

Legal Matters: Distributing savings can be tricky

By Donna Engle, Legal Matters

You're working steadily, putting money into your Individual Retirement Account or 401(k) plan, dreaming of retirement. Not to rain on your sunny situation, but if you become disabled or mentally incapacitated and can no longer manage your financial affairs, what will happen to your retirement savings plan?

As a related issue, what happens to your IRA if you die before exhausting all or part of the account?

Here's the short answer to the first question: If you haven't created a power of attorney, no one will be able to act for you in managing the investments. If it appears unlikely that you will recover from your incapacity, someone may petition the court to be appointed as your guardian, and that person will then be able to manage the IRA or 401(k).

If the situation is covered by a financial power of attorney and guardianship is unnecessary, your family members will thank you, your IRA management company will thank you and the courts will thank you.

But use caution.

Before you race out to have a power of attorney drafted, check with the company that is custodian of your retirement savings plan. Some companies have their own preferred forms, and powers of attorney can be a minefield. No matter how careful your lawyer has been, if he didn't cross a "t" and dot an "i" where the custodians' form has a "t" crossed and an "i" dotted, they may reject it and refuse to allow your attorney-in-fact to act for you.

Here's the short answer to the second question: There isn't one. What happens depends on what type of IRA you have and your beneficiary's relationship to you.

If the beneficiary is your spouse, she can roll your traditional IRA into hers and will not be required to take a distribution until the year in which she reaches age 70.5. When she does take the distribution, she will be required to pay income tax on it. If your beneficiaries are other individuals, such as your children, they may take a lump-sum distribution, elect to take the entire balance within five years, or elect to take withdrawals based upon life expectancy. They will have to pay income tax on the amounts they receive.

Now, what if you have a Roth IRA?

If the beneficiary is your spouse, he can roll your Roth IRA into his and will not be subject to minimum distribution rules.

If the beneficiaries are your children or other individuals, they must take a Roth IRA distribution by the end of the year containing the fifth anniversary of your death, or over the life expectancy of the beneficiary, starting no later than Dec. 31 of the year following the year in which you died.

If the five-tax-year holding period is met, the distribution will not be treated as income to the children; if they take the money sooner, it may be subject to income tax.