The SECURE Act
Responding to the “10-Year Rule”
Effective January 1, 2020

Presented by Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished)
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Responding to the “10-Year Rule”

Outline

• Current Law compared to the “Ten-Year Rule”
• Conduit v. Accumulation Trusts after the Secure Act
• Solutions to Analyze
  – Multi-generational Spray Trusts
  – Fiscal Year Planning
  – Roth Conversions
  – Spousal Rollovers and the New Spousal Rollover Trap
  – IRAs Payable to CRTs
  – IRA Trusts for State Income Tax Savings
  – Life Insurance Solutions
  – Qualified Charitable Contributions
  – Naming a Charity as a Beneficiary
Pre-Secure Act Law
Foundation Concepts

Importance of Planning

- Federal Estate Tax, 40%
- Federal Income Tax, 22%
- State Income Tax, 5%
- Net to Family, 33%
Foundation Concepts

Importance of Planning

• Maximize use of Unified Credit (where needed)
• Maximize use of GST Exemption (where needed)
• Coordinate estate plan under will or revocable trust, including:
  – Distribution rates
  – Conduit v. accumulation trusts
  – Principal v. income state law issues
• Generally, the IRA or qualified plan is the largest asset of the estate
• To minimize income tax on distributions and thereby maximize deferral
Foundation Concepts

Disposition After Death

• Beneficiary designation form, as opposed to a will, controls the property owner after death
• State property law preempted by ERISA or REA
• Income tax consequences will vary substantially depending how the beneficiary form is completed
Arguably, the spouse could designate a beneficiary of his/her marital property interest in the IRA.

To Spouse

Spouse may be entitled to a portion of IRA under state community/marital property laws. Remainder to named beneficiary.

STOP
The spouse has no property rights at death.

Does the state law terminate spouse’s interest at death?

No

Who Dies First?

Participant

Spouse

Is the spouse the beneficiary?

Yes

No

Yes

No
Foundation Concepts

ERISA Plans at Death

Who Dies First?

Participant

Spouse

Is the spouse the only beneficiary?

Yes

To Spouse

No

REA Waiver Requirements Met?

No

To Named Beneficiary

Yes

STOP
The spouse has no property rights at death.
Stretch Out IRAs

“Inherited” IRA

**Objective**: Prolong IRA payments over longest possible period of time, thus increasing wealth to future generations
Stretch Out IRAs

“Inherited” IRA – Key Terms

- **Required Beginning Date (RBD)** – the date when distributions are required to begin
- **Required Minimum Distributions (RMD)** – the minimum amount that must be distributed from the account each year
- **Beneficiary** – person/persons/entity named as beneficiary of the account
- **Designated Beneficiary** – person or trust that qualifies as a designated beneficiary under the 401(a)(9) Regulations. A qualified designated beneficiary is allowed to utilize the life expectancy of a beneficiary. Term defined in Treas. Reg. Sec. §1.401(a)(9)-4, Q&A 1.
Stretch Out IRAs

“Inherited” IRA

• An IRA is treated as “inherited” if the individual for whose benefit the IRA is maintained acquired the IRA on account of the death of the original owner.

• Under current law, the IRA assets can be distributed based upon the life expectancy of the beneficiary.

IRC Sec. 401(a)(9)
Stretch Out IRAs

“Inherited” IRA

• Two Strategies
  – Spousal Rollover
  – Inherited IRA

• Advantages
  – Rollover delays RMD until spouse’s own RBD
  – Inherited IRA provisions allow beneficiary’s life expectancy to be used for distributions after death of IRA owner.
Stretch Out IRAs

“Inherited” IRA – Spousal Beneficiary – Rollover

• Exception to Inherited IRA rules.
• Only available to surviving spouse.
• Allows spouse to roll over assets received as beneficiary to a new IRA in his/her own name.
• Spouse’s age used to determine when required minimum distributions must begin.
• Spouse may use the Uniform Lifetime Table to determine distributions.
Stretch Out IRAs

“Inherited” IRA – Case Study

• Scenarios
  – Immediate distribution
  – IRA payable to non-qualified beneficiary (five-year rule)
  – IRA payable to surviving spouse (no spousal rollover)
  – IRA payable to surviving spouse (spousal rollover)
  – IRA payable to child
  – IRA payable to grandchild
Stretch Out IRAs

“Inherited” IRA – Case Study

• Assumptions
  – IRA owner’s age – 65
  – Spouse’s age – 60
  – Child’s age – 35
  – Grandchild’s age – 10
  – IRA balance – $1,000,000
  – Brokerage account balance – $0
  – Pre-tax growth rate – 8%
  – Ordinary income tax rate – 40%
  – Capital gains tax rate – 20%
## Stretch Out IRAs

### “Inherited” IRA – Case Study

### Summary

<table>
<thead>
<tr>
<th>Year</th>
<th>Immediate Distribution</th>
<th>IRA Payable to Non-Qualified Designated Beneficiary (i.e. 5-Year Rule)</th>
<th>IRA Payable to Surviving Spouse (No Spousal Rollover)</th>
<th>IRA Payable to Surviving Spouse (Spousal Rollover)</th>
<th>IRA Payable to Oldest Non-Spousal Beneficiary</th>
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Stretch Out IRAs

“Inherited” IRA – Case Study

Summary – Year 10

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<th>Year 10</th>
<th>Immediate Distribution</th>
<th>IRA Payable to Non-Qualified Designated Beneficiary (i.e. 5-Year Rule)</th>
<th>IRA Payable to Surviving Spouse (No Spousal Rollover)</th>
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Stretch Out IRAs

“Inherited” IRA – Case Study

Summary – Year 20

IRA Transfer to Family
(The Power of Deferral)

- Immediate Distribution
- IRA Payable to Non-Qualified Designated Beneficiary (i.e. 5-Year Rule)
- IRA Payable to Surviving Spouse (No Spousal Rollover)
- IRA Payable to Surviving Spouse (Spousal Rollover)
- IRA Payable to Oldest Non-Spousal Beneficiary
- IRA Payable to Youngest Non-Spousal Beneficiary

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Stretch Out IRAs

“Inherited” IRA – Case Study

Summary – Year 30

IRA Transfer to Family
(The Power of Deferral)

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- Immediate Distribution
- IRA Payable to Non-Qualified Designated Beneficiary (i.e. 5-Year Rule)
- IRA Payable to Surviving Spouse (No Spousal Rollover)
- IRA Payable to Surviving Spouse (Spousal Rollover)
- IRA Payable to Oldest Non-Spousal Beneficiary
- IRA Payable to Youngest Non-Spousal Beneficiary
Stretch Out IRAs

*Income in Respect of a Decedent (IRD)*

- **Income in respect of a decedent (IRD)** – is all items of gross income in respect of a decedent which were not properly included as taxable income in a tax period falling on or before a taxpayer’s death and are payable to his/her estate and/or another beneficiary

- IRAs & Qualified Plans will generate IRD

IRC Sec. 691(a)
Understanding the Final 401(a)(9) Regulations
401(a)(9) Regulations

Foundational Concepts – Required Beginning Date (RBD)

• Required Beginning Date (RBD): Generally, April 1 of the year following the year the owner turns age 70½.

• Once at RBD, required minimum distributions (RMD) must occur every year by December 31st.
401(a)(9) Regulations

Foundational Concepts – Required Minimum Distribution (RMD)

- RMDs are calculated based upon the aggregate prior year ending account balance divided by the applicable life expectancy factor.

\[
\text{RMD} = \frac{\text{12/31 Balance}}{\text{Life Expectancy Factor}} = \frac{\text{Prior Year 12/31 Balance}}{\text{Life Expectancy Factor}}
\]
## 401(a)(9) Regulations

### Foundational Concepts

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## 401(a)(9) Regulations

### Foundational Concepts – Current Law

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<th><strong>Death Before Required Beginning Date</strong></th>
<th><strong>Death On or After Required Beginning Date</strong></th>
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<td><strong>Designated Beneficiary</strong></td>
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<td><strong>Life Expectancy Rule</strong></td>
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<td><strong>Non-Designated Beneficiary</strong></td>
<td><strong>Five-Year Rule</strong></td>
<td><strong>Owner’s “Ghost” Life Expectancy Rule</strong></td>
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SECURE ACT
TEN-YEAR RULE
SECURE ACT
TEN-YEAR RULE

H.R. 1994 – Sec. 401
Modification of
Required Minimum Distribution Rules
for Designated Beneficiaries

Basically, requires all IRAs and Qualified Plans to be distributed within 10-years of death
SECURE ACT
TEN-YEAR RULE

EFFECTIVE DATE
DECEMBER 31, 2019
SECURE ACT

TEN-YEAR RULE

• Exceptions for certain beneficiaries ("eligible designated beneficiary")

  – Surviving Spouse
  – The employee’s **Children** under the age of majority (*not grandchildren or any other children*)
  – Disabled
  – Chronically ill
  – Individual not more than ten years younger than employee

IRC § 401(a)(9)(E)(ii)
### SECURE ACT

#### TEN-YEAR RULE

*Example*

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
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<tbody>
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<td>After-Tax Growth Rate</td>
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<td>Average Income Tax Rate - Life Expectancy Rule</td>
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<td>Average Income Tax Rate - Ten Year Rule</td>
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<td>Distributions Occur at Beginning or End of Period?</td>
<td>End</td>
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<td>Lump-Sum Distribution or Amortize Payments?</td>
<td>Amortize</td>
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SECURE ACT
TEN-YEAR RULE

Example
The Conduit Trust Disaster

• A conduit ("safe-haven") trust requires all RMDs to be distributed to the beneficiaries annually as received
• This worked well under the life expectancy rules
• However, it can be a disaster under the ten-year rule
# The Conduit Trust Disaster

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<th>Years after Death</th>
<th>RMD Current Method</th>
<th>10-Year Rule Options</th>
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</tr>
<tr>
<td>7</td>
<td>$30,409</td>
<td>$142,378</td>
</tr>
<tr>
<td>8</td>
<td>$32,584</td>
<td>$142,378</td>
</tr>
<tr>
<td>9</td>
<td>$34,917</td>
<td>$142,378</td>
</tr>
<tr>
<td>10</td>
<td>$37,417</td>
<td>$142,378</td>
</tr>
</tbody>
</table>

Assumes $1,000,000 IRA at death & a 7% growth rate
Modifying a Conduit Trust

• When to Consider
  – Death occurs after the effective date
  – The long-term benefits of a trust are required
  – The 10-year period is locked in

• Reform or Decant
  – Remove the conduit language
  – Replace with accumulation type language

• Income Tax Planning

• Why reformations have less tax-risk
Managing the Income Tax
Consequences of the Ten-Year Rule

SOLUTIONS TO ANALYZE
Solutions – Key Concepts

- Retain Income Tax Deferral
- Bracket Management within a Family
- Fulfill Charitable Goals with IRD
- “Convert” Ordinary Income to Capital Gain
- Manage State Income Taxes
Solutions to Analyze

Overview

- Multi-generational Spray Trusts
- Fiscal Year Planning
- Roth Conversions
- Spousal Rollovers and the New Spousal Rollover Trap
- IRAs Payable to CRTs
- IRA Trusts for State Income Tax Savings
- Life Insurance Solutions
- Qualified Charitable Contributions
- Naming a Charity as a Beneficiary
2020 Ordinary Income Tax Rates

**Single**
- < $9,875: 10%
- $9,875 to $40,125: 12%
- $40,125 to $85,525: 22%
- $85,525 to $163,300: 24%
- $163,300 to $207,350: 32%
- $207,350 to $518,400+: 35%
- $518,400+: 37%

**MFJ**
- < $19,750: 10%
- $19,750 to $80,250: 12%
- $80,250 to $171,050: 22%
- $171,050 to $326,600: 24%
- $326,600 to $414,700: 32%
- $414,700 to $622,050: 35%
- $622,050+: 37%

**199A Threshold**
- Single: $85,525
- MFJ: $171,050

**NIIT Threshold**
- Single: $207,350
- MFJ: $414,700
Foundational Concepts
General Tax Rules

• Income taxed to either the trust or the beneficiaries
  – If income is accumulated, then the income is taxed to the trust/estate
  – If income is distributed, then the trust/estate gets an income tax deduction and beneficiaries report taxable income
Foundational Concepts

2020 Ordinary Income Tax Rates for Estates & Trusts

- 37% above $12,950
- 35% above $9,450
- 24% above $2,600
- 10% below $2,600
Foundational Concepts
Types of “Income”

• Fiduciary accounting income
  – Governed by state law and the trust instrument
  – Determines the amount that may or must pass to the trust’s or estate’s beneficiaries

• Tax accounting income
  – Governed by the federal income tax law
  – Determines who is taxed on the income
Foundational Concepts
Typical Types of “Income” Under Traditional Fiduciary Accounting

• Interest
  – Taxable
  – Tax-exempt

• Dividends

• Rents (net of expenses)

• Royalties

• A portion of IRAs and/or RMDs (varies by state law)
  – RMD rule
  – 10% rule
  – 4% rule
Foundational Concepts

Typical Types of “Principal” Under Traditional Fiduciary Accounting

• A portion of IRAs and/or RMDs (varies by state law)
• Increases in asset value (i.e. growth)
• Realized long-term capital gain
• Realized short-term capital gain
Foundational Concepts
Distributable Net Income (DNI)

- Determines the amount of the trust’s or estate’s income distribution deduction.
- Determines how much the beneficiaries must report as income on their tax returns.
- Determines the character (e.g. interest, dividends, IRAs etc.) of the taxable income in beneficiaries’ hands.
Foundational Concepts
Distributable Net Income (DNI)

**Trust/Estate**
DNI acts as a ceiling for purposes of the allowable deduction

**Beneficiary**
DNI acts as a ceiling for the total amount of income the beneficiary must report on his/her tax return

DNI
Foundational Concepts
Distributable Net Income (DNI)

Example
Assume that a complex trust had the following sources of income and deductions during the current tax year:

Interest income $  1,000
Dividend income 1,000
IRA distributions 48,000
Attorney/accountant fees 500
**Foundational Concepts**

**Distributable Net Income (DNI)**

Example (cont.)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income</td>
<td>$ 1,000</td>
</tr>
<tr>
<td>Dividend income</td>
<td>$ 1,000</td>
</tr>
<tr>
<td>IRA Distributions</td>
<td>$ 48,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>$ 50,000</strong></td>
</tr>
<tr>
<td>Less: Attorney/accountant fees</td>
<td>(500)</td>
</tr>
<tr>
<td><strong>Adjusted Gross Income (AGI)</strong></td>
<td><strong>$ 49,500</strong></td>
</tr>
<tr>
<td>Less: Exemption</td>
<td>(100)</td>
</tr>
<tr>
<td><strong>Taxable Income</strong></td>
<td><strong>$ 49,400</strong></td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$ 49,400</td>
</tr>
<tr>
<td>Add-In: Exemption</td>
<td>100</td>
</tr>
<tr>
<td><strong>Distributable Net Income (DNI)</strong></td>
<td><strong>$ 49,500</strong></td>
</tr>
</tbody>
</table>
MULTI-GENERATION SPRAY TRUST

• As it relates to the new 10-year rule, the purpose of using a spray trust is to spread income across a large number of taxpayers thereby lowering the effective rate and to retain the ability to accumulate income as prudent

Kiddie Tax Issues
IRC § 1(g)
FISCAL YEAR PLANNING
FISCAL YEAR PLANNING

• An estate (and/or “filing trust” under an IRC §645 election) may opt for a fiscal year-end not to exceed 12 months.
  - A “filing trust” is the decedent’s Qualified Revocable Trust (QRT) prior to death.
  - A probate estate does not need to exist in order to make an IRC §645 election. Instead, the “filing trust” becomes the estate for income tax purposes.
  - The IRC §645 election (using IRS Form 8855) must be made by the due date (including extensions) for the first income tax return.
FISCAL YEAR PLANNING

• By electing a fiscal year for the estate/QRT, the five-year IRA distribution period is allocated over six tax years.

**Fiscal Year 1**
7/13/2019 to 11/30/2019

**Fiscal Year 2**
12/1/2019 to 11/30/2020

**Fiscal Year 3**
12/1/2020 to 11/30/2021

**Fiscal Year 4**
12/1/2021 to 11/30/2022

**Fiscal Year 5**
12/1/2022 to 11/30/2023

**Fiscal Year 6**
12/1/2023 to 11/30/2024

**2019 Tax Year**
7/13/2019 to 11/30/2019

**2020 Tax Year**
12/1/2019 to 11/30/2020

**2021 Tax Year**
12/1/2020 to 11/30/2021

**2022 Tax Year**
12/1/2021 to 11/30/2022

**2023 Tax Year**
12/1/2022 to 11/30/2023

**2024 Tax Year**
12/1/2023 to 11/30/2024

NOTE: In order for the six-year IRA distribution strategy to work, the first fiscal year must end before December 31st of the year of death (e.g. November 30th)

Date of death: 7/13/2019

Fiscal year-end of final income tax return: 11/30/2024

Last day of “five-year” IRA distribution period: 12/31/2023
### FISCAL YEAR PLANNING

- Example

<table>
<thead>
<tr>
<th></th>
<th>Normal Fiscal Year</th>
<th>Six-Year Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019 Tax Year</td>
<td>$200,000</td>
<td>$166,667</td>
</tr>
<tr>
<td>2020 Tax Year</td>
<td>$200,000</td>
<td>$166,666</td>
</tr>
<tr>
<td>2021 Tax Year</td>
<td>$200,000</td>
<td>$166,667</td>
</tr>
<tr>
<td>2022 Tax Year</td>
<td>$200,000</td>
<td>$166,666</td>
</tr>
<tr>
<td>2023 Tax Year</td>
<td>$200,000</td>
<td>$166,667</td>
</tr>
<tr>
<td>2024 Tax Year</td>
<td>$0</td>
<td>$166,667</td>
</tr>
<tr>
<td><strong>TOTAL</strong>*</td>
<td><strong>$1,000,000</strong></td>
<td><strong>$1,000,000</strong></td>
</tr>
</tbody>
</table>

* Assumes 0% growth of the IRA
FISCAL YEAR PLANNING

• Planning considerations
  – An IRC §645 is only valid for the later of: (a) two years from the date of the decedent’s death or (b) six months after the “final determination of estate tax” (if an IRS Form 706 was filed).
  – If an estate is open for more than two years, then an explanation must be made on the IRS Form 1041 as to why the estate is being held open (see IRS Form 1041, Page 2, Other Information, Question 8).
FISCAL YEAR PLANNING

• By having an estate paid to multiple trusts, IRA distributions would be allocated over a great number of distributees, thus lowering overall taxable income.

OPTION 1 – Outright to Beneficiaries

$1,000,000 IRA

$200,000/year over five years

Estate

$50,000 $50,000 $50,000 $50,000

B1 B2 B3 B4

OPTION 2 – Paid in Trust

$1,000,000 IRA

$200,000/year over five years

Estate

$50,000 $50,000 $50,000 $50,000

T1 T2 T3 T4

$37,500 $37,500 $37,500 $37,500

B1 B2 B3 B4
Roth Conversions
ROTH CONVERSIONS

- As it relates to the new 10-year rule, the purpose of Roth Conversions is to spread distributions over many years and lower brackets
General Concepts

• 100% of growth is tax-exempt
• No required minimum distributions at age 70½ (72 under the SECURE Act)
  – NOTE: Distributions from Roth IRAs cannot be used to fulfill the RMD from a traditional IRA
• RMDs on Inherited Roth IRAs
The graphic compares a $100,000 Roth Conversion at age 60 to “doing nothing.” It assumes 24% tax rate applies to all distributions/conversions, the conversion tax is paid from the IRA, a 6% pre-tax rate of return, and a 4.75% after-tax rate of return.
General Concepts

• Convertible accounts
  – Traditional IRAs
  – 401(k) plans
  – Profit sharing plans
  – 403(b) annuity plans
  – 457 plans
  – “Inherited” 401(k) plans (see Notice 2008-30)

• Non-convertible accounts
  – “Inherited” IRAs
  – Education IRAs
General Concepts

• Reasons for converting to a Roth IRA
  – Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), high basis non-deductible traditional IRAs, etc.
  – Suspension of the minimum distribution rules at age 70½ provides a considerable advantage to the Roth IRA holder
  – Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax
  – Taxpayers who can pay the income tax on the IRA from non-IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields
General Concepts

• Reasons for converting to a Roth IRA
  – Taxpayers who need to use IRA assets to fund their Basic Exclusion Amount (BEA) bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds
  – Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates
  – Federal tax brackets are more favorable for married couples filing joint returns than for single individuals
  – Post-death distributions to beneficiaries are tax-free
  – Tax rates are expected to increase in the near future
  – Impact of the new 3.8% Medicare surtax
General Concepts

• Reasons for converting to a Roth IRA
  – Impact on the taxation of Social Security
  – Impact on Medicare premiums
  – Bracket management when IRAs are payable to trusts
The New Spousal Rollover Trap
THE NEW SPOUSAL ROLLOVER TRAP

• Prior to SECURE Act, a spousal rollover was generally the best practice to preserve the IRA

• However, for many it may now be better to begin distributing the IRA earlier in order to minimize exposure to higher tax brackets
THE NEW SPOUSAL ROLLOVER TRAP

Old Best Practice

Deceased Spouse

Surviving Spouse

“Inherited” IRA

Children

Spousal Rollover
THE NEW SPOUSAL ROLLOVER TRAP

Old Best Practice & the New Spousal Rollover Trap

First Death

8 Years ?

Second Death

10 Years

10-Year Rule Distributions

Lifetime RMDs
THE NEW SPOUSAL ROLLOVER TRAP

New Best Practice

Deceased Spouse

Spousal Rollover

“Inherited” IRA

Surviving Spouse

“Inherited” IRA

Children
THE NEW SPOUSAL ROLLOVER TRAP

New Best Practice

Roth Conversions or Distributions

10-Year Rule Distributions

First Death

8 Years?

Second Death

10 Years

Lifetime RMDs
Charitable Remainder Trusts
Charitable Remainder Trusts

Overview

IRD § 401(a)(9), 664.
Charitable Remainder Trusts

*Types of CRTs*

- Charitable Remainder Annuity Trust (CRAT)
  - The beneficiaries receive a fixed percentage of the initial trust value or a stated amount annually or more frequently.
  - The amount paid doesn’t change from year to year.
  - The annual payment must be 5-50% of the fair market value of the assets at the time of contribution.
  - The term of the annuity can be:
    - For a term up to 20 years,
    - Over the life of the annuitant(s),
    - Over the shorter of the two, or
    - Over the longer of the two.
Charitable Remainder Remainder Trusts

*Types of CRTs*

- Charitable Remainder Unitrust (CRUT)
  - Income beneficiaries receive a stated percentage of the trust’s assets revalued each year.
  - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn.
Charitable Remainder Trusts

**Taxation of Distributions**

- The character of income received by the recipient is subject to and controlled by the tier rules of IRC §664(b):
  - First, distributions are taxed as ordinary income
  - Second, distributions are taxed as capital gains
  - Third, distributions are taxed as tax-exempt income (e.g. municipal bond income)
  - Finally, distributions are assumed to be the non-taxable return of principal
Charitable Remainder Trusts

Taxation of Distributions

STEP 1: Current Ordinary Income

Tier 1

STEP 2: Accumulated Ordinary Income

Tier 2

STEP 3: Current Capital Gains

STEP 4: Accumulated Capital Gains

Tier 3

Tier 4

STEP 5: Current Tax-Exempt Income

STEP 6: Accumulated Tax-Exempt Income

STEP 7: Return of Capital
State Income Tax Planning
State Income Tax Planning

• Review State Law of the IRA Owner
  – Will the home state tax the IRA Trust?
  – Does the home state have a throwback rule?
• Design a beneficiary form to be payable to non-grantor trust in states with no income tax
• The payments trapped in the trust will avoid state income taxes
## State Income Tax Planning

### 4th Annual Non-Grantor Trust State Income Tax Chart - Page 1 of 2

<table>
<thead>
<tr>
<th>State (alphabetical)</th>
<th>Taxing Statute</th>
<th>Top 2018 Tax Rate</th>
<th>Under What Conditions does the State Tax a Non-Grantor Trust?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>Ala. Code §§40-18-1(33)</td>
<td>5.00%</td>
<td>If the trust is set up by the Will of an AL resident or settlor was an AL resident at time trust became irrevocable, and an AL resident is a beneficiary or trustee for more than seven months during the tax year</td>
</tr>
<tr>
<td>Alaska</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>Arizona</td>
<td>Ariz. Rev. Stat. §43-1301(15)</td>
<td>4.54%</td>
<td>If there is at least one AZ trustee</td>
</tr>
<tr>
<td>Arkansas</td>
<td>Ark. Code Ann. §§26-51-201(a)(c)</td>
<td>6.90%</td>
<td>If the trust is set up by the Will of an AR resident or settlor was an AR resident, and there is an AR trustee</td>
</tr>
<tr>
<td>California</td>
<td>Cal. Rev. &amp; Tax. Code §177242</td>
<td>13.30%</td>
<td>If the trust has either a CA trustee or a CA non-contingent beneficiary, tax apportioned based on CA vs. non-CA trustees and beneficiaries</td>
</tr>
<tr>
<td>Colorado</td>
<td>Colo. Rev. Stat. §§39-22-161(10)</td>
<td>4.63%</td>
<td>If the trust is administered in CO</td>
</tr>
<tr>
<td>Connecticut</td>
<td>Conn. Gen. Stat. §12-70(a)(1)(C); (D); (E)</td>
<td>6.99%</td>
<td>If the trust is set up by the Will of a CT resident or settlor was a CT resident at time property transferred to an irrevocable trust or at the time property transferred to revocable trust that later became irrevocable --- other than for Will transfer, tax is modified fractionally to the extent there are nonresident non-contingent beneficiaries</td>
</tr>
<tr>
<td>Delaware</td>
<td>Del. C. §§1601.8; 39; Del. C. §1636</td>
<td>6.60%</td>
<td>If the trust is set up by the Will of a DE resident, or settlor of trust was a DE resident, or the majority of the trustees are DE residents for more than ½ the year; in all of such cases only if there is a DE beneficiary</td>
</tr>
<tr>
<td>Florida</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>Georgia</td>
<td>O.C.G.A. §48-7-22</td>
<td>6.00%</td>
<td>If there is trust property located in GA or if the trustee is “managing funds for the benefit of a resident of” GA</td>
</tr>
</tbody>
</table>

https://www.oshins.com/state-rankings-charts
Life Insurance Solutions
Life Insurance

• Two Strategies
  – IRA Roth Conversion Hedge
  – IRA Relocation
Life Insurance – Roth Hedge

It’s a Balancing Act …
Bet to Live? Bet to Die?
Life Insurance – Roth Hedge

• The 10-year rule, creates new actuarial risk of early death:
  – Under current law, qualified accounts can be drawn-down over decades after death capturing deferral and virtually assuring bracket arbitrage
  – However, a 10-year distribution requirement will unfairly tax those who die when their savings peak around retirement age or shortly thereafter
  – Life insurance could however offset this risk that family wealth will be lost to tax
Life Insurance – Roth Hedge

• Roth conversions will be the primary way in which those with large IRAs avoid exposure to higher rates after death
  – However, the effectiveness of this strategy increases with time
  – A life insurance policy equal to the difference between the theoretical terminal tax and the terminal tax in the event of early death would offset this risk
Life Insurance – Relocation

• The basic theory is that Roth Conversions will generally produce the same tax deferral result as a permanent life insurance policy
• Therefore, using IRA distributions to fund premium payments can sometimes make sense
  – Often works for those with excessive RMDs and high tax rates (basic minimal funding until RMDs begin possible)
  – Often works for those who may be subject to an estate tax
  – Can work in other situations
Life Insurance – Relocation

Current Account Balance
- Traditional IRA: $1,000,000
- Roth IRA: $1,000,000
- Life Insurance: $1,000,000

Less: Income Taxes @ 40%
- Traditional IRA: $(400,000)
- Roth IRA: $(400,000)

Net Balance
- Traditional IRA: $1,000,000
- Roth IRA: $600,000
- Life Insurance: $600,000

Growth Until Death
- 300.00%

Account Balance @ Death
- Traditional IRA: $3,000,000
- Roth IRA: $1,800,000
- Life Insurance: $1,800,000

Less: Income Taxes @ 40%
- Traditional IRA: $(1,200,000)
- Roth IRA: $-
- Life Insurance: $-

Net Account Balance to Family
- Traditional IRA: $1,800,000
- Roth IRA: $1,800,000
- Life Insurance: $1,800,000
Charitable Planning with IRAs
Charitable Planning with IRAs

Basic Overview

• Available Options to Transfer IRD Assets to Charity
  – Name a Charity as the Beneficiary of the IRA
  – Specific Bequest of IRD Assets to Charity under a Will
  – Power of Executor to make a non-pro rata Distribution to Residuary Beneficiaries
  – Assignment of IRD to charity to satisfy a Pecuniary Bequest
  – Recognition of income with § 642(c) Charitable Deduction
  – Recognition of income without § 642(c) Charitable Deduction
Charitable Planning with IRAs

Basic Overview

§ 642(c)(1) General rule

In the case of an estate or trust, there shall be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c)
Charitable Planning with IRAs

Basic Overview

§ 642(c)(2) Amounts permanently set aside

There shall also be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c).

*Applies only to estates – not to trusts funded later than 1969

See the remainder of the statute for details.
To be added to our IRA update newsletter, please visit:

keeblerandassociates.com/speaking