Estate Planning for IRAs & Qualified Plans with an Emphasis on IRAs Payable to Trusts

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Outline

• Secure Act – Ten Year Rule
• Foundation Concepts
• Stretch Out IRAs
• 401(a)(9) Regulations
• Charitable Planning with IRAs
• IRAs Payable to Trusts
• Disclaimer Planning
• Spousal Rollover Trap
SECURE ACT
TEN-YEAR RULE

EFFECTIVE DATE:
January 1st, 2020
Secure Act: 10 Year Rule

The SECURE Act basically, requires all IRAs, Roth IRAs, and Qualified Plans to be distributed within 10-years of death.
Secure Act: 10 Year Rule

• Post-Death Distributions after the Secure Act:
  – Non-Designated Beneficiaries
    • Five-Year Rule
    • “Ghost” Rule
    • Guidance Needed from IRS or Treasury
  – Designated Beneficiaries
    • Ten-Year Rule
  – Eligible Designated Beneficiaries
    • Spouses – Life Expectancy
    • Minor Children – Life Expectancy (modified)
    • Disabled Beneficiaries – Life Expectancy
    • Chronically ill Beneficiaries – Life Expectancy
    • Individual not more than ten years younger than employee

IRC § 401(a)(9)
Secure Act: 10 Year Rule

Eligible Designated Beneficiaries

• Minor Child
  – As described in IRC §409(a)(9)(F) and in the attendant regulations, a child may be treated as having not reached majority if they have not completed a “specified course of education” and is under the age of 26.
  – If both of the requirements are met, the minor child beneficiary may use the Life Expectancy until 26 years of age.
Secure Act: 10 Year Rule

Eligible Designated Beneficiaries

• Disabled Persons
  – As described in IRC §72(m)(7), “an individual shall be considered to be disabled if they are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration.”
  – An individual must provide proof of their disability.
  – If an individual is deemed disabled, they are allowed to use the Life Expectancy rule.
Secure Act: 10 Year Rule

Eligible Designated Beneficiaries

• Chronically ill
  – As described in IRC §7702B(c)(2), a “chronically ill individual” means an individual who has been certified by a licensed health care practitioner as:
    • Being unable to perform at least two activities of daily living for a period of at least 90 days due to loss of functional capacity,
    • Having a level of disability that is to the level of the bullet point described above, or
    • Requiring substantial supervision to protect such individual from threats to health and safety due to cognitive impairment.
  – If an individual is deemed chronically ill, they are allowed to use the Life Expectancy rule.
Responding to the “Ten-Year Rule”

• Prior Law Compared to the “Ten-Year Rule”
• Beneficiary Options after the Secure Act
• Conduit v. Accumulation Trusts after the Secure Act
• Solutions to Analyze which may Reduce the Impact of the 10-Year Rule:
  – Multi-generational Spray Trusts
  – 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
Foundation Concepts
Foundation Concepts

Basics

• An IRA is either a trust or a custodial account.
• The trustee or custodian must be a bank or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which they will administer the account will be consistent with the requirements of this section.

IRC Sec. 408(a) & (h)
Foundation Concepts

Basics

• Federal law which defines and controls IRAs and qualified plans:
  – IRC §408 and §408A
  – IRC §401 – Distribution Rules
  – Other Tax Law – Income Tax, Estate Tax, GST
  – Private Letter Rulings, Revenue Rulings, etc.
  – Employee Retirement Income Security Act (ERISA)
  – Retirement Equity Act (REA)
  – Bankruptcy Law
Foundation Concepts

Basics

- State law which may apply to IRAs & qualified plans:
  - Uniform Principal and Income Act (UPIA)
  - Power of attorney
  - Guardianship
  - Intestacy
  - Elective share, community property & divorce
  - Bankruptcy
  - Tort

Conduit Trust and the Ten-Year Rule:
Fiduciary Accounting & Property Law Issues
Foundation Concepts

Basics

• Wills and the executor control assets of an estate.
• Trust instruments and the trustee control assets in trust.
• Beneficiary designation forms or a default provision of the contract with the custodian or trustee control the disposition of an IRA and a qualified plan.
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
• Generally, the IRA or qualified plan is the largest asset of the estate
• To minimize income tax on distributions and thereby maximize deferral
• Address Secure Act changes
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.
Foundation Concepts

Retirement Equity Act

• Retirement Equity Act & *Boggs v. Boggs*:
  – Plans must offer automatic survivor benefits.
  – Non-employee spouse’s community/marital property interest in the plan terminates the non-employee spouse’s death.
  – Non-employee spouse does not have the power to name a plan beneficiary.
  – Spousal permission required for the employee spouse to name a non-spousal beneficiary; called a REA Waiver.

IRC § §417 and 401(a)(11); Treas. Reg. §1.401(a)-20; *Boggs*, 177 S Ct 1754, 138 L Ed 2d 45 (1997).
Foundation Concepts

Disposition at Death After Divorce

• **Kennedy v. Plan Administrator**
  – Ex-spouse gave up her right to the retirement plan, but the decedent did not change the beneficiary form.
  – **Holding**: The plan administrator is required by ERISA to pay benefits to the ex-spouse per the plan documents.
  – **Reasoning**: ERISA preempts the marital settlement agreement.

Foundation Concepts

Disposition at Death After Divorce

• *Egelhoff v. Egelhoff*
  
  – State law purported to automatically revoke a former spouse's status as beneficiary following a divorce.
  
  – **Held:** State law that purports to control distributions from an ERISA plan is preempted.

Foundation Concepts

Reclassification of Retirement Accounts

• PLR 8929046 – A transaction in which a wife transmuted her community property interest in her husband's IRA in return for his community property interest in other assets was not subject to income tax.

• PLR 199937055 – IRS allows IRA to be classified as community property pursuant to a community property agreement. Taxpayer then proposed to transfer the community property interest in IRA to spouse. IRS would treat the transfer as a taxable distribution.

• PLR 20021501 – Husband and wife entered into a post-nuptial agreement that provided for the division of an IRA at divorce will not be considered a prohibited transaction under IRC Sec. 4975(c) or cause a loss of exemption with respect to the IRA.
Foundation Concepts

Community Property Swaps

• PLR 199925033 – The non-pro rata partition of community property in a trust and the allocation of an IRA to a survivor's trust is neither a sale or exchange under section 1001, nor a transfer under section 691.

• PLR 201125047 – Marital property exchange facilitated spouse rollover of entire IRA.
Foundation Concepts

Reclassification of Retirement Accounts

• Spouses may provide in a community/marital property agreement that at the death of a spouse some or all of their community/marital property will be divided based on aggregate value rather than divided item by item.

• Surviving spouse and successor in interest to the decedent's share of community/marital property may enter into an agreement providing that some or all of the community/marital property in which each has an interest will be divided based on aggregate value rather than divided item by item.
Arguably, the spouse could designate a beneficiary of his/her marital property interest in the IRA.

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

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

To Spouse

STOP
The spouse has no property rights at death.

No

Yes

Who Dies First?

Participant

Spouse

Is the spouse the beneficiary?

Yes

No
Foundation Concepts

ERISA Plans at Death

Who Dies First?

Participant

Is the spouse the only beneficiary?

Yes

To Spouse

No

REA Waiver Requirements Met?

No

Spouse

STOP
The spouse has no property rights at death.

Yes

To Named Beneficiary
Pre-2020 Law

TRADITIONAL IRA DISTRIBUTION FLOWCHART

Is the IRA owner living?

Yes: Is the spouse the “sole beneficiary”?
- Yes: Is the spouse more than 10 years younger than IRA participant?
  - Yes: Calculate using Joint and Last Survivor Table
  - No: Calculate using Uniform Lifetime Table
- No: Calculate using Uniform Lifetime Table

No: Spouse

Is the trust a designated beneficiary? See PLRs 200228025 and 200235039.

Yes: Rollover or inherited IRA?
- Yes: Rollover (take RMD, if applicable, then go to step one treating survivor as new owner)
- No: Inherited IRA

No: Trust by disclaimer

Did owner die before RBD?

Yes: Children or grandchildren by disclaimer

No: Charity

Remaining life expectancy of decedent as of death based on Single Life Table

Five-Year Rule

Yes: Life expectancy of each beneficiary

No: Life expectancy of oldest beneficiary

Please email us for more information on this chart and for other education products: contactus@keeblerandassociates.com

## Secure Act Beneficiary RMD Summary

**Draft**

<table>
<thead>
<tr>
<th>Tax Terminology</th>
<th>Designated Non-Eligible Beneficiary</th>
<th>Surviving Spouse</th>
<th>Eligible Minor Child</th>
<th>Person Less Than 10 years younger</th>
<th>Disabled or Chronically ill Person</th>
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<td><strong>Outright Beneficiary</strong></td>
<td>Ten-Year Rule</td>
<td>Life Expectancy Rule</td>
<td>Life Expectancy Rule (Until Majority then Ten-Year Rule)</td>
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<td><strong>Designated Beneficiary Trust</strong></td>
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<td>Life Expectancy Rule</td>
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</table>
Stretch Out IRAs Before and After the Secure Act
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.
- **Non-Designated Beneficiary** – A beneficiary that is not a designated beneficiary
- **Eligible Designated Beneficiary** – A beneficiary excepted from the 10-year rule created by the SECURE Act as defined under IRC §401(a)(9)(H)
Stretch Out IRAs

“Inherited” IRA

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

Secure Act: Key Concepts

- Five-Year Rule
- Ten-Year Rule
- “Ghost” Rule
- Life Expectancy Rule
- Spousal Rollover Rule
- Ten-Year Rule, at Beneficiary's Death
Stretch Out IRAs

“Inherited” IRA After Secure

• 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.

• Ten-Year Rule for Most Post-Secure Deaths

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

“Inherited” IRA

• Post-death RMDs based on whether a “designated beneficiary” exists:
  – Only “individuals” with quantifiable life expectancy can be “designated beneficiaries”.
  – If trust qualifies, look through to underlying trust beneficiaries.

  Payout Rules
  • Pre-Secure Rules
  • Post-Secure Rules
Stretch Out IRAs

“Inherited” IRA – Post-Secure

• “Designated beneficiaries:”
  – Individuals
  – Certain Designated Beneficiary Trusts
  – Eligible Designated Beneficiary Trusts

• “Non-designated beneficiaries:”
  – Estates
  – Distribution out of estates to estate beneficiaries does not make the beneficiary the “designated beneficiary”
  – Charities
  – Non-Designated Beneficiary Trusts
    • Five-Year rule for Pre-RBD Deaths
    • “Ghost” Rule for Post-RBD Deaths
Stretch Out IRAs

“Inherited” IRA – The Surviving Spouse

• Basic Strategies
  – Spousal Rollover
  – Inherited IRA

Both Available after the Secure Act

• Primary Advantages of a Spousal Rollover:
  – Rollover delays RMD until spouse’s own RBD
  – Rollover reduces RMDs
  – Rollover preserves the opportunity to name an “eligible designated beneficiary” at the surviving spouse’s death
Stretch Out IRAs

“Inherited” IRA – Spousal Beneficiary

• Marital deduction should be available
• Typically the default
• If no rollover is chosen, then the life expectancy factor of the spouse is used by reference to the Single Life Table beginning in the year the IRA owner would have turned age 70½ (Note: Age 72 After 12-31-2019).
• Each year thereafter the life expectancy divisor is recalculated by referencing the Single Life Table.
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.
- Available for a Roth IRA.
- Spouse’s age used to determine when required minimum distributions must begin.
- Spouse may use the Uniform Lifetime Table to determine distributions.
- Allows for Post-Rollover Roth Conversions
- Allows for Post-Rollover IRA Relocation
- Allows for Post-Rollover CRT Planning
- Allows for an eligible designated beneficiary to be named at the surviving spouse’s death
Stretch Out IRAs

“Inherited” IRA – Adult Child / Grandchild Beneficiary

• Utilizes the exception to the Five-Year or Ghost rule
• Avoids IRA assets being subject to estate tax in spouse’s estate
• Achieves “Inherited IRA” to the degree that distributions occur over Ten-Year Rule

IRA \[\xrightarrow{\text{Ten-Year Distribution Rule}}\] Adult Child

IRC §401(a)(9)(H)

Note: No RMDs until the final year. Earlier distributions are simply tax planning.
Stretch Out IRAs

“Inherited” IRA – Minor Child Beneficiary

• Life expectancy of a minor child is determined in year after the year of the IRA owner’s death by reference to the Single Life Table and then is reduced by a value of one each subsequent year.

• Upon reaching “Majority” the Ten-Year Rule Applies
MULTI-GENERATION SPRAY TRUST

• As it relates to the new ten-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)
Stretch Out IRAs
“Inherited” IRA – Pension Protection Act of 2006

• Beginning in 2007, non-spousal beneficiaries (e.g. children, grandchildren, friends, etc.) are permitted to roll over a qualified retirement plan (e.g. 401(k)), via a trustee-to-trustee transfer, into an “inherited” IRA
• “Designated beneficiary” trusts are also permitted to roll over qualified retirement plans to “inherited” IRAs
• Notice 2007-7

Continues to apply after the Secure Act
Stretch Out IRAs

Roth Conversion of “Inherited” Qualified Plan

• Notice 2008-30 – Section II, Q&A 7, allows non-spouse beneficiaries to convert inherited qualified plans to inherited Roth IRAs.

Continues to apply after the Secure Act
Stretch Out IRAs

“Inherited” IRA – Key Issues in Making the “Inherited IRA” Work

- Beneficiary Designation Forms
- Tax Apportionment Language
- Irrevocable Life Insurance Trust (ILIT)
- Properly Drafted IRA Trusts
Stretch Out IRAs

“Inherited” IRA – Common Mistakes to Avoid

• Incorrect titling
• Failure to take RMDs
  – Before death
  – Year of death
  – After death
• Failure to utilize disclaimers when appropriate
• Failure to analyze contingent beneficiaries when utilizing disclaimers
• Taking a lump-sum distribution
Stretch Out IRAs

“Inherited” IRA – Common Mistakes to Avoid

• Spousal rollover before age 59 ½
  – Will cause pre-59 ½ distributions to be subject to the 10% early distribution penalty. *Sears v. Commissioner*, TC Memo 2010-146.
  – If no rollover occurred, pre-59 ½ distributions can be taken penalty free.

• Solution
  – Do not perform spousal rollover for the funds that are needed before the spouse reaches age 59 ½.
Stretch Out IRAs

“Inherited” IRA – Common Mistakes to Avoid

• For non-spousal beneficiaries, it is critical to keep inherited IRA in the name of the deceased IRA owner.
  
  – **Example (Individual):** “John Smith, deceased, IRA for the benefit of James Smith”
  
  – **Example (Trust):** “John Smith, deceased, IRA for the benefit of James Smith as Trustee of the Smith Family Trust dated 1/1/2018.”
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

IRC Sec. 691(a)
Stretch Out IRAs

*Income in Respect of a Decedent (IRD)*

- **Specific Items of IRD**
  - IRAs and other qualified retirement plans
  - Unpaid salaries/wages at the time of death
  - Dividends and interest earned, but not taxed, prior to death
  - Unrecognized capital gain on an installment note at the time of the seller’s death
  - Net Unrealized Appreciation (NUA) on employer securities
Stretch Out IRAs

*IRC §691(c) Deduction*

- To the extent that a decedent’s taxable estate includes items of IRD and a federal estate tax is assessed, the estate and/or its beneficiaries are entitled to an income tax deduction for the estate tax attributable to IRD.
  - This deduction is a miscellaneous itemized deduction NOT subject to the 2% AGI limitation and is not suspended by the TCJA.
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 72.

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

• RMDs do not apply to Roth IRAs during the owner’s life.
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.

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

Foundational Concepts

• Life expectancy tables
  – Uniform Lifetime Table
  – Single Life Table
  – Joint and Last Survivor Table
    ○ Available where the spouse is the sole beneficiary and is more than 10 years younger than the account owner.
# 401(a)(9) Regulations

## Foundational Concepts

### Single Life Table

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401(a)(9) Regulations

*Foundational Concepts*

- Post-death RMDs based on whether “designated beneficiary” exists
  - Only “individuals” with quantifiable life expectancy can be “designated beneficiaries”
  - If trust qualifies, look through to underlying trust beneficiaries
    - Distribution out of trust to beneficiary does not make the beneficiary the “designated beneficiary”
- Types of Trusts
  - Conduit trusts
  - Accumulation trusts
    - Non-Designated Beneficiary Trust
    - Designated Beneficiary Trust
    - Eligible Designated Beneficiary Trust (New Concept)
401(a)(9) Regulations

Foundational Concepts

• Qualifying “designated beneficiaries”:
  – Individuals
    ◦ Spouse
    ◦ Child
    ◦ Parent
    ◦ Grandchild
    ◦ Brother/sister
    ◦ Niece/Nephew
    ◦ Friend
  – Designated Beneficiary Trusts
  – Eligible Beneficiaries
  – Eligible Designated Beneficiary Trusts
401(a)(9) Regulations

Foundational Concepts

• “Non-designated beneficiaries”:
  – Estates
  – Charities
  – Non-Designated Beneficiary Trusts
### 401(a)(9) Regulations

**Foundational Concepts Pre-Secure**

<table>
<thead>
<tr>
<th></th>
<th>Death Before Required Beginning Date</th>
<th>Death On or After Required Beginning Date</th>
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<tr>
<td><strong>Designated Beneficiary</strong></td>
<td><em>Life Expectancy Rule</em></td>
<td><em>Life Expectancy Rule</em></td>
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<tr>
<td><strong>Non-Designated Beneficiary</strong></td>
<td><em>Five-Year Rule</em></td>
<td><em>Owner’s “Ghost” Life Expectancy Rule</em></td>
</tr>
</tbody>
</table>
### 401(a)(9) Regulations

**Foundational Concepts Post-Secure**

<table>
<thead>
<tr>
<th>Beneficiary Type</th>
<th>Death Before RBD</th>
<th>Death on or After RBD</th>
</tr>
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<tbody>
<tr>
<td>Non-Designated Beneficiary</td>
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<td>Designated Beneficiary</td>
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<tr>
<td>Conduit Eligible Beneficiary Trust</td>
<td>Life Expectancy Rule (Adjustment for Minors)</td>
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</tr>
<tr>
<td>Accumulation - Eligible Beneficiary Trust – Spouse, Child or Person &gt;10 years Younger</td>
<td>Ten-Year Rule</td>
<td>Ten-Year Rule</td>
</tr>
<tr>
<td>Accumulation - Eligible Beneficiary Trust – Disabled or Chronically ill</td>
<td>Life Expectancy Rule</td>
<td>Life Expectancy Rule</td>
</tr>
</tbody>
</table>
401(a)(9) Regulations

Foundational Concepts

Pre-Secure

• Generally, if individual beneficiaries exist, post-death RMDs are based upon oldest designated beneficiary’s life expectancy under the Single Life Table.

• If separate shares are created by 12/31 of the year following the year of death, then each beneficiary’s life expectancy is used.

Post-Secure

• Special separate share rule for disabled and chronically ill beneficiary. IRC § 401(a)(9)(H)(iv).
401(a)(9) Regulations

Foundational Concepts

Pre-Secure

• A designated beneficiary determines his/her RMD life expectancy factor by reference to the Single Life Table.

• The individual beneficiary calculates the RMD for the first year (i.e. the year following the year of the IRA owner’s death) by dividing the IRA balance by the RMD factor.

• Each year thereafter, the designated beneficiary calculates the RMD by subtracting one from the RMD factor – This is otherwise known as the “subtract one” method

Post-Secure

• Ten-Year Rule
  – Can be Deferred until the end of year “11”
  – No set Withdrawal pattern – All tax planning
401(a)(9) Regulations

Foundational Concepts – Example

Pre-Secure

• Agnes died in 2018, naming her granddaughter, Iris, as the beneficiary of her IRA. Assuming that Iris will be 23 in 2019, Iris’s RMD factor for 2019 would be 60.1.

• Beginning in 2020 and every year thereafter, Iris’s RMD factor will be reduced by one (i.e. 2020 = 59.1, 2021 = 58.1, etc).

Post-Secure

• Option A – Defer until year 10
  – Excellent for Roth IRA
  – Negative Bracket Arbitrage for Traditional IRA

• Option B – Strategic Withdrawals Annually
  – Tax Bracket Management
  – Excellent for Traditional IRA
  – Not Desired for Roth IRA
401(a)(9) Regulations

Foundational Concepts

- Spousal rollover where spouse is “sole beneficiary” – Rollover may occur at any time
- Non-spousal rollovers – Not permitted

No Changes Under the Secure Act
401(a)(9) Regulations

*Foundational Concepts – Critical dates*

- **September 30** of the year following the year of death
  - Date at which the beneficiaries are identified
- **October 31** of the year following the year of death
  - Date at which trust documentation (in the case where as trust is named as a designated beneficiary) must be provided to the custodian
- **December 31** of the year following the year of death
  - Date at which the first distribution must be made by each IRA beneficiary
  - Date at which separate shares must be created
401(a)(9) Regulations

Foundational Concepts – September 30th Determination Date

• Example #1
  – Jane names a trust as beneficiary of her IRA. 90% of the trust is payable to her children over their lifetimes. 10% of the trust is payable to Jane’s favorite charity.
  – If the charity’s 10% is paid out of the trust by September 30th of the year following the year of Jane’s death, the charity’s interest will not taint the rest of the trust.
401(a)(9) Regulations

Foundational Concepts – September 30th Determination Date

• Example #2
  – John names his sister as primary beneficiary of his IRA and his nephew as contingent beneficiary.
  – If John’s sister dies before September 30th of the year following the year of John’s death without performing a qualified disclaimer, RMDs are still calculated based on the sister’s life expectancy.
401(a)(9) Regulations

Foundational Concepts

• Weaving the IRA Beneficiary Designation Form into the Overall Plan:
  – Contingent beneficiaries
  – Trust as beneficiary
  – Second marriage issues
  – Asset protection issues
  – Charitable bequests
  – REA Waivers for qualified plans
  – Community property issues
  – Eligible Beneficiaries
  – Conduit Eligible Beneficiary Trusts
  – Disability Trusts
  – Chronically Ill Trusts
Paying IRAs to Trusts
Trusts After the Secure Act

All Trusts

Designated Beneficiary Trusts

Eligible Designated Beneficiary Trusts
<table>
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<th>Designated Non-Eligible Beneficiary</th>
<th>Surviving Spouse</th>
<th>Eligible Minor Child</th>
<th>Person Less Than 10 years younger</th>
<th>Disabled or Chronically ill Person</th>
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<tbody>
<tr>
<td>Outright Beneficiary</td>
<td>Ten-Year Rule</td>
<td>Life Expectancy Rule</td>
<td>Life Expectancy Rule (Until Majority then Ten-Year Rule)</td>
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<tr>
<td>Conduit Trust</td>
<td>Ten-Year Rule</td>
<td>Life Expectancy Rule</td>
<td>Life Expectancy Rule (Until Majority then Ten-Year Rule)</td>
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<tr>
<td>Designated Beneficiary Trust</td>
<td>Ten-Year Rule</td>
<td>Ten-Year Rule</td>
<td>Ten-Year Rule</td>
<td>Ten-Year Rule</td>
<td>Life Expectancy Rule</td>
</tr>
</tbody>
</table>
Paying IRAs to Trusts

Benefits of Utilizing a Trust

- Spendthrift protection
- Creditor protection
- Divorce protection
- Special needs
- Investment management
- Estate planning
- “Dead-hand” control

Income Tax Planning is even more Important after Secure
Paying IRAs to Trusts

Disadvantages of Utilizing a Trust

• Trust tax rates
• Legal and trustee fees
• Trust income tax returns
• Greater complexity
Paying IRAs to Trusts

*Common Mistakes to Avoid*

- Non-Designated Beneficiary Trust
  - Five-Year Rule
  - “Ghost” Life Expectancy Rule
- Older or unidentifiable contingent beneficiary
- Estate as contingent beneficiary
- Powers of appointment
- Failure of beneficiaries clause
- Failure to provide trust document to custodian by October 31 of year following year of death
- Making lump sum distribution to trust
- General powers of appointment
- Conduit trusts in second marriages
- Asset protection issues
Paying IRAs to Trusts

*Naming a Trust as a “Designated Beneficiary”*

An IRA Can Be Payable to a Trust

Diagram:
- **IRA**
  - Beneficiary Designation Form
- **Trust**
  - Pre-Secure: IRA distributions over the life expectancy of the oldest beneficiary
  - Post-Secure: Ten-Year Rule unless an Eligible Designated Beneficiary Trust
  - Spouse
  - Children
Paying IRAs to Trusts

Four Requirements for **ALL** Designated Beneficiary Trusts Before and After Secure

1. Trust is valid under state law
   - Treas. Reg. § 1.401(a)(9)-4, Q&A 5(b)(1)
2. Trust is irrevocable upon death of owner
   - Treas. Reg. § 1.401(a)(9)-4, Q&A 5(b)(2)
3. Beneficiaries of the trust are identifiable from the trust instrument
   - Treas. Reg. § 1.401(a)(9)-4, Q&A 5(b)(3)
4. Documentation requirement is satisfied
   - Treas. Reg. § 1.401(a)(9)-4, Q&A 5(b)(4)
The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable within the meaning of 1.401(a)(9)-4, A-1 from the trust instrument.

- Can oldest trust beneficiary be identified by Sept. 30 of the year following the year of death?

- Are all such beneficiaries individuals?

- Designated beneficiary does not need to be specified by name.

- Members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible, to identify the class member with the shortest life expectancy.
Class of Beneficiaries

IRA → Trust

“To My Children in Equal Shares”
Identifiable Beneficiary Issue

1. IRA → Trust
   - Discretionary Distributions
   - Child
     - At Child’s death
     - Child given power to appoint to children and spouse

- Child could appoint to an older person
Identifiable Beneficiary Problem

Beneficiaries of the trust are identifiable from the trust instrument

- September 30 of year following year of death = beneficiary designation determination date

- Beneficiaries that exist under the trust as of date of death that remain beneficiaries as of September 30 of the year following the year of death
Charitable Problem

IRA → Trust

50% → IRA Owner’s Son

50% → Charity

Non-individual beneficiary = Trust does **not** qualify
Requirements

Treas. Reg. Sec. 1.401(a)(9)-5, Q&A 7(b)

Except as provided in paragraph (c)(1) of this A-7, if a beneficiary's entitlement to an employee's benefit after the employee's death is a contingent right, such contingent beneficiary is nevertheless considered to be a beneficiary for purposes of determining whether a person other than an individual is designated as a beneficiary (resulting in the employee being treated as having no designated beneficiary under the rules of A-3 of §1.401(a)(9)-4) and which designated beneficiary has the shortest life expectancy under paragraph (a) of this A-7.
A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy under paragraph (a) of this A-7, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death...
Requirements

Treas. Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(1)

...Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.
Paying IRAs to Trusts

Types of Testamentary Trusts

- Unified Credit Trust
- Marital Trust
- QTIP Trust
- Generation-Skipping Trusts
- Charitable Remainder Trust
- Non-Designated Beneficiary Trust
- Designated Beneficiary Trust
- Eligible Designated Beneficiary Trust
- Conduit Eligible Designated Beneficiary Trust
Paying IRAs to Trusts

Types of Trusts

• Conduit Trusts
  – Designated Beneficiary Trust
  – Eligible Designated Beneficiary Trust

• Accumulation Trusts
  – Non-Designated Beneficiary Trust
  – Designated Beneficiary Trust
  – Eligible Designated Beneficiary Trust

• Treas. Reg. § 1.401(a)(9)-4, Q&A 5 requirements apply to both types
Paying IRAs to Trusts

Conduit Trust

- A trust in which all distributions from the IRA are immediately distributed to the trust beneficiary(ies).
- Very limited asset protection
- Ten-Year Rule Disaster
Conduit Trust

• A trust in which all distributions from the IRA are immediately distributed to the trust beneficiary(ies).

• Allows for easier identification of beneficiaries.
(i) The facts are the same as Example 1 except that the testamentary trust instrument provides that all amounts distributed from A's account in Plan X to the trustee while B is alive will be paid directly to B upon receipt by the trustee of Trust P.

(ii) In this case, B is the sole designated beneficiary of A's account in Plan X for purposes of determining the designated beneficiary under section 401(a)(9)(B)(iii) and (iv). No amounts distributed from A's account in Plan X to Trust P are accumulated in Trust P during B's lifetime for the benefit of any other beneficiary. Therefore, the residuary beneficiaries of Trust P are mere potential successors to B's interest in Plan X. Because B is the sole beneficiary of the testamentary trust's interest in A's account in Plan X, the annual required minimum distributions from A's account to Trust P must begin no later than the end of the calendar year in which A would have attained age 70½, rather than the calendar year immediately following the calendar year of A's death.

Emphasis Added.
Conduit Trust

- IRA → Conduit Trust
  - Son
    - At son’s death
      - Son given POA exercisable in favor of children or spouse
      - POA can be ignored since conduit trust
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

<table>
<thead>
<tr>
<th>Years after Death</th>
<th>RMD Current Method</th>
<th>10-Year Rule Options</th>
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<td>10 40</td>
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</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 ten-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
Paying IRAs to Trusts

*Accumulation Trust*

- A trust in which distributions from the IRA are allowed to accumulate within the trust.
- Stronger asset protection than a conduit trust.
Accumulation Trust

• The key issue in analyzing an accumulation trust is to determine which beneficiaries are “countable.”

• All beneficiaries are countable unless such beneficiary is deemed to be a “mere potential successor” beneficiary.
Accumulation Trust

Example #1

IRA → Trust

Discretionary Distributions → Child

Entire Trust outright upon children reaching age 30 → Child – age 30

If children die before reaching age 30

Mother – Age 80

Mother is “countable” for determining applicable life expectancy if eligible designated beneficiary trust

See PLR 200228025 and Treas. Reg. § 1.401(a)(9)-5 Q&A 7
Accumulation Trust

Example #2

IRA → Trust → Child #1

Discretionary Distributions

At Child #1’s death

To Red Cross

Contingent beneficiary must be counted.
Non-individual contingent beneficiary.
No designated beneficiary status.

Treas. Reg. § 1.401(a)(9)-5 Q&A 7
Paying IRAs to Trusts

Separate Share Rule

Payable to single trust

No separate shares identified in the beneficiary designation form

IRA paid over oldest life expectancy if an eligible trust or alternative
Post-Secure Rule
Paying IRAs to Trusts

Separate Share Rule

IRA payable to multiple trusts

Each trust named in beneficiary designation form

IRA paid over each separate eligible trust beneficiary’s life expectancy

PLR 200537044
Paying IRAs to Trusts

Revocable Living Trust as a “Designated Beneficiary”

• Proper apportionment language regarding payment of debts, expenses and taxes of estate (See PLR 9820021).
• Recognition of income in respect of a decedent (IRD) if pecuniary funding clause is utilized.
• Unanticipated loss of designated beneficiary due to the inclusion of power of appointment (general or limited).
• Recent problems with custodians allowing the “in-kind” assignment of IRAs to subtrusts.
• Solution – stand-alone IRA trust such as “IRA Legacy Trust.”
Paying IRAs to Trusts

Revocable Living Trust as a “Designated Beneficiary”

• Revocable trust should use a fractional funding clause to determine the marital and bypass shares – PLRs in which pecuniary funding clause utilized and no IRD acceleration issue (PLRs 199912040, 9808043, 9744024).
Paying IRAs to Trusts

Revocable Living Trust as a “Designated Beneficiary”

Sample Pecuniary Clause:

The Marital Share shall consist of assets in a pecuniary amount which, after taking into account all other property included in the Settlor’s gross estate for federal estate tax purposes which qualified for the federal estate tax marital deduction and which passes or has passed to the Settlor’s wife under this instrument or in any other manner, is equal to the smallest amount which will eliminate all federal estate tax payable by the Settlor’s estate, or if that is not possible, the amount which will result in the least federal estate tax payable by the Settlor’s estate. In determining “federal estate tax payable”, all credits and deductions against that tax shall be taken into account, provided that the federal credit for state death taxes shall only be considered for the extent it does not create or increase a state death tax which is based on the federal credit for state death taxes.
Paying IRAs to Trusts

Revocable Living Trust as a “Designated Beneficiary”

Sample Fractional Clause:

The Marital Share shall consist of that fractional share of the trust estate which shall be determined as follows:

(a) The numerator of the fraction shall be the smallest amount which, after taking into account all other property included in the Settlor’s gross estate for federal estate tax purposes which qualifies for the federal estate tax marital deduction and which passes or has passed to the Settlor’s wife under this instrument or in any other manner, will eliminate all federal estate tax payable by the Settlor’s estate, or if that is not possible, the amount which will result in the least federal estate tax payable by the Settlor’s estate. In determining “federal estate tax payable”, all credits and deductions against that tax shall be taken into account, provided that the federal credit for state death taxes shall only be considered to the extent it does not create or increase a state death tax which is based on the federal credit for state taxes.

(b) The denominator of the fraction shall be the value of the trust estate.
IRAs Payable to Trusts

Standalone vs. IRA Trust

• Advantages to standalone retirement trust:
  • Avoids confusion and potential loss of stretch out of retirement account.
  • Alerts account custodian, the trustee and each beneficiary of unique nature.
  • Allows main Will or Living Trust to be simpler.
  • Unaffected by later RLT amendments by another attorney.
  • Allows RLT more flexibility.

• Disadvantages to standalone retirement trust:
  • Additional trustee fees
  • Additional tax preparation and accounting fees
  • Additional legal fees in drafting two trusts
  • Coordination between multiple trusts
IRAs Payable to an Estate

- Death Before RBD
  - Traditional IRA: Five-Year Rule
  - Roth IRA: Five-Year Rule

- Death After RBD
  - Traditional IRA: “Ghost” Rule
  - Roth IRA: Five-Year Rule

Note: Consider a spousal rollover when the IRA or Roth IRA is payable to an estate and the estate passes to the surviving spouse.
Questions
To be added to our IRA update newsletter, please visit:

keeblerandassociates.com/speaking
Appendixes

I. Sample Clauses
II. Disclaimer Planning
III. Charitable Planning with IRAs
IV. Income Taxation of IRA Trusts
V. Charitable Remainder Trusts
Sample Clauses
Irrevocable

• The Trustor reserves the right to revoke and amend this Trust until the time of Trustor's death. Upon the death of the Trustor this Trust shall become irrevocable.

• Caution: Revocable Sub-Trusts (e.g. Survivor’s Trust)
Notwithstanding anything herein to the contrary, no payment of taxes of any kind, or payment of debts or expenses of administration shall be made from any Retirement Assets, or the proceeds of such account or plan, for any such taxes, debts or expenses of administration if such payment would cause the Trust or any such plan or account to be considered to have a beneficiary other than a qualified Designated Beneficiary under IRC § 401(a)(9)(D) for purposes of determining required minimum distributions under IRC § 401(a)(9)(A)(ii) and the Regulations thereunder.
Failure of Beneficiaries

If at any time prior to final distribution hereunder, all the beneficiaries identified by the Trustor are deceased and no other disposition of the property is directed by this Trust, the remaining property of this Trust shall be distributed to the Trustor’s lineal descendants by right of representation, provided that any such descendant born before the Oldest Primary Beneficiary shall be deemed deceased. In default thereof the property shall be distributed to, the Trustor’s next of kin then living, regardless of how remote their degree of kinship is, provided that any such next of kin born before the Oldest Primary Beneficiary shall be deemed deceased. With respect to usage of the term “next of kin,” it is my intent to override any State law provision regarding failed transfer, potentially requiring escheat to such State. Rather use of this term is intended to create interests based on consanguinity.
Cash Out

Notwithstanding other provisions of this Trust agreement, the Trustee may fully payout the interest of any beneficiary who is not an “individual,” and is therefore not a qualified beneficiary within the meaning of IRC § 401(a)(9) and the Regulations and Proposed Regulations thereunder, by the Beneficiary Determination Date, if in the Trustee’s judgment failure to do so would result in acceleration of distributions from retirement accounts to the detriment of the other beneficiaries or the objectives of this Trust. In the event that the value of the beneficial interest of any beneficiary who is not a qualified “individual” is not readily ascertainable, the Trustee shall have the authority to negotiate and finalize compromise settlement agreements with such beneficiary. It is intended that such settlements would be reached for the purpose of allowing the trustee to pay out the interest of such non qualified beneficiary thereby qualifying this trust as a trust for which the remaining qualified beneficiary’s or beneficiaries’ life expectancy will be used to determine required distributions. It is further provided that such settlements must be finalized prior to the Beneficiary Determination Date.
Intent

The Trustor intends, through a properly executed Beneficiary Designation Form, to name the Trustee as the beneficiary of certain Retirement Assets. Although it is Trustor’s intent that this Trust be a qualified “designated beneficiary” as that term is used in Internal Revenue Code section 401(a)(9), this Trust shall not be construed or interpreted as a beneficiary designation of any accounts noted herein or on exhibits attached hereto, nor shall this Trust be construed as an assignment of any interest in any of the aforesaid plans or accounts. The Trustor expressly reserves the right during the Trustor’s lifetime to create, modify and amend beneficiary designations regarding any and all Retirement Assets, accounts or other assets that may now or hereafter be payable to this Trust.
Withdraw RMDs

In the year of death and each subsequent year, the Trustee shall withdraw from such Retirement Assets made payable to this Trust, the Required Minimum Distribution(s) for such year. Additionally, the Trustee may withdraw so much of the net income and principal of Retirement Assets payable to this Trust as is necessary for health, education, support or maintenance of the Trustor’s children, and the issue of any deceased children. Required Minimum Distribution(s) shall be those amounts required to be distributed under IRC § 401(a)(9) and the Regulations promulgated thereunder.
Documentation

The Trustee shall comply with the procedural requirements of the Code and Regulations (or applicable proposed Regulations) to allow the beneficiaries of the Trust to be treated as being designated beneficiaries of the Retirement Assets for purposes of determining the distribution period under IRC § 401(a)(9). These requirements are currently set forth in Treas. Reg. § 1.401(a)(9)-4 Q&A 5 and Q&A 6 and require certain documentation to be furnished to the plan administrator by October 31 of the year following the year of the death of the Trustor.
QTIP

The Trustor’s spouse shall have the right to require payment from the Trust of an amount equal to all or any part of the net income of the Trust to the Trustor’s spouse, during the spouse’s lifetime. This right may be exercised annually, semi-annually or quarterly as the Trustor’s spouse shall choose. If in any year the Trustor’s spouse does not request the distribution of all of the income as provided herein, at the end of the year the undistributed trust income shall be added to the principal of the Trust.

The income subject to the spouse’s power to require distribution shall include that portion of any Retirement Asset which constitutes the accounting income of a Retirement Asset, undiminished by any fees or expenses of administering this Trust which would otherwise be chargeable to the distributions, all of which shall be charged to Trust principal. The Trustor’s spouse shall have the power to compel the Trustee to exercise its powers as beneficiary of the Retirement Asset in a manner to ensure that all of the accounting income of the Retirement Asset is paid to it and subject to the right of the Trustor’s spouse to require distribution of such amounts. If the Trustor’s spouse does not exercise this power, the Trustee may withdraw from the Retirement Asset a lesser amount as the Trustee shall deem necessary, but no less than the annual minimum required distribution. For purposes of this Provision, the term “accounting income” shall be determined pursuant to the state law of the Trust situs and shall be calculated as if the Retirement Asset were a Trust.
**Stub Income**

Commencing with the date of Trustor’s death, the Trustee shall pay to or apply for the benefit of Settlor’s wife, JANE SMITH, during her lifetime all the net income from this Marital Trust in convenience installments but no less frequently than quarterly. Any accrued and undistributed income at the death of Trustor’s wife shall be paid to her estate.

**Caution:** Do **not** allow stub income to flow to estate.
Disclaimer Planning

Overview

• Disclaimer must be “qualified.”
  – In writing
  – Within 9 months
  – No acceptance of the interest or any of its benefits,
  – Interest passes without any direction on the part of the person making the disclaimer

• A disclaimer of plan benefits or IRA is neither a prohibited assignment or alienation.

IRC § 2518; GCM 39858.
Disclaimer Planning

*Example*

- Alex dies at age 70. Alex’s wife disclaims amount of Alex’s unified credit to bypass trust for benefit of herself and their children
  - Disclaimer must occur within nine months from date of death
  - Disclaimer must be served to the IRA custodian
  - Disclaimer must be fractional to avoid immediate income taxation
Disclaimer Planning

Example

- Disclaimer must be Qualified Disclaimer

Spouse Disclaims

Spouse

Trust FBO of Spouse & Children

Trust FBO Children

Spouse Disclaims Again
Disclaimer Planning

Example

• DB Status – Trust is Irrevocable
• No Separate Share Treatment
• Life Expectancy of Oldest Beneficiary
• Mother and Spouse Disclaim 100%
• Oldest Child is DB
Disclaimer Planning

Revenue Ruling 2005-36

• A beneficiary's disclaimer of a beneficial interest in a decedent's IRA is a qualified disclaimer even though, prior to making the disclaimer, the beneficiary receives the required minimum distribution for the year of the decedent's death from the IRA.
Disclaimer Planning

Revenue Ruling 2005-36

SCENARIO 1 – Pecuniary Disclaimer by Spouse

Key assumptions:
- IRA Balance (date of death) - $2,000,000
- IRA Balance (date of disclaimer) - $2,040,000
- Required Minimum Distribution - $100,000

Result: Spouse’s pecuniary disclaimer, after taking RMD, still results in a “qualified disclaimer”
SCENARIO 2 – Fractional Disclaimer by Spouse

Key assumptions:
- IRA Balance (date of death) - $2,000,000
- IRA Balance (date of disclaimer) - $2,040,000
- Required Minimum Distribution - $100,000

Result: Spouse’s fractional disclaimer, after taking RMD (plus attributable income), still results in a “qualified disclaimer”
Disclaimer Planning

Revenue Ruling 2005-36

SCENARIO 3 – Full Disclaimer by Child A

Key assumptions:
- IRA Balance (date of death) - $2,000,000
- IRA Balance (date of disclaimer) - $2,040,000
- Required Minimum Distribution - $100,000

Required Minimum Distribution ($100,000) plus income earned since date of death ($2,000)

Full disclaimer of net remaining IRA balance after RMD (including income attributable to RMD) plus income earned since date of death

Result: Child A’s full disclaimer, after taking RMD (plus attributable income), still results in a “qualified disclaimer”
Disclaimer Planning

Spousal Rollover Planning Through Estate

IRA → Estate

Surviving spouse is executor

Spouse sole residuary beneficiary

PLR 201618011
Disclaimer Planning

Spousal Rollover Planning Through Trust

Spouse is trustee vested with power to allocate assets among trusts.

IRA → Rev. Trust

Marital Trust GPA

Spouse Trustee of GPA Trust

Credit Shelter Trust

See PLR 201225020 Rollover Allowed
Disclaimer Planning

Spousal Rollover Planning Through Trust

- IRA
- Estate of IRA owner
  - Pour over will
  - Revocable Trust
    - All to spouse unless disclaimed

Surviving spouse is sole executor

Spouse is sole trustee
Disclaimer Planning

Spousal Rollover Planning Through Trust

IRA → Trust

- Spouse and sons co-trustees; only spouse has right to allocate assets

- GPA vested in spouse

Marital Trust

Credit Shelter Trust

PLR 9851049

Rollover Allowed
Disclaimer Planning

Spousal Rollover Planning Through Trust

- IRA
- Trust
  - Non-spouse trustees
  - Formula Funding
    - GPA Marital
    - Credit Shelter Trust
      - PLRs 9145041 & 9303031
      - Rollover Not Allowed
Disclaimer Planning

**Spousal Rollover Planning Through Trust**

- IRA → Trust
- Trust → Non-spouse trustees
- Trust → Formula Funding
  - A Trust GPA Marital
  - B Trust "Reverse QTIP"
  - C Trust Credit Shelter

**PLR 200128056**
- Rollover Allowed
- Limited to IRA portion in which there was no allocation discretion.
Disclaimer Planning

Spousal Rollover Planning Through Trust

Spouse and issue disclaim interest in credit shelter trust and allow IRA to be payable to spouse by intestate succession.

See PLRs 9401039, 9450041 and 9820010

Rollovers Allowed
Charitable Planning with IRAs

*Basic Overview*

- Available Options to Transfer IRD Assets of Charity
  - Name the charity as the designated beneficiary of the assets
  - 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.
Income Taxation of IRA Trusts
Income Taxation of IRA Trusts

• 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
  – Roth and Traditional
  – IRA income distributed on a pro rata basis
Foundational Concepts

2020 Ordinary Income Tax Rates for Estates & Trusts

37%

35% $12,950

24% $9,450

10% $2,600

137
Foundation Concepts

General Tax Rules

• Two Trust Strategy
  – One Trust for the Traditional IRA
  – One Trust for the Roth IRA
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
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:

<table>
<thead>
<tr>
<th>Income Source</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>Attorney/accountant fees</td>
<td>500</td>
</tr>
</tbody>
</table>
## 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>
Charitable Remainder Trusts
Charitable Remainder Trusts

Overview

- CRT named as the designated beneficiary
- Payments over life or up to 20 years
- At the or at the end of the trust term, the charity receives the residual assets held in the trust

IRA → CRT → Children

Charity (Remainder Beneficiary)

IRC §§ 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

STEP 2: Accumulated Ordinary Income

STEP 3: Current Capital Gains

STEP 4: Accumulated Capital Gains

STEP 5: Current Tax-Exempt Income

STEP 6: Accumulated Tax-Exempt Income

STEP 7: Return of Capital

Tier 1

Tier 2

Tier 3

Tier 4