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Estate Planning & Administration Group

UPDATE

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Beneficiary Designations for Retirement Plans and IRAs

These are among the most important details of your estate plan.

When was the last time you reviewed your beneficiary designations for your retirement plans and IRAs? It is a good idea to do so periodically to ensure that your beneficiary designations satisfy all technical requirements and are consistent with the rest of your estate plan. Where your spouse is not named as beneficiary of the retirement plan, you may need to comply with the "elect out" provisions of federal law.

New distribution rules.

Effective January 2003, the IRS liberalized the rules for distributions from retirement plans and IRAs. One of the most significant changes is the ability to stretch out lifetime distributions regardless of the identity of the beneficiary.

For example, it used to be that distributions from a retirement plan or IRA had to be taken in larger amounts and sooner if the owner named a charity as beneficiary, rather than naming a spouse or children. To plan around this rule, some owners named his or her spouse as the primary beneficiary and the intended charity as the contingent beneficiary. The owner would rely on the spouse to disclaim the retirement plan or IRA benefits at the owner's death so that the proceeds could pass to charity.

This potentially risky strategy (would the spouse disclaim? would the spouse be disabled and lack the capacity to disclaim? would the disclaimer be timely?) is no longer necessary in most cases. The same lifetime payout rules apply whether the first named beneficiary is the spouse or charity (unless the spouse is more than 10 years younger than the owner).

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HIPAA Makes Health Care Powers Even More Important

Make sure you have the power to beat the bureaucracy in emergency situations.

You have seen the signs in doctor offices and signed their new disclosure forms - so you know a law named the Health Insurance Portability and Accountability Act ("HIPAA") has created a new level of bureaucracy for the medical profession.

HIPAA created new rules to ensure the privacy of patient health information. The breadth of the rules, and the sanctions and fees that can be imposed for violating them, have caused health care providers to strictly limit access to a patient's medical information, even access by close family members.

As a result, you may not be able to obtain information about the condition of a family member who has been hospitalized. Consider, for example, what could happen if your young adult child was in an accident and hospitalized. If he or she was not in a condition to authorize release of information, you may not be able to find out about his or her condition or treatment.

Health Care Powers of Attorney.

The HIPAA restrictions make the Health Care Power of Attorney even more important. A Health Care Power of Attorney authorizes the individuals that you designate as agent to make medical decisions on your behalf if you are unable to do so.

The Illinois Health Care Power of Attorney form also authorizes the designated agent to obtain medical information and records, by stating:

"My agent shall have the same access to medical records that I have, including the right to disclose the contents to others."

In states that do not have such an authorization in their forms, you can add a specific direction authorizing the agent to have access to all medical information notwithstanding HIPAA limitations. In addition to making sure your own Health Care Powers are up-to-date, consider having your children sign Health Care Powers when they turn eighteen, designating you as agent.

Beneficiary Designations *cont.*

Complex rules require caution and professional advice.

As with all tax rules, there are many exceptions, twists and turns, especially if a trust is named as a beneficiary. In more and more cases, retirement benefits are the largest assets in the estate, so it is well worth consulting your lawyer to review the beneficiary designations.

Illinois's New Animal Act for Estate Planning

Beginning in 2005, a new Illinois law will permit pet owners to set up trusts for the care of their beloved animals. Before the change in the law, a trust fund for a pet could not be legally enforced in Illinois. Pet owners could give money to a friend to care for a pet, but there was no assurance that the funds would be used as directed. The new law authorizes an actual pet trust fund with a trustee. To further protect the pet, the owner may name a second person to watch over the trustee and enforce the terms of the trust on behalf of the pet.

There are a couple of limitations, however. The amount set aside in trust for a pet must be reasonable. The courts are permitted to reduce the amount of a pet's trust fund if it substantially exceeds the reasonable amount required for the pet's care.

Trust Funds for Pets

Several other states also permit trusts to be created for pets. So when you work on your estate plan, confirm whether you want to make planning for the animal members of your household a pet project.

By the way, does your pet have to pay income taxes?

Due to the popularity of pet trusts, the IRS has made its own determination as to the tax treatment of such funds. The IRS will not recognize a pet as a beneficiary of a trust for income tax purposes. The good news is that Fido won't need a social security number. The bad news is that the taxable income of a pet trust that is valid under state law is taxed to the trust and it will need a tax identification number.

A "mini-amnesty" program for certain shelters (affectionately known as "Son of Boss" transactions) has recently closed, but that program may signal the government's willingness to resolve these matters if the taxpayer agrees to pay the taxes owed plus interest and a modest penalty.

How Taxpayers Can Assess Their Tax Shelter Vulnerability and Mitigate Liability.

Tax shelters come in various shapes and sizes. Some are defensible, but others regrettably are not. Taxpayers who purchased tax shelters should immediately consult with a tax advisor experienced in dealing with the IRS and other taxing authorities in connection with assessing their specific individual facts and, where appropriate, resolving these matters proactively.

As an example, it may still be possible to file a "Qualified Amended Return" for the year(s) at issue, in an effort to avoid the imposition of penalties. These returns generally are effective only if neither you nor your tax shelter promoter has already been contacted by the IRS.

How Schiff Hardin Can Help.

We currently represent a number of taxpayers who are attempting to untangle themselves from a variety of shelter transactions. We also provide "independent evaluations" in connection with currently active examinations. Note - the tax professionals who advised you in connection with entering into a shelter may have a conflict of interest if they represent you in connection with an audit or investigation of the same transaction. As a result, we believe it is important for you to have an independent party take a fresh look at your situation.



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