# PLANNING FOR THE END OF THE STRETCH IRA

## THE ESTATE PLANNING COUNCIL OF ST. LOUIS

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# Legislative Changes

- CARES Act (March 2020) – The *Coronavirus Aid, Relief, and Economic Security Act* – the $2.2 trillion legislation to provide relief from the economic damage triggered by the coronavirus Covid-19
- SECURE Act – (December 2019) – The *Setting Every Community Up for Retirement Enhancement Act* – made major changes to the laws governing retirement accounts

# *Coronavirus Aid, Relief, and Economic Security* (CARES) *Act* Changes that Affect Retirement Accounts

- No RMDs required in the year 2020

  This includes accounts of people over age 70 ½ and people of all ages who have inherited retirement accounts

- 401(k) plans: Employees who have been diagnosed with Covid-19 (including a spouse or a dependent) or who have lost income from a layoff, business closure, quarantine, reduced hours, or inability to work because of child care:

* Hardship distribution possible. (Under age 59 ½, no 10% penalty)

It is still taxable income, but can avoid tax if repay in 3 years

* Loan from plan possible: maximum increased to $100,000

# REQUIRED MINIMUM DISTRIBUTIONS
# *LIFETIME DISTRIBUTIONS*

***THREE CHANGES FOR LIFETIME RMDs:***

1. **New RMD Age : 72**
   **(for people who attain age 70 ½ after 2019)**
   **(Despite new age 72, charitable QCD still 70 ½)**

2. **RMDs are not required in year 2020 - *CARES***
   **-- from either your own IRA or an inherited IRA**

3. **New life expectancy tables (beginning in 2021)**
   **Annual RMD amounts will decline by**
   **between 0.3% and 0.5% each year (varies by age)**

# REQUIRED MINIMUM DISTRIBUTIONS
# *LIFETIME DISTRIBUTIONS – YEAR 2019*

| Age of Account Owner | Required Payout |
|---|---|
| 72 | 3.91% |
| 75 | 4.37% |
| 80 | 5.35% |
| 85 | 6.76% |
| 90 | 8.75% |
| 95 | 11.63% |
| 100 | 15.88% |

# REQUIRED MINIMUM DISTRIBUTIONS
# *LIFETIME DISTRIBUTIONS – YEAR 2021+ *

| Age of Account Owner | Required Payout |
|---|---|
| 72 | 3.67% |
| 75 | 4.07% |
| 80 | 4.95% |
| 85 | 6.25% |
| 90 | 8.27% |
| 95 | 11.24% |
| 100 | 15.71% |

# REQUIRED MINIMUM DISTRIBUTIONS
# *LIFETIME DISTRIBUTIONS*

## *A. THREE CHANGES FOR LIFETIME RMDs:*

1. **New RMD Age : 72 (for people who attain age 70 ½ after 2019)**
   **(Despite new age 72, charitable QCD still 70 ½)**
2. **No RMDs required in year 2020**
3. **New life expectancy tables (beginning in 2021)**
   **Annual RMD amounts will decline by**
   **between 0.3% and 0.5% each year (varies by age)**

## B. WORKING INDIVIDUALS OVER AGE 70 ½ CAN MAKE TAX-DEDUCTIBLE CONTRIBUTIONS TO A TRADITIONAL IRA (Year 2020 maximum: $7,000)

# Want to make charitable gifts from your IRA (“QCD”)?
# *Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½*

New last sentence added to end of Sec 408(d)(8)(A):

***The amount of distributions not includible in gross income by reason of the preceding sentence for a taxable year (determined without regard to this sentence) shall be reduced (but not below zero) by an amount equal to the excess of—***

- ***(i) the aggregate amount of deductions allowed to the taxpayer under section 219 for <u>all</u> taxable years ending on or after the date the taxpayer attains age 70 ½,  over***
- ***(ii) the aggregate amount of reductions under this sentence for <u>all</u> taxable years preceding the current taxable year.***

# Want to make charitable gifts from your IRA ("QCD")?
# *Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½*

LEGISLATIVE INTENT

- To get a tax benefit from a charitable gift, a taxpayer must generally itemize deductions (state taxes, mortgage interest, etc)
- Only 11% of tax returns itemized deductions in 2018
- A working senior could (a) contribute $7,000 to an IRA and then (b) distribute $7,000 that same year to charities, and indirectly deduct charitable gifts via IRA contributions

ADMINISTRATIVE and BOOKEEPING HEADACHES

- People in their 80s and 90s will need to keep all tax records after age 70 ½ and then make cumulative computations

# Want to make charitable gifts from your IRA ("QCD")?
# *Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½*

EXAMPLE

- I. Work's RMD both for this year and next year is $5,000
- She donates each year's RMD to charity; would be QCD
- She is employed. This year she deducts $7,000 for IRA.

  Next year she does not deduct any IRA contribution
- How much can she EXCLUDE from income for QCD?

| Year | Donate | Exclude | Taxable |
|---|---|---|---|
| This year | $5,000 | -0- | $5,000* |
| Next year | $5,000 | $3,000 | $2,000* |

* Taxpayer can claim an *itemized* charitable deduction

# Want to make charitable gifts from your IRA ("QCD")?
# *Then NEVER make a tax-deductible contribution to your IRA after attaining age 70 ½*

STRATEGIES

- If ever want to make a QCD, don't contribute after age 70 ½
- Working seniors can contribute to plan at work (401(k), etc.)
- Working seniors can contribute to a Roth IRA

- *Footnote:* Employed upper-income taxpayers can't even make tax-deductible contributions to an IRA if there is a plan at work (e.g., 401(k) ). No tax deduction is permitted in year 2020 if AGI is over $75,000 ($124,0000 on married

# *Setting Every Community Up for Retirement Enhancement* (SECURE) *Act*

CHANGES TO THE LAW:

- Make it easier for 401(k) plans to offer annuities

  -- Convert assets into reliable income in retirement

- RMDs to begin at age 72 (up from age 70 ½)
- Permit working individuals over age 70 ½ to make contributions to a traditional IRA
- Other changes to retirement plans and 529 plans
- Kill the *Stretch IRA*. QRP and IRA accounts would generally have to be liquidated by the end of the 10th year after death. There would be no RMDs in years 1 through 9.

# *Setting Every Community Up for Retirement Enhancement* (SECURE) *Act*

OTHER CHANGES TO RETIREMENT and 529 PLANS:

- 529 plan account owners may withdraw up to $10,000 tax-free (per beneficiary) to pay qualified education loans
- 529 plans can be used for apprenticeships (old: schools only)
- No 10% penalty on up to $5,000 distributed from a retirement plan to a person under age 59 ½ within one year of a birth or adoption (though is still taxable income)
- “Kiddie tax” – parent’s rate (repeal T & E tax rates). Amend 2018?
- Graduate student taxable stipends permit IRA contributions
- Part-time employees with three consecutive years of 500 hours of service (¼ time) are eligible for 401(k). Law already provides for eligibility if 1,000 hours in a single year

# Distributions from Inherited Retirement Accounts Are Taxable Income
## *Income In Respect of A Decedent "IRD" –§691*

- No stepped up basis for retirement assets
- Distributions from inherited retirement accounts are usually taxable income to the beneficiaries.

# USUAL OBJECTIVE:
# Defer paying income taxes in order to get greater cash flow

| | Principal | 10% Yield |
|---|---|---|
| • Pre-Tax Amount | $ 100,000 | $ 10,000 |
| • Income Tax on Distribution (40%) | 40,000 | |
| • Amount Left to Invest | $ 60,000 | $ 6,000 |

# Stretch IRA

- “Stretch IRA” means an inherited retirement account (e.g., IRA), where payments are gradually made over the beneficiary’s life expectancy
- Until the enactment of the SECURE Act, it was fairly easy for any beneficiary who inherited a retirement account to receive distributions until the age of 83 (or older for beneficiaries who inherited at an older age)
- New rules apply beginning in year 2020
- Compare rules of the present, past & future

# Distributions After Death
(for decedents who die in 2020 and later)

**Maximum time period to empty account:**

- **Ten years** *(No RMD until year #10)*

*[the account needs to be empty by December 31 of the tenth year after the year of the decedent' death, or else there is a 50% penalty on the balance]*

# RETIREMENT ACCOUNTS IN MARRIAGES: TYPES OF QRPs

- Section 401(a) - Employer pension, profit sharing and stock bonus plans[*incl. 401(k)*]
- Section 408 – IRAs
- Section 403(b) - School and charity employers
- Section 457(b) plans - Government and tax-exempt employers

# Distributions
# After Death

<u>Company policy may require faster liquidation</u>

- Employer might require account of deceased employee to liquidated in just one year
- No such problem with IRAs
- Beneficiary of employer plan account can compel transfer to an inherited IRA

# Distributions After Death
## (for decedents who die in 2020 and later)

**Maximum time period to empty account:**

- **Ten years** *(No RMD until year #10), **or***
- **Remaining life expectancy of an "*eligible designated beneficiary*"** *(RMD every year)*

  *-- surviving spouse*

# MARRIED COUPLES: RETIREMENT ASSETS

**Surviving spouse has an option that no other beneficiary has:**

a ***<u>rollover</u>*** of deceased spouse's retirement assets to her or his own new IRA (creditor protection, too!)

**Other beneficiaries cannot do a rollover.**

Main option: liquidate over ten years

# LEAVE MONEY IN DECEDENT'S ACCOUNT?
# Required Distributions if the Surviving Spouse is the <u>Sole</u> Beneficiary

- Spouse can recalculate life expectancy
- IRAs only: Spouse can elect to treat IRA as her own
- Decedent died before age 72 ?
  - No required distribution until year the deceased spouse would have been age 72

# Distributions After Death
(for decedents who die in 2020 and later)

**<u>Maximum time period to empty account:</u>**

- **Ten years** *(No RMD until year #10)*, ***or***
- **Remaining life expectancy of an "*eligible designated beneficiary*"** *(RMD every year)*

  *-- surviving spouse -- minor child of the decedent*

  *-- disabled individual -- chronically ill person*

  *-- beneficiary within 10 years of age of decedent*

# LIQUIDATE INHERITED IRAs IN TEN YEARS

**EXCEPTION: “*Eligible* *Designated Beneficiary*”**

*-- surviving spouse* *-- minor child of the decedent*

*-- disabled individual* *-- chronically ill person*

*-- beneficiary within 10 years of age of decedent*

An ***eligible*** designated beneficiary may take distributions over her/his life expectancy *

* When minor child attains majority, the 10 year clock starts

* When an EDB dies, the 10 year clock starts for successor

# Distributions After Death
## (for decedents who die in 2020 and later)

**<u>Maximum time period to empty account:</u>**

- **Ten years** *(No RMD until year #10)*, ***or***
- **Remaining life expectancy of an “*eligible designated beneficiary*”, or**
- **Five Years, or**
- **“Ghost life expectancy”**

# REQUIRED MINIMUM DISTRIBUTIONS
# * *DEFINITIONS* *

- **Required Beginning Date ("RBD")**

  April 1 in year after attain age 72
- **Designated Beneficiary ("DB")**

  **A human being**. An **estate** or **charity** can be a beneficiary of an account, **but not a DB**.
- **Determination Date**

  September 30 in **year <u>after</u> death.**

# REQUIRED DISTRIBUTIONS
# IF THERE IS EVEN JUST ONE
# NON-DESIGNATED BENEFICIARY

| <u>Death Before RBD</u> | <u>Death After RBD</u> |
| --- | --- |
| FIVE YEARS | Remaining life expectancy of someone who is decedent’s age at death<br>***Roth IRA: Just 5 years*** |

# ACTIONS THAT CAN BE TAKEN BEFORE THE DETERMINATION DATE

- Disclaimers
- Full distribution of share
- Divide into separate accounts

  For example, separate accounts when:

  - one beneficiary is an EDB and another is not
  - one beneficiary is a charity & can't pay by 9/30

# REQUIRED DISTRIBUTIONS IF THERE IS EVEN JUST ONE NON-DESIGNATED BENEFICIARY

| Death Before RBD | Death After RBD |
| --- | --- |
| FIVE YEARS | Remaining life expectancy of someone who is decedent's age at death |
| ***[No RMD until year #5]*** | ***[Each year has an RMD]*** ***["ghost life expectancy"]*** |

# REQUIRED MINIMUM DISTRIBUTIONS

## **Ghost Life Expectancy**

| Age of Beneficiary | | Life Expectancy |
|---|---|---|
| 72 | | *Too soon! 5 year liquidation !* |
| 73 | | *April & later is after RBD* |
| 74 | *6.4%* | 15.6 more years |
| 75 | *6.8%* | 14.8 |
| 76 | *7.1%* | 14.0 |
| 77 | *7.5%* | 13.3 |
| 78 | *7.9%* | 12.6 |
| 78 | *8.4%* | 11.9 |
| 80 | *8.9%* | 11.2 |

# Distributions After Death

(for decedents who die in 2020 and later)

**<u>Maximum time period to empty account:</u>**

- **Ten years** *(No RMD until year #10),* ***or***
- **Remaining life expectancy of an "*eligible designated beneficiary*", or**

**<u>If on Sept 30:</u>**

- **Five Years, or** **<< Charity is beneficiary**
- **"Ghost life expectancy"** **<< Charity is beneficiary**

# LIQUIDATE INHERITED IRAs IN TEN YEARS

EFFECTIVE DATES:

* Rules apply for decedents dying after December 31, 2019

* For decedents who died ***before 2020***, beneficiaries can continue to receive payments over remaining life expectancy.

- However, upon the death of that beneficiary, the 10 year clock starts ticking.
- EXAMPLE: A 60 year old beneficiary inherited an IRA in 2019 when he had a life expectancy to age 85 (for 25 years). That beneficiary dies 2 years later at age 62. The inherited IRA must be empty in the 10$^{th}$ year after death [rather than the year that the individual would have been age 85]

# Distributions After Death

“ ***life expectancy***“

Oversimplified:  Half of population will die before that age, and half will die after

# REQUIRED MIN. DISTRIBUTIONS
# *LIFE EXPECTANCY TABLE*
# "STRETCH IRAS - LAW BEFORE 2020"

| Age of Beneficiary | | Life Expectancy |
|---|---|---|
| 30 | *1.9%* | 53.3 more years |
| 40 | *2.3%* | 43.6 |
| 50 | *2.9%* | 34.2 |
| 60 | *4.0%* | 25.2 |
| 70 | *5.3%* | 18.7 |
| 80 | *8.9%* | 11.2 |
| 90 | *17.5%* | 5.7 |

# REQUIRED MINIMUM DISTRIBUTIONS

## Example: Death at age 80?

# NEW LAW: TEN YEARS (if >10 year younger)

| **Age of Beneficiary** | | **Life Expectancy** |
|---|---|---|
| **30** | | **10 years** |
| **40** | | **10** |
| **50** | | **10** |
| **60** | | **10** |
| **70** | ***5.3%*** | **18.7** |
| **80** | ***8.9%*** | **11.2** |
| **90** | ***8.9%*** | **5.7 * [11.2 yrs]** |

# LIQUIDATE INHERITED IRAs IN TEN YEARS

## STRATEGIES:

- **Lotsa beneficiaries!  Share the love!  Spread the wealth!**

  Example: Children and grandchildren, rather than just children

- **Lifetime Roth IRA conversions, if current income tax rate is likely to be less than future tax rates**
- **Are any beneficiaries "eligible designated beneficiaries"?**
- **Charitable bequests**

  * Have pre-tax dollars used for charitable purposes,

    especially if estate will be subject to federal or state estate taxes

  * Charitable remainder trusts (more on this later)

# IRAs PAYABLE TO TRUSTS

General Rule: Trust is not DB

Exception: “Look-through” trust if four conditions are met. Reg. § 1.409(a)(9)-4, Q&A 5 & 6

- (1) The trust is a valid trust under state law
- (2) The trust is irrevocable (or will become irrevocable on death)
- (3) The beneficiaries are identifiable from the trust instrument,
- (4) A document is given to the plan administrator. Either:
  - (a) a copy of the entire trust instrument or
  - (b) a certified list of all of the beneficiaries of the trust

# IRAs PAYABLE TO TRUSTS

General Rule: Trust is not DB

Exception: "Look-through" trust if four conditions are met. Reg. § 1.409(a)(9)-4, Q&A 5 & 6

Types:-- ***"accumulation trusts"***

-- "***conduit trusts***"

# CONDUIT TRUSTS

- Defined: Where the governing instrument provides that all amounts distributed from the retirement account to the trustee while the primary beneficiary is alive will, upon receipt by the trustee, be paid directly from the trust to that beneficiary. Reg. § 1.409(a)(9)-5, Q&A 7(c)(3), Example 2.
- Advantage of a conduit trust: The *conduit beneficiary* is considered to be the *sole beneficiary* of that trust. The RMD computation ignores beneficiaries who will receive retirement plan $$ after the conduit beneficiary dies.

# ACCUMLATION TRUSTS

- Defined: A trust where the trustee has the power to either distribute or retain distributions that the trustee receives from a retirement plan account. Reg. § 1.409(a)(9)-5, Q&A 7(c)(1)
- If retained, the income tax rate will likely be 37%
- Effect of remainder beneficiaries: Except for a “mere potential successor”, all possible beneficiaries must be considered for the RMD computation. PLR 200228025 (Apr. 18, 2002)
- **Potential negative impact when some beneficiaries are EDBs and others aren’t?**

# IRAs PAYABLE TO TRUSTS

- Payable to a “minimum RMD” trust?
- Is the IRA itself a “trusteed IRA”?
- Payable to a conduit trust?
- Payable to an accumulation trust?

# “Minimum RMD” Trust

- Review the terms of the trust!

  Does the trust instrument state (oversimplified):

  “distribute only the minimum RMD required by law”? If so, there would be zero distributions in years 1 through 9 and 100% would be distributed in year #10.

  An income tax disaster!

- If appropriate, consider modification of the trust instrument, or decanting
- Most states permit modification to achieve the settlors’ tax objectives when laws change.

  UTC § 416

# CONDUIT TRUSTS

- *Unless* the beneficiary is an *eligible* designated beneficiary, the retirement account will be fully liquidated in ten years. The beneficiary will personally own all of the retirement assets.
- So what are the advantages of naming a conduit trust as the beneficiary, compared to simply naming the individual as the beneficiary on the IRA/retirement plan beneficiary form?

# ACCUMLATION TRUSTS

- Trusts pay the highest income tax rate: 37%.

  Will the beneficiaries be in a much lower income

  tax bracket?
- If so, will the benefits of the trust outweigh the much higher income tax cost?
- Benefits include:

  * Asset protection        * Professional management

  * Restricted withdrawals by spendthrift beneficiaries

# ACCUMLATION TRUSTS

- In general, there should a real need for a trust. If the beneficiaries are stable, mature adults who will pay substantially lower income tax rates than the trust’s 37% income tax rate, the rules are simpler if they are named as the beneficiaries of the account.
- If a trust will be a beneficiary of a retirement account, adopt specific strategies for the receipt of retirement assets. Those assets are pure taxable income that could be taxed at the highest 37% rate.

(Individuals don’t pay that 37% rate unless taxable income is over $500,000+ single ($600,000+ married joint))

# Twin TEA POT Trust System℠

*Alan Gassman, Christopher Denicolo and Brandon Ketron*

Concept:

- *If* an estate has both taxable IRD assets and tax-free assets (e.g., assets that have a stepped-up income tax basis),
- *Then* the greatest amount of wealth will be transferred to the heirs and beneficiaries if the IRD will be taxed at the lowest possible income tax rate.

# Twin TEA POT Trust System℠

*Alan Gassman, Christopher Denicolo and Brandon Ketron*

- A trust arrangement for beneficiaries (e.g., children) who are in very different income tax brackets.
- A pot trust is named as the beneficiary of the retirement accounts.  Trustee has discretion to give different amounts to different beneficiaries.
- The pot trust is a look-through accumulation trust. Yes, IRA is liquidated in ten years.  Trustee distributes most taxable retirement income to low tax-rate beneficiaries.
- A separate pot trust distributes tax-free principal to high-tax rate beneficiaries.  Equalizes after-tax dollars to all.
- Caution: Take steps to avoid “merger” of the two trusts

# Beneficiary Deemed Owner Trust (BDOT)

- A "grantor trust," where the income of the trust is taxed to the *beneficiary* under §678(a)
- The beneficiary is usually in a lower income tax bracket than the trust's 37%.  Trust distributes cash to pay tax.
- Beneficiary is given a withdrawal power over the taxable income of the trust.  But no withdrawal power over the principal.  This provides asset protection and other benefits for the assets retained in the trust.
  - Not perfect, of course.  Wouldn't want to have a withdrawal power for a substance abuser or when trying to qualify for public assistance with a special-needs beneficiary
- Comprehensive article by Ed Morrow:  Google search:    SSRN  BDOT

# IRAs PAYABLE TO TRUSTS THAT BENEFIT BOTH EDBs and non-EDBS

**ISSUE:** Does naming an ***accumulation trust*** for a spouse (e.g., QTIP trust), minor child, etc. as an IRA beneficiary require liquidation of the IRA in 10 years, if there are also beneficiaries who are not eligible designated beneficiaries?

GENERALLY YES: Under current tax regulations, all beneficiaries of an accumulation trust are considered when computing RMDs.  Regs bias to faster payout.

# IRAs PAYABLE TO TRUSTS THAT BENEFIT BOTH EDBs and non-EDBS

EXAMPLE: An ***accumulation trust*** states (oversimplified): “pay to my second wife (an EDB) for life, remainder to my children from my first marriage (adult children are not EDBs)”

An IRA payable to such a trust must be liquidated within ten years after the decedent’s death.

Consider alternatives. Conduit trust? Percent outright to spouse (who can rollover) and percent to kids?

# IRAs PAYABLE TO TRUSTS THAT BENEFIT BOTH EDBs and non-EDBS

**ISSUE: N**aming an ***accumulation trust*** for a <u>spouse</u> (e.g., QTIP trust), <u>minor child</u>, etc. as an IRA beneficiary requires liquidation of the IRA in 10 years.

**EXCEPTIONS & PLANNING:**

- Accumulation trust for disabled & chronically ill
- Conduit trust for other type of EDB

# ACCUMLATION OR CONDUIT TRUST FOR DISABLED OR CHRONICALLY ILL

EXCEPTION IN STATUTE: A retirement account payable to a trust (either <u>accumulation</u> or conduit) that benefits a <u>disabled or chronically ill beneficiary</u> could qualify for stretch life-expectancy payouts. Upon the death of that beneficiary, the ten year rule would apply.

**Statute only provides an exemption for trust beneficiaries who are disabled or chronically ill.**

**There is no comparable provision for other EDBs:**

**surviving spouse, minor child, person within ten years age**

# Conduit Trusts for Eligible Designated Beneficiaries

Conduit trusts for EDBs permit RMDs to be made over the EDB's life expectancy, without considering the potential impact of contingent or remainder beneficiaries who are not EDBs.

Conduit trusts can still make sense for:

- A surviving spouse (though a rollover is better)
- A person not more than ten years younger
- A minor child (but have flexibility after majority age)

# MANDATORY DISTRIBUTIONS
## [Assume inherit IRA at age 80 and die at 94]

EXAMPLE: D. John Mustard owned three IRAs when he died this year at age 93. His surviving spouse, Honey, turned age 80 the year after his death. Each IRA had a different beneficiary:

- An accumulation trust for Honey, remainder to his children from his first marriage
- A conduit trust for Honey, remainder to his children from his first marriage
- Honey was the sole beneficiary ( rollover is possible )

# MANDATORY DISTRIBUTIONS
## [Assume inherit IRA at age 80 and die at 94]

| AGE | Accumulation Trust | |
|---|---|---|
| 80 | -0-% | |
| 85 | -0- % | |
| 90 | 100.00% | << 10 years, since it is |
| 91 | empty | an accumulation trust |
| 92 | empty | |

# REQUIRED MINIMUM DISTRIBUTIONS
# *LIFE EXPECTANCY TABLE*

**1. Conduit trust permits an EDB to receive distributions over remaining life expectancy**

**(**There are RMDs every year)

**2. Surviving spouse can annually recompute remaining life expectancy**

| Age of Beneficiary | Life Expectancy |
| --- | --- |
| **80** | **11.2 more years** |
| **90** | **5.7 more years** |

# MANDATORY DISTRIBUTIONS
## [Assume inherit IRA at age 80 and die at 94]

| AGE | ROLL - OVER | Accumulation Trust | Conduit Trust . |
|---|---|---|---|
| 80 | 4.95% | -0-% | 8.93% |
| 85 | 6.25% | -0- % | 12.35% |
| 90 | 8.26% | 100.00% | 17.54% |
| 91 | 8.77% | empty | 18.87% |
| 92 | 9.26% | empty | 20.41% |

# Conduit Trusts
# for Eligible Designated Beneficiaries

Conduit trusts for EDBs permit RMDs to be made over the EDB’s life expectancy, without considering the potential impact of contingent or remainder beneficiaries who are not EDBs.

Conduit trusts can still make sense for:

- A surviving spouse (**though a rollover is better**)
- A person not more than ten years younger
- A minor child  (but have flexibility after majority age)

# IRAs PAYABLE TO TRUSTS

- Payable to a “minimum RMD” trust?
- Is the IRA a “trusteed IRA”?
- Payable to a conduit trust?
- Payable to an accumulation trust?
- If appropriate, consider modification of the trust instrument, or decanting

# LIQUIDATE INHERITED IRAs IN TEN YEARS

**IMPLICATIONS FOR CHARITIES**

Donors more likely to consider

- Outright bequests
- Retirement assets to tax-exempt CRT
  - Child: income more than 5 years; then charity
  - Spouse & children (no estate tax marital deduction)

# CHARITABLE REMAINDER TRUST

- Payment to non-charitable beneficiary (ies) for *__life__* *or* for a *__term of years__*

  (maximum 20 years)

- Remainder interest distributed to charity
- ***Exempt from income tax***

# 2-GENERATION
# CHARITABLE REMAINDER UNITRUST

- Typically pays 5% to elderly surviving spouse for life, then 5% to children for life, then liquidates to charity
- Like an IRA, a CRT is exempt from income tax
- Can be like ***a QTIP trust for IRD assets*** *[but <u>no</u> estate tax marital deduction]*

# Theory: Tax advantage of income tax deferral !

**Move IRD tax-free after death from one tax exempt trust (e.g., the IRA) to another tax-exempt trust (the CRT).**

It can be done! PLR 199901023. No taxable income to beneficiaries until they receive distributions from CRT

*[ **compare:***

*a charitable lead trust is NOT tax-exempt;*

*don't name a CLT as an IRA beneficiary !]*

# Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

**Yes. It is possible. But usually not likely.**

- It can happen with long-term CRUTS (e.g., 40 or 50 years) and beneficiaries who pay high income tax rates
- Outcomes vary with investment returns and tax rates

# Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

| 5% CRUT -- Investments earn 5% -- Tax rate: **40%** | | | | | |
|---|---|---|---|---|---|
| | | | 5% Annual | | |
| | | | Income | *Consume* | *Save* |
| CRT | $1,000,000 | | **$50,000** | *$30,000* | *$20,000* |
| | | | | | |
| Income tax | -400,000 | | *Income tax >>>* | | *-$8,000* |
| | | | *Net annual investment* | | ***$12,000*** |
| After-tax | **$600,000** | *Purchase* | *$600k* | *life insurance?* | **<50 years?** |

# Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

| 5% CRUT -- Investments earn 5% -- Tax rate: **20%** | | | | | |
|---|---|---|---|---|---|
| | | | 5% Annual | | |
| | | | Income | *Consume* | *Save* |
| CRT | $1,000,000 | | **$50,000** | *$40,000* | *$10,000* |
| | | | | | |
| Income tax | -200,000 | | *Income tax >>>* | | *-$2,000* |
| | | | *Net annual investment* | | ***$8,000*** |
| After-tax | **$800,000** | | | | **<50 years?** |

# Can a CRT Produce More Family Wealth Than a Ten Year Liquidation?

**Yes. It is possible. But usually not likely.**

- It can happen with long-term CRUTS (e.g., 40 or 50 years) and beneficiaries who pay high income tax rates
- Outcomes vary with investment returns and tax rates
- How often have you seen outcomes over 40 or 50 years actually match the projections & assumptions that had been made 40 or 50 years earlier? (Me? Never)
- A CRT is best for someone with charitable intentions who also wants to benefit family. It should not be foisted on people who have no charitable intent.

# PLANNING and LEGAL HURDLES

A. Choosing the trustee and the charity

B. Choosing the Best Type of CRT

- CRAT, CRUT, FLIPCRUT, or NIMCRUT

C. How Long ? Term of Years? For Life?

D. CRT Requirements That Can Pose Challenges

E. Extra Requirements for CRATs

F. Asset protection issues

G. Four-tier system for taxation of beneficiaries [*WIFO*]

H. What do you say if a client or a charity suggest
"a charitable gift annuity" instead of a CRT ?

# CRT Requirements That Can Pose Challenges

1. Annual payouts between 5% and 50%
2. Minimum 10% charitable deduction
3. Avoid multiple donors to a single CRT
4. Private foundation self-dealing rules apply to CRTs
5. Problematic assets (partnership interests, debt-encumbered, etc)
6. Was trust actually administered in accordance with its terms

# Distributions After Death
## (for decedents who die in 2020 and later)

<u>**Maximum time period to empty account:**</u>

- **Ten years** *(No RMD until year #10)**, or***
- **Remaining life expectancy of an "*eligible designated beneficiary*",** or
- **Five Years, or << when pay to a CRT**
- **"Ghost life expectancy" << when pay to a CRT**