Planning for Inherited IRAs

The Tulsa Estate Planning Forum

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What We Will Cover Today:

- Review the rules for lifetime and testamentary required distributions from retirement accounts
- Examine strategies for naming individuals or trusts as beneficiaries to get the most favorable outcomes under the new rules
- Determine when, and if, naming a tax-exempt charitable remainder trust as the beneficiary of a retirement account will provide favorable tax outcomes to family members and to a charity

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REQUIRED MINIMUM DISTRIBUTIONS
LIFETIME DISTRIBUTIONS

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

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REQUIRED MINIMUM DISTRIBUTIONS
*LIFETIME DISTRIBUTIONS – YEAR 2021

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%

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REQUIRED MINIMUM DISTRIBUTIONS
*LIFETIME DISTRIBUTIONS – YEAR 2022

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%**

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

Kill the *Stretch IRA*.

- QRP and IRA accounts will generally have to be liquidated by the end of the 10th year after death.
- There are no RMDs in years 1 through 9.

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Why do people want a long stretch?

When administering a decedent's estate,
isn't the usual objective to close the estate
within a year of death and have everything distributed
to the heirs and the beneficiaries?

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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.

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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

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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**

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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]

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RETIREMENT PLANS SUBJECT TO THE LAW

- 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

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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

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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

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MARRIED COUPLES: RETIREMENT ASSETS

Surviving spouse has an option that no other beneficiary has:

a ***rollover*** 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

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LEAVE $ IN DECEASED SPOUSES' ACCOUNT?

- Generally, a rollover produces greater income tax deferral than leaving assets in the decedent's account
- Two situations when it may be advisable to leave some assets in the decedent's account (at least for a while)

➢ Surviving spouse is under age 59 ½

➢ Deceased spouse was under age 72, and surviving spouse is past that age (e.g., deceased was age 68 and survivor is age 74)

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LEAVE ASSETS IN DECEDENT'S ACCOUNT?
Required Distributions if the Surviving Spouse is the Sole 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

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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 -- minor child of the decedent

  -- disabled individual -- chronically ill person

  -- beneficiary within 10 years of age of decedent

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LIQUIDATE INHERITED IRAs
IN TEN YEARS

EXCEPTION: "*<u>Eligible</u> 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, 10 year clock starts

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

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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"**

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REQUIRED MINIMUM DISTRIBUTIONS
Ghost Life Expectancy

Age of Beneficiary	**Life Expectancy**
74	**15.6 more years**
75	**14.8**
76	**14.0**
77	**13.3**
78	**12.6**
78	**11.9**
80	**11.2**

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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.**

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

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

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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

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

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

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

<u>Death Before RBD</u>	<u>Death After RBD</u>
	Remaining life
FIVE	expec
YEARS	some is
	decedent's age at death
	Roth IRA: Just 5 years

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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**

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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 10th year after death [rather than the year that the individual would have been age 85]

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Distributions After Death

“ life expectancy“

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

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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

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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]**

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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"?**
- **IRAs payable to trusts**

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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

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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***"

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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)

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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**	

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REQUIRED MINIMUM DISTRIBUTIONS
CONDUIT vs. ACCUMULATION TRUST

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**

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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%**

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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)

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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***

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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 no estate tax marital deduction]*

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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 !]

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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
- 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.

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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 ?

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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

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Minimum 10% charitable deduction

- The value of the charity's remainder interest of a CRT must be at least 10 percent of the initial net fair market value of all property placed in the trust
- [*computed using the Section 7520 discount rates in effect at the time of contribution.*]
- If a contribution is made to a trust that fails the 10 percent requirement, the trust will not qualify as a tax-exempt CRT.

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Minimum 10% charitable deduction

Oversimplified, there are two ways that the present value of a charity's remainder interest in a CRT can be less than 10 percent of the value of the property contributed to the trust.

- **The first is if the stated payout rate is too high** (e.g., "for the next 20 years, distribute to my child 30% of the trust's assets each year").
- The solution is to lower the CRT's payout rate, but it cannot be lowered below 5%.

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Minimum 10% charitable deduction

The second way is if the projected term of the trust is too long.

- The 10 percent requirement limits the projected term of a CRUT to a maximum of roughly 55 years.
- For example, in 2021 if there was only one beneficiary of a CRUT, then the 10 percent test was met only if the beneficiary was at least age **28**. If there were two beneficiaries who were the same age (e.g., husband and wife), then each had to be at least age **39**.

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Minimum 10% charitable deduction

What can an estate planner do if the beneficiaries are so young that a CRT fails the 10 percent test?

- One strategy is to create multiple CRTs. For example, if a client has three children who are triplets and each is age 28, there could be three CRTs (one per child) rather than a single CRT.
- Another option is to have a CRT for a term of years.

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Minimum 10% charitable deduction

The “Sweet Spot”: A 5% CRUT

- With a 5% payout (the lowest distribution rate permitted by law), both the CRUT assets and the annual distributions can grow if the trustee can earn more than 5%
- The benefit to the family of a 5% CRUT is greatest with a long-term trust (maximum projected term of about 55 years) compared to a term-of-years CRT.

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CRT Requirements That Can Pose Challenges

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