount is prescribed) within the first 90 days of plan membership or within the first 90 days of the new contract year.

Plans are also required to provide written notice that you're using your transition supply, and explain in writing what your rights are.

You're entitled to a transition refill when you first enroll in a Part D plan, when you move to a new plan that doesn't cover your current medication, when your current plan drops your medication or imposes new restrictions on the drug, or when you experience a change in your level of care (such as a move from a hospital to a nursing home).

The 30-day supply is designed to give you time to talk to your doctor about substitute medication or request a coverage exception from your current plan. If you ask for a coverage exception, your plan must provide temporary refills until the request has been processed.

Residents in long-term care facilities get additional protections. If you're in a long-term care facility, your plan must cover all the 30-day refill requests you submit in the first 90 days on the plan. After the first 90 days, the plan must offer an emergency 30-day supply if your request for an exception has not yet been processed.