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Lynn Brenner
 FAMILY FINANCE

Options for inherited 457s

October 8, 2006

I have two questions about 457 retirement savings plans. I'm a widow and my three children are my beneficiaries on my 457 plan and on my individual retirement account. I don't want to convert the 457 into an IRA; there's one investment option in the 457 plan that's not available in the IRA. So first: Can my children roll each of their inherited shares of the 457 plan into IRAs, setting them up as inherited IRAs - i.e., with my name (deceased) on the account, and their respective names as beneficiaries? Second: Is a 457 plan treated the same as an IRA when it comes to Medicaid? I know that IRA distributions being taken after age 70 1/2 must be used to pay for nursing home care, but the IRA principal is protected. Must the principal of a 457 account be used to pay for nursing home care?

GV, Lake Ronkonkoma



Your questions show you've been doing a lot of research about this.

Today, only a spouse can roll an inherited 457 plan into an IRA. All other beneficiaries typically receive an inherited 457 in a taxable lump sum. But starting in 2007, non-spouse beneficiaries for the first time will be able to roll inherited retirement plans like 457s and 401(k)s into IRAs - provided these IRAs are titled in the name of the deceased account owner. (It will still only be a spouse who can roll a 457 or a 401(k) into an IRA in his or her own name.)

This means your kids can avoid paying an immediate tax on the inherited 457: They can empty the IRAs over their own life expectancies, paying taxes only on the distributions they take. And by prolonging the tax-deferred growth of their inheritance, perhaps over decades, they may be able to increase its value substantially.

"A rollover from a 457 or 401(k) plan into an inherited IRA must be done as a trustee-to-trustee transfer," warns Barry C. Picker, a Brooklyn tax accountant. In other words: You can't take a check from a 457 and deposit it into an IRA; that would make the entire amount taxable.

As to New York's Medicaid program, 457 plans - and 401(k)s, 403(b)s and Keogh plans - are treated the same as IRAs: These accounts all require that you take minimum annual distributions after you're 70 1/2. At that point, the account is "in pay status": Your annual distributions must be spent on your care, but you don't have to spend the principal to qualify for Medicaid nursing home benefits, says Bernard A. Krooks, a Manhattan elder care attorney.

Medicaid is entitled to recoup the cost of your benefits from your estate after your death, but under current law it can't assert that claim on assets that go to named beneficiaries. So your designated beneficiaries keep the retirement account principal remaining at your death.

Will Medicaid consider your account to be "in pay status" if you're younger than 70 1/2 and you're taking distributions that aren't legally required? Yes, says Krooks, but with an important difference: "If you're under 70 1/2, you must use Medi-caid's life expectancy table to determine your minimum annual distributions, not the IRS table you use after turning 70 1/2."

The Medicaid table is less generous. It might give you 12 to 15 years to empty an account that the IRS lets you empty over 27 years, for example. So the annual distributions will be larger - and of course, they must be spent on your care.

Send questions to Family Finance, Business Desk, Newsday, 235 Pinelawn Rd., Melville, NY 11747-4250, or e-mail to Bfamfin@aol.com. Include your age, income and a list of major assets. Letters and e-mails can't be answered personally.

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