The Mathematics of Estate Planning for IRAs After the Secure Act

How to Simulate Stretch Benefits for Your Clients

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1. Special thanks to Stephen J Bigge, CPA for his assistance with modeling alternative strategies
Outline

• 2019 Law and Secure Act Changes
• Conduit Trust Disaster – The Math
• New Post-mortem Payout Rules
• Roths vs. Traditional IRAs
• Solutions to Analyze
  – Roth conversions
  – Multi-generational spray trusts
  – Spousal rollovers and the *new* spousal rollover trap
  – IRAs to CRTs
  – IRA trusts for state income tax savings
  – IRA relocation to life insurance
  – Life insurance to offset increased tax-risk of early death
  – Naming a charity as a beneficiary
Pre-Secure Law
Stretch Out IRAs

“Inherited” IRA

**Objective**: Prolong IRA payments over longest possible period of time, thus increasing wealth to future generations
Pre-Secure Bill Distribution Flowchart

**SPECIAL NOTE**
Pursuant to §629 of the Pension Protection Act of 2006, beginning in tax years after December 31, 2006, non-spousal qualified retirement plan beneficiaries (e.g., children, siblings, friends, etc.) will be permitted to make trustee-to-trustee transfers from qualified retirement plans to inherited IRAs.

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**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

- **No**
  - Calculate using Uniform Lifetime Table

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

**Trust**
- Is the trust a designated beneficiary? See PLRs 200228025 and 200235039.
  - **Yes**
    - Trust by disclaimer
  - **No**
    - Calculate using Uniform Lifetime Table

**Trust by disclaimer**
- Were separate shares created by Dec. 31st of year following the year of death?
  - **Yes**
    - Life expectancy of oldest beneficiary
  - **No**
    - Possible life expectancy of each beneficiary if separate trust share is in existence on the date that a person dies and the BDF specifically names each separate share as beneficiary. See PLR 200537044.

**Charity**
- Did owner die before RBD?
  - **Yes**
    - Calculate using Uniform Lifetime Table
  - **No**
    - Five-Year Rule

**Estate**
- Did you create separate accounts by Dec. 31st of year following the year of death?
  - **Yes**
    - Life expectancy of each beneficiary
  - **No**
    - Life expectancy of oldest beneficiary

**Children or grandchildren by disclaimer**
- Children or grandchildren

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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 Pre-Secure law, the IRA assets could 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

Both Still Available After the Secure Act
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>
<th>IRA Payable to Youngest Non-Spousal Beneficiary</th>
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<tr>
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Stretch Out IRAs
“Inherited” IRA – Case Study

Summary – Year 30

IRA Transfer to Family
(The Power of Deferral)

Year 30

- 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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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.

THE SECURE ACT INCREASES THE RBD TO AGE 72.
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**

### Single Life Table

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<th>Age</th>
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## 401(a)(9) Regulations

### Foundational Concepts – Pre-Secure Bill

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

Both the Five-Year and “Ghost” Life Expectancy appear to have survived the Secure ACT for non-designated beneficiaries.
SECURE BILL
KEY CHANGES
RMDs after Death

**EFFECTIVE DATE:**

Deaths which Occur After 12/31/19
RMDs after Death

Basically, requires all IRAs, Roth IRAS, and Qualified Plans to be distributed within 10-years of death
<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
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<tbody>
<tr>
<td>Age of (Oldest Trust) Beneficiary</td>
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<tr>
<td>IRA Balance</td>
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<td>Pre-Tax Growth Rate</td>
<td>6.00%</td>
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<tr>
<td>After-Tax Growth Rate</td>
<td>4.75%</td>
</tr>
<tr>
<td>Average Income Tax Rate - Life Expectancy Rule</td>
<td>24.00%</td>
</tr>
<tr>
<td>Average Income Tax Rate - Ten Year Rule</td>
<td>28.00%</td>
</tr>
<tr>
<td>Distributions Occur at Beginning or End of Period?</td>
<td>End</td>
</tr>
<tr>
<td>Lump-Sum Distribution or Amortize Payments?</td>
<td>Amortize</td>
</tr>
</tbody>
</table>
RMDs after Death

Example

![Chart showing RMDs after Death]

- **10-Year Rule**
- **Life Expectancy**
RMDs after Death

Exceptions from the 10-year Rule 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

§§ 401(a)(2)(E)(ii)
## 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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<tbody>
<tr>
<td><strong>Outright Beneficiary</strong></td>
<td>10-Year Rule</td>
<td>Life Expectancy Rule</td>
<td>Life Expectancy Rule (Until Majority then 10-Year Rule)</td>
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<td><strong>Conduit Trust</strong></td>
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<td>Life Expectancy Rule (Until Majority then 10-Year Rule)</td>
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<td><strong>Designated Beneficiary Trust</strong></td>
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<td><strong>Non-Designated Beneficiary Trust</strong></td>
<td>Before RBD: 5-Year Rule</td>
<td>Before RBD: 5-Year Rule</td>
<td>Before RBD: 5-Year Rule</td>
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<tr>
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<td>After RBD: Ghost Life Expectancy Rule</td>
<td>After RBD: Ghost Life Expectancy Rule</td>
<td>After RBD: Ghost Life Expectancy Rule</td>
<td>After RBD: Ghost Life Expectancy Rule</td>
<td>After RBD: Ghost Life Expectancy Rule</td>
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</tbody>
</table>
Trusts for Disabled and Chronically Ill Beneficiaries

• Life Expectancy Treatment is Available with a “Eligible Designated Beneficiary Trust”
• Need to Draft an Accumulation Trust
• Roth IRAs may work better due to:
  – The difference in the individual and trust tax rates
  – The ability to pay the income tax on conversion out of nonqualified funds
• Two trusts is advisable if the client has both a traditional IRA and a Roth IRA – this avoids “trapping” the taxable IRA income
Math of the Conduit Trust Disaster

- A conduit ("safe-haven") trust requires all RMDs to be paid annually
- This worked well under the life expectancy rules
- However, it is a disaster under the 10-year rule
- In year ten, the entire remaining IRA balance must be paid to the beneficiary

IRA $142,387 Distribution Trust $142,387 Distribution Beneficiary
The Conduit Trust Disaster

*Illustrated*

<table>
<thead>
<tr>
<th>Years after Death</th>
<th>Age</th>
<th>RMD Current Method</th>
<th>10-Year Rule Options</th>
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Assumes $1,000,000 IRA at death & a 7% interest rate
Ten Year Rule - Roth vs. Traditional IRA

• If minimizing income taxation is the only concern, Roth distributions after death should generally be deferred until the end of the Ten-Year period – “The Roth Reprieve”

• Traditional IRA distributions will be tactically withdrawn to manage income tax rates
The Roth Reprieve

Roth conversion example to illustrate the value of the “Roth Reprieve;” Consider the following:

- 66 year-old IRA married owner who expects to live to 85
- She can undertake a $100,000 conversion within the 24% bracket; to avoid confusing the driving factors of model assume all future taxable distributions from the IRA are subject to a 24% rate
- She pays the conversion tax without “outside funds”
- Assume a pre-tax rate of return of 6% and after tax-tax rate of return of 5%
- Assume the 10-year rule deferral is taken advantage of in full
The Roth Reprieve

Final Distribution

Death

No Conversion
Conversion
Tax-Driven Beneficiary Designations

• Utilize Spousal Rollovers
• Utilize Exception Beneficiaries
• Avoid the application of the Five-Year Rule with an outright beneficiary or a Designated Beneficiary Trust
• Consider forcing the Ghost Life Expectancy Rule to apply for clients aged 72 to 81
Tax-Driven Beneficiary Designations

• Examples – Universal Assumptions:
  – 6% pre-tax return
  – 5% after-tax return; very conservative difference
  – Distributions are subject to a 25% average tax rate – held constant to avoid confusion regarding the changes provided by the new law
Tax-Driven Beneficiary Designations

Spouse as Beneficiary

• Example 1:
  – Consider a 76-year-old surviving spouse who expects to live to age 85
  – What is the value of capturing the Spousal Rollover for a $1,000,000 IRA?
Tax-Driven Beneficiary Designations

![Bar chart showing the total wealth accumulated over years after death, comparing different beneficiary designations: 10-Year Rule, Spousal Inherited IRA, and Spousal Rollover.]
Tax-Driven Beneficiary Designations

• **Example 1 – Lesson**
  – The exemption from the 10-year rule provides limited additional value
  – A spousal rollover is still prudent
  – This is because the Uniform Lifetime Table provides for a longer life expectancy than the Single Life Table
Tax-Driven Beneficiary Designations

Minor Child as Beneficiary

• Example 2:
  – Consider 40-year-old married doctors with a seven-year-old child
  – Assume the doctors have saved $300,000 in their pre-tax 401ks
  – Is it worthwhile to name their child as the IRA beneficiary, compared an ineligible beneficiary, in case of accidental death?
Tax-Driven Beneficiary Designations

- **Example 2 – Lesson**
  - The additional deferral provides significant value with time
  - The RMDs required before reaching age 26 are relatively small
  - The distributions required from ages 27-36 must be managed and thought through to minimize negative tax and other life consequences
Tax-Driven Beneficiary Designations

*Disabled Person as Beneficiary*

- **Example 3 - 1:**
  - Consider a 60 year-old surviving spouse and a 30 year old disabled child
  - There’s at least $1,000,000 in the deceased client’s IRA beyond which the surviving spouse never expects to need
  - Assume the surviving spouse’s life expectancy is 85 and the disabled child’s is 55 (both expect to live 25 more years)
  - Compare naming the surviving spouse versus the child as beneficiary
Tax-Driven Beneficiary Designations

Years after Death

Total Wealth Accumulated

- 10-Year Rule
- Disabled or Chronically Ill
- Spousal Rollover

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Tax-Driven Beneficiary Designations

• **Example 3 – 1 – Lessons:**
  – The example assumes the disabled child is expected to die at about of the same age surviving spouse thereby eliminating the requirement for a multi-step analysis
  – The Surviving Spouse is able to defer taking RMDs until age 72 thereby allowing that option to overcome the benefit of reduced RMDs for the disabled child
  – Should the disabled child outlive the Surviving Spouse if the rollover option was used, taking advantage of the disability exemption remains available and advisable.
Tax-Driven Beneficiary Designations

Disabled Person as Beneficiary

• Example 3 - 2:
  – Consider the same example, except with different ages
  – Assume the surviving spouse is 76 and expects to live to 85
  – Assume the disabled child is 51 and expects to live to 60
  – Both expect to live 9 more years
Tax-Driven Beneficiary Designations

• **Example 3 – 2 – Lessons:**
  – The example assumes the disabled child is expected to die at about the same age surviving spouse thereby eliminating the requirement for a multi-step analysis
  – The benefit of the reduced RMDs for the disabled beneficiary allows for more wealth accumulation despite the equal life expectancies
  – A disclaim plan might be prudent
Tax-Driven Beneficiary Designations

Chronically Ill Person as Beneficiary

• Example 4:
  – Consider a client undertaking death-bed planning who would like to leave $100,000 to his chronically ill nephew
  – Assume the nephew will be 70 when the client dies with a life expectancy of two years
  – Does this plan make sense?
Tax-Driven Beneficiary Designations

![Bar graph showing total wealth accumulated over years after death under 10-Year Rule and Disabled or Chronically Ill designations.](image-url)
Tax-Driven Beneficiary Designations

• **Example 4 Lessons:**
  - The plan provides a nominal additional benefit because the IRA is distributed over 2-3 additional years beyond what the 10-year rule allows.
  - However, importantly – unlike under previous law – this plan does not decrease wealth transfer to the surviving family due to negative tax consequences.
Tax-Driven Beneficiary Designations

*Person Not More than 10-Years Younger as Beneficiary*

• **Example 5 -1:**
  – Consider a client who would like to leave $250,000 to her younger cousin
  – The cousin is 9-years younger than the client
  – The cousin is 75 years-old and is expected to live to age 84
  – Does this plan make sense?
Tax-Driven Beneficiary Designations

Years after Death

Total Wealth Accumulated

- 5
- 10
- 15
- 20

$350,000
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$-

10-Year Rule
Not More Than 10-Years Younger
Tax-Driven Beneficiary Designations

• **Example 5-1 Lessons:**
  
  - The plan provides a some additional benefit because the IRA is distributed over 9-10 additional years beyond what the 10-year rule allows.
  
  - However, importantly – unlike under previous law – this plan does not decrease wealth transfer to the surviving family due to negative tax consequences.
Tax-Driven Beneficiary Designations

*Person Not More than 10-Years Younger as Beneficiary*

- **Example 5-2:**
  - Consider a 35-year old childless divorcee re-building his estate plan in case of accidental death
  - Among other significant assets, he has $150,000 of assets in his 401k and IRAs
  - Does naming his youngest brother, who is 27, as the designated beneficiary make sense from a tax perspective?
  - Assume his brother has a normal life expectancy of 85
Tax-Driven Beneficiary Designations

• **Example 5-2 Lessons:**
  – The plan is excellent from a tax-perspective and provides a identical “stretch” available under previous law
Tax-Driven Beneficiary Designations

• **Example 6-1:**
  - Consider a 72-year-old who wants to leave her IRA to her only child who is not an eligible designated beneficiary
  - You are debating whether to advise her to name an non-qualified designated beneficiary or a qualified designated beneficiary to most efficiently transfer the funds
  - Assume 6% pre-tax return and a 5% after-tax return
  - Assume the distributions are subject to a 25% average tax rate
  - Which is better for her $1,000,000 IRA: the ten-year rule or the “ghost” life expectancy rule?
Tax-Driven Beneficiary Designations

Years after Death

Total Wealth Accumulated

- 10 Year Rule
- Ghost Life Expectancy

<table>
<thead>
<tr>
<th>Years after Death</th>
<th>10 Year Rule</th>
<th>Ghost Life Expectancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>$1,000,000</td>
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<td>9</td>
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<tr>
<td>18</td>
<td>$2,500,000</td>
<td>$2,500,000</td>
</tr>
</tbody>
</table>
Tax-Driven Beneficiary Designations

• **Example 6-2:**
  – Now consider a similarly situated client who is age 87.
  – Does the an non-qualified designated beneficiary named still make sense?
  – Assume 6% pre-tax return and a 5% after-tax return
  – Assume the distributions are subject to a 25% average tax rate
Tax-Driven Beneficiary Designations

The chart illustrates the difference in total wealth accumulated under different beneficiary designation rules.

- **Years after Death**
  - 2
  - 5
  - 8
  - 10

- **Total Wealth Accumulated**
  - $1,400,000
  - $1,200,000
  - $1,000,000
  - $800,000
  - $600,000
  - $400,000
  - $200,000

- **Legend**
  - 10 Year Rule
  - Ghost Life Expectancy

- **Comparison**
  - The chart compares the total wealth accumulated under a 10-year rule and ghost life expectancy over different years after death.
Tax-Driven Beneficiary Designations

- **Examples 6 Lesson:**
  - If the RMD factor is less than ten, can make sense to force the ghost life expectancy rule
  - However, the “ghost” life expectancy rule forces RMDs annually whereas the ten-year rule does not. Therefore, the flexibility provided by the ten-year rule may reduce the income tax on distributions that the additional deferral cannot overcome.

<table>
<thead>
<tr>
<th>Age</th>
<th>Current LE Factor</th>
<th>Proposed LE Factor</th>
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<tr>
<td>70</td>
<td>17.0</td>
<td>18.7</td>
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<tr>
<td>71</td>
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<tr>
<td>72</td>
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<td>17.1</td>
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<td>16.3</td>
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<tr>
<td>74</td>
<td>14.1</td>
<td>15.6</td>
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<td>75</td>
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<td>76</td>
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<td>77</td>
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<td>79</td>
<td>10.8</td>
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<td>80</td>
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<td>81</td>
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<td>84</td>
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<td>8.6</td>
</tr>
<tr>
<td>85</td>
<td>7.6</td>
<td>8.1</td>
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</table>
PLANNING SOLUTIONS TO ANALYZE
Solutions to Analyze

Overview

• Roth conversions
• Designated Beneficiary - multi-generational spray trusts
• Spousal rollovers and the new spousal rollover trap
• IRAs to CRTs
• IRA trusts for state income tax savings
• IRA relocation to life insurance
• Life insurance to offset increased tax-risk of early death
• Naming a charity as a beneficiary
• Avoiding the Five-Year Rule
• Avoiding or using the “Ghost Rule”

Does the Client Wish to Enhance Wealth Transfer?

- Yes: Is the Client Charitably Inclined?
  - Yes: Explore CRT or Direct Charity Gifts
  - No: Explore Eligible Beneficiaries
- No: Explore Insurance Options

Explore Roth Conversion Options
# Solutions After the Secure Act

## Spousal Rollover Strategies

| A. | Traditional IRA to Spouse – 100% Rollover |
| B. | Traditional IRA to Spouse – X% Disclaimer |
|    | 1.) Result: Deferral until RBD followed by 10-year payout. |
|    | 2.) Result: Children begin a 10-year payout followed by an additional 10 years at the second death |

## Roth Conversions

| A. | Lifetime Conversions by Plan Owner |
| B. | Death-Time Conversions by Plan Owner’s Family |
| C. | Spousal Rollover Followed by a Roth Conversion |

## Charitable Remainder Trusts

| A. | Death-Time Payment to CRT – Spouse |
| B. | Death-Time Payment to CRT - Children |

## Life Insurance “Relocation”

| A. | Acquire Life Insurance, in ILIT, on Plan Owner |
| B. | Acquire Life Insurance, in ILIT, on Spouse |
| C. | Acquire Life Insurance, in ILIT, Second to Die |
THE NEW SPOUSAL ROLLOVER TRAP

Old Best Practice

Deceased Spouse -> Spousal Rollover -> Surviving Spouse

Surviving Spouse -> “Inherited” IRA -> Children

IRC § 408
THE NEW SPOUSAL ROLLOVER TRAP

Old Best Practice & the New Spousal Rollover Trap

First Death

8 Years ?

Second Death

10 Years

Lifetime RMDs

10-Year Rule Distributions
THE NEW SPOUSAL ROLLOVER TRAP

*Potential New Best Practice*

- Deceased Spouse
- Spousal Rollover
- "Inherited" IRA
- Surviving Spouse
- "Inherited" IRA
- Children
THE NEW SPOUSAL ROLLOVER TRAP

Potential New Best Practice

First Death
8 Years?
Second Death
10 Years

Lifetime RMDs

10-Year Rule Distributions
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.
2020 Tax Brackets

Single

NIIT Threshold

199A Threshold

Married

NIIT Threshold

199A Threshold

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# Taxation of Roth IRA Distributions

<table>
<thead>
<tr>
<th>Age &lt; 59½</th>
<th>Distribution within 5 years</th>
<th>Distribution beyond 5 years</th>
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</thead>
<tbody>
<tr>
<td>Income Tax: Yes (earnings only)</td>
<td>Income Tax: Yes (earnings only)</td>
<td></td>
</tr>
<tr>
<td>10% Penalty: Yes (earnings &amp; taxable portion of prior conversion amounts)</td>
<td>10% Penalty: Yes (earnings only)</td>
<td></td>
</tr>
<tr>
<td>Age ≥ 59½</td>
<td>Income Tax: Yes (earnings only)</td>
<td>Income Tax: No</td>
</tr>
<tr>
<td>10% Penalty: No</td>
<td>10% Penalty: No</td>
<td></td>
</tr>
</tbody>
</table>
Mathematics of Roth IRA Conversions

• In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:
  – The annual growth rates are the same
  – The tax rate in the conversion year is the same as the tax rate during the withdrawal years (i.e. $A \times B \times C = D; A \times C \times B = D$)
## Mathematics of Roth IRA Conversions

<table>
<thead>
<tr>
<th></th>
<th>Traditional IRA</th>
<th>Roth IRA</th>
<th>Life Insurance</th>
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</thead>
<tbody>
<tr>
<td>Current Account Balance</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Less: Income Taxes @ 40%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Balance</td>
<td>$1,000,000</td>
<td>$600,000</td>
<td>$600,000</td>
</tr>
<tr>
<td>Growth Until Death</td>
<td>300.00%</td>
<td>300.00%</td>
<td>300.00%</td>
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<tr>
<td>Account Balance @ Death</td>
<td>$3,000,000</td>
<td>$1,800,000</td>
<td>$1,800,000</td>
</tr>
<tr>
<td>Less: Income Taxes @ 40%</td>
<td>(1,200,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Account Balance to Family</td>
<td>$1,800,000</td>
<td>$1,800,000</td>
<td>$1,800,000</td>
</tr>
</tbody>
</table>
Mathematics of Roth IRA Conversions

• Critical decision factors
  – Tax rate differential (year of conversion vs. withdrawal years)
  – Use of “outside funds” to pay the income tax liability
  – Need for IRA funds to meet annual living expenses
  – No RMDs
  – Tax-free post-mortem distributions
  – Time horizon
  – Estate tax considerations
  – Ten Year “Roth Coast” period
Mathematics of Roth IRA Conversions

- Deferral Beyond the RBD
- Using Outside Funds to Pay Conversion Tax
- Tax Rate Arbitrage
- 10-Year Post-mortem Tax-free Growth “Roth Coast Period”
Mathematics of Roth IRA Conversions

• The key to successful Roth IRA conversions is usually to avoid large jumps in brackets (e.g. converting at a 32% when distributions will likely be subject to a 24% rate will often be ineffective)

• Although brackets are the primary consideration, there are others: capital gains, AMT, NIIT, 199A, etc.
Mathematics of Roth IRA Conversions

Example of a possible “optimum” conversion amount

Current taxable income

- 10% tax bracket
- 12% tax bracket
- 22% tax bracket
- 24% tax bracket
- 32% tax bracket
- 35% tax bracket
- 37% tax bracket
Mathematics of Roth IRA Conversions

Target Roth IRA conversion range for most “middle income” taxpayers

Black steps = Current law
Red steps = Pre-TCJA (which the tax law reverts to in 2026)
Mathematics of Roth IRA Conversions

• Tactical considerations
  – Unused charitable contribution carryovers
  – Current year ordinary losses
  – Net Operating Loss (NOL) carryovers
  – Alternative Minimum Tax (AMT) credits
  – Other credit carryovers
Estate Tax Considerations

• “Missing” IRC § 691(c) deduction
  – When a taxpayer dies with an item of Income in Respect of a Decedent (IRD), such as a traditional IRA, in his/her taxable estate the estate (and/or its beneficiaries) must not only pay estate tax on the IRD but also pay income tax on the IRD
  – To prevent double-taxation of IRD, the federal income tax law allows an income tax deduction (on IRS Form 1040, Schedule A), for federal estate taxes paid on IRD
  – This is typically known as the “IRC § 691(c) deduction”
Estate Tax Considerations

• “Missing” IRC § 691(c) deduction
  – The dilemma with the IRC § 691(c) deduction is that it only is available for federal estate taxes paid on IRD, not state death/estate taxes
  – Thus, the state death/estate tax portion is subject to tax twice (i.e. “missing” IRC § 691(c) deduction)
Estate Tax Considerations

• “Missing” IRC § 691(c) deduction example

<table>
<thead>
<tr>
<th>IRA balance</th>
<th>Roth IRA balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Less: Federal and state income taxes on Roth IRA conversion (40%)</td>
<td>(400,000)</td>
</tr>
<tr>
<td>Taxable Estate</td>
<td>$600,000</td>
</tr>
<tr>
<td>Federal estate tax (35%)</td>
<td>$350,000</td>
</tr>
<tr>
<td>State death tax (10%)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Total estate taxes</td>
<td>$450,000</td>
</tr>
</tbody>
</table>

Post-death traditional IRA balance | $1,000,000
Less: IRC §691(c) deduction | (350,000)
Post-death traditional IRA balance subject to income tax | $650,000

Federal and state income taxes on IRA distributions (40%) | $260,000

Net IRA balance to beneficiaries | $290,000
| $330,000

**Reconciliation:** $100,000 state death tax x 40% post-death income tax rate = $40,000 (double-tax component) OR $400,000 income tax on conversion x 10% state death tax rate = $40,000 (estate tax savings)
Estate Tax Considerations

• “Fading” IRC § 691(c) deduction
  – Another dilemma with the IRC § 691(c) deduction is that it is only calculated on the value of the IRD at the time of death
  – Thus, post-death appreciation is not sheltered against income tax by the IRC § 691 deduction, resulting in additional income tax being incurred (i.e. “fading” IRC § 691(c) deduction)
Estate Tax Considerations

• “Fading” IRC § 691(c) deduction example

<table>
<thead>
<tr>
<th></th>
<th>No Planning</th>
<th>Roth IRA Conversion at Death</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional IRA balance at death</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Less: IRC §691(c) deduction</td>
<td>-</td>
<td>(450,000)</td>
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<tr>
<td>Taxable portion of Roth IRA conversion</td>
<td>$1,000,000</td>
<td>$550,000</td>
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<tr>
<td>Federal and state income taxes on Roth IRA conversion (40%)</td>
<td>-</td>
<td>$220,000</td>
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<tr>
<td>IRA balance available for future distributions</td>
<td>$1,000,000</td>
<td>$780,000</td>
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<td>Total future IRA distributions</td>
<td>$2,000,000</td>
<td>$1,560,000</td>
</tr>
<tr>
<td>Less: IRC §691(c) deduction</td>
<td>(450,000)</td>
<td>-</td>
</tr>
<tr>
<td>Less: Amounts not subject to income tax</td>
<td>-</td>
<td>(1,560,000)</td>
</tr>
<tr>
<td>Taxable portion of future IRA distributions</td>
<td>$1,550,000</td>
<td>-</td>
</tr>
<tr>
<td>Federal and state income taxes on future IRA distributions (40%)</td>
<td>$620,000</td>
<td>-</td>
</tr>
<tr>
<td><strong>After-tax total future IRA distributions</strong></td>
<td><strong>$1,380,000</strong></td>
<td><strong>$1,560,000</strong></td>
</tr>
</tbody>
</table>

**Reconciliation**: $1,560,000 - $1,380,000 = $180,000 OR $620,000 future income tax liability - $440,000 future value of income tax liability on Roth IRA conversion (i.e. $220,000 x 2).
ROTH CONVERSIONS

• 10-year analysis period
• 7% rate of return
• Tax paid from retirement account
• RMDs do not start within period

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.
**ROTH CONVERSIONS**

- 10-year analysis period
- 7% rate of return
- Tax paid from retirement account
- RMDs do not start within period
- Sunset distribution rates

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion

### Rate @ Conversion

<table>
<thead>
<tr>
<th>Rate @ Conversion</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%</th>
<th>32%</th>
<th>35%</th>
<th>37%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.00</td>
<td>-0.04</td>
<td>-0.24</td>
<td>-0.28</td>
<td>-0.43</td>
<td>-0.49</td>
<td>-0.53</td>
</tr>
<tr>
<td>15%</td>
<td>0.10</td>
<td>0.06</td>
<td>-0.14</td>
<td>-0.18</td>
<td>-0.33</td>
<td>-0.39</td>
<td>-0.43</td>
</tr>
<tr>
<td>25%</td>
<td>0.30</td>
<td>0.26</td>
<td>0.06</td>
<td>0.02</td>
<td>-0.14</td>
<td>-0.20</td>
<td>-0.24</td>
</tr>
<tr>
<td>28%</td>
<td>0.35</td>
<td>0.31</td>
<td>0.12</td>
<td>0.08</td>
<td>-0.08</td>
<td>-0.14</td>
<td>-0.18</td>
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<tr>
<td>33%</td>
<td>0.45</td>
<td>0.41</td>
<td>0.22</td>
<td>0.18</td>
<td>0.02</td>
<td>-0.04</td>
<td>-0.08</td>
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<tr>
<td>35%</td>
<td>0.49</td>
<td>0.45</td>
<td>0.26</td>
<td>0.22</td>
<td>0.06</td>
<td>0.00</td>
<td>-0.04</td>
</tr>
<tr>
<td>39.6%</td>
<td>0.58</td>
<td>0.54</td>
<td>0.35</td>
<td>0.31</td>
<td>0.15</td>
<td>0.09</td>
<td>0.05</td>
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ROTH CONVERSIONS

- 20-year analysis period
- 7% rate of return
- Tax paid from retirement account
- RMDs do not start within period

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.
ROTH CONVERSIONS

- 20-year analysis period
- 7% rate of return
- Tax paid from retirement account
- RMDs do not start within period
- Sunset distribution rates

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.

<table>
<thead>
<tr>
<th>Rate @ Conversion</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%</th>
<th>32%</th>
<th>35%</th>
<th>37%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.00</td>
<td>-0.08</td>
<td>-0.46</td>
<td>-0.54</td>
<td>-0.85</td>
<td>-0.97</td>
<td>-1.04</td>
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<tr>
<td>15%</td>
<td>0.19</td>
<td>0.12</td>
<td>-0.27</td>
<td>-0.35</td>
<td>-0.66</td>
<td>-0.77</td>
<td>-0.85</td>
</tr>
<tr>
<td>25%</td>
<td>0.58</td>
<td>0.50</td>
<td>0.12</td>
<td>0.04</td>
<td>-0.27</td>
<td>-0.39</td>
<td>-0.46</td>
</tr>
<tr>
<td>28%</td>
<td>0.70</td>
<td>0.62</td>
<td>0.23</td>
<td>0.15</td>
<td>-0.15</td>
<td>-0.27</td>
<td>-0.35</td>
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<tr>
<td>33%</td>
<td>0.89</td>
<td>0.81</td>
<td>0.43</td>
<td>0.35</td>
<td>0.04</td>
<td>-0.08</td>
<td>-0.15</td>
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<tr>
<td>35%</td>
<td>0.97</td>
<td>0.89</td>
<td>0.50</td>
<td>0.43</td>
<td>0.12</td>
<td>0.00</td>
<td>-0.08</td>
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<tr>
<td>39.6%</td>
<td>1.15</td>
<td>1.07</td>
<td>0.68</td>
<td>0.60</td>
<td>0.29</td>
<td>0.18</td>
<td>0.10</td>
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</table>
ROTH CONVERSIONS

- 10-year analysis period
- 7% rate of return inside retirement account
- 5.5% after-tax rate of return outside retirement account
- Tax paid with outside funds
- RMDs do not start within period

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.
ROTH CONVERSIONS

- 10-year analysis period
- 7% rate of return inside retirement account
- 5.5% after-tax rate of return outside retirement account
- Tax paid with outside funds
- RMDs do not start within period
- Sunset distribution rates

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.
ROTH CONVERSIONS

- 20-year analysis period
- 7% rate of return inside retirement account
- 5.5% after-tax rate of return outside retirement account
- Tax paid with outside funds
- RMDs do not start within period

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.

<table>
<thead>
<tr>
<th>Rate @ Conversion</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%</th>
<th>32%</th>
<th>35%</th>
<th>37%</th>
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</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.10</td>
<td>0.04</td>
<td>-0.25</td>
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<td>-0.55</td>
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<tr>
<td>12%</td>
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<td>-0.24</td>
<td>-0.47</td>
<td>-0.56</td>
<td>-0.62</td>
</tr>
<tr>
<td>22%</td>
<td>0.56</td>
<td>0.50</td>
<td>0.21</td>
<td>0.15</td>
<td>-0.08</td>
<td>-0.17</td>
<td>-0.23</td>
</tr>
<tr>
<td>24%</td>
<td>0.64</td>
<td>0.58</td>
<td>0.29</td>
<td>0.23</td>
<td>0.00</td>
<td>-0.09</td>
<td>-0.15</td>
</tr>
<tr>
<td>32%</td>
<td>0.95</td>
<td>0.89</td>
<td>0.60</td>
<td>0.54</td>
<td>0.30</td>
<td>0.22</td>
<td>0.16</td>
</tr>
<tr>
<td>35%</td>
<td>1.06</td>
<td>1.00</td>
<td>0.71</td>
<td>0.65</td>
<td>0.42</td>
<td>0.33</td>
<td>0.27</td>
</tr>
<tr>
<td>37%</td>
<td>1.14</td>
<td>1.08</td>
<td>0.79</td>
<td>0.73</td>
<td>0.50</td>
<td>0.41</td>
<td>0.35</td>
</tr>
</tbody>
</table>
ROTH CONVERSIONS

- 20-year analysis period
- 7% rate of return inside retirement account
- 5.5% after-tax rate of return outside retirement account
- Tax paid with outside funds
- RMDs do not start within period
- Sunset distribution rates

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.

<table>
<thead>
<tr>
<th>Rate @ Conversion</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%</th>
<th>32%</th>
<th>35%</th>
<th>37%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.10</td>
<td>0.04</td>
<td>0.25</td>
<td>0.31</td>
<td>0.55</td>
<td>0.63</td>
<td>0.69</td>
</tr>
<tr>
<td>15%</td>
<td>0.29</td>
<td>0.23</td>
<td>0.06</td>
<td>0.12</td>
<td>0.35</td>
<td>0.44</td>
<td>0.50</td>
</tr>
<tr>
<td>25%</td>
<td>0.68</td>
<td>0.62</td>
<td>0.33</td>
<td>0.27</td>
<td>0.03</td>
<td>-0.05</td>
<td>-0.11</td>
</tr>
<tr>
<td>28%</td>
<td>0.79</td>
<td>0.73</td>
<td>0.44</td>
<td>0.38</td>
<td>0.15</td>
<td>0.06</td>
<td>0.00</td>
</tr>
<tr>
<td>33%</td>
<td>0.99</td>
<td>0.93</td>
<td>0.64</td>
<td>0.58</td>
<td>0.34</td>
<td>0.26</td>
<td>0.20</td>
</tr>
<tr>
<td>35%</td>
<td>1.06</td>
<td>1.00</td>
<td>0.71</td>
<td>0.65</td>
<td>0.42</td>
<td>0.33</td>
<td>0.27</td>
</tr>
<tr>
<td>39.6%</td>
<td>1.24</td>
<td>1.18</td>
<td>0.89</td>
<td>0.83</td>
<td>0.60</td>
<td>0.51</td>
<td>0.45</td>
</tr>
</tbody>
</table>
ROTH CONVERSIONS

- 10-year analysis period
- 7% rate of return inside retirement account
- 5.5% after-tax rate of return outside retirement account
- Tax paid with inside funds
- Taxpayer is age 70 and RMDs begin in the first period

A positive factor indicates an effective conversion, whereas a negative factor indicates an ineffective conversion.
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- 7% rate of return inside retirement account
- 5.5% after-tax rate of return outside retirement account
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<th>35%</th>
<th>37%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.08</td>
<td>0.04</td>
<td>-0.14</td>
<td>-0.17</td>
<td>-0.32</td>
<td>-0.37</td>
<td>-0.41</td>
</tr>
<tr>
<td>12%</td>
<td>0.12</td>
<td>0.08</td>
<td>-0.10</td>
<td>-0.13</td>
<td>-0.28</td>
<td>-0.33</td>
<td>-0.37</td>
</tr>
<tr>
<td>22%</td>
<td>0.32</td>
<td>0.29</td>
<td>0.11</td>
<td>0.07</td>
<td>-0.07</td>
<td>-0.13</td>
<td>-0.16</td>
</tr>
<tr>
<td>24%</td>
<td>0.37</td>
<td>0.33</td>
<td>0.15</td>
<td>0.11</td>
<td>-0.03</td>
<td>-0.09</td>
<td>-0.12</td>
</tr>
<tr>
<td>32%</td>
<td>0.53</td>
<td>0.49</td>
<td>0.31</td>
<td>0.28</td>
<td>0.13</td>
<td>0.08</td>
<td>0.04</td>
</tr>
<tr>
<td>35%</td>
<td>0.59</td>
<td>0.55</td>
<td>0.37</td>
<td>0.34</td>
<td>0.19</td>
<td>0.14</td>
<td>0.10</td>
</tr>
<tr>
<td>37%</td>
<td>0.63</td>
<td>0.60</td>
<td>0.42</td>
<td>0.38</td>
<td>0.24</td>
<td>0.18</td>
<td>0.15</td>
</tr>
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ROTH CONVERSIONS

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<th>32%</th>
<th>35%</th>
<th>37%</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>0.44</td>
<td>0.38</td>
<td>0.07</td>
<td>0.01</td>
<td>-0.24</td>
<td>-0.33</td>
<td>-0.39</td>
</tr>
<tr>
<td>12%</td>
<td>0.52</td>
<td>0.46</td>
<td>0.15</td>
<td>0.09</td>
<td>-0.16</td>
<td>-0.25</td>
<td>-0.31</td>
</tr>
<tr>
<td>22%</td>
<td>0.89</td>
<td>0.83</td>
<td>0.52</td>
<td>0.46</td>
<td>0.22</td>
<td>0.12</td>
<td>0.06</td>
</tr>
<tr>
<td>24%</td>
<td>0.97</td>
<td>0.91</td>
<td>0.60</td>
<td>0.54</td>
<td>0.29</td>
<td>0.20</td>
<td>0.14</td>
</tr>
<tr>
<td>32%</td>
<td>1.27</td>
<td>1.21</td>
<td>0.90</td>
<td>0.84</td>
<td>0.59</td>
<td>0.50</td>
<td>0.44</td>
</tr>
<tr>
<td>35%</td>
<td>1.38</td>
<td>1.32</td>
<td>1.01</td>
<td>0.95</td>
<td>0.71</td>
<td>0.61</td>
<td>0.55</td>
</tr>
<tr>
<td>37%</td>
<td>1.46</td>
<td>1.40</td>
<td>1.09</td>
<td>1.03</td>
<td>0.78</td>
<td>0.69</td>
<td>0.63</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.

WARNING: Don’t forget about the “kiddie” tax
General Trust 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
  – IRC §§ (661-663)

Consider how Roth’s are taxed
Foundational Concepts

2020 Ordinary Income Tax Rates for Estates & Trusts

- 37% up to $12,950
- 35% from $12,950 to $9,450
- 24% from $9,450 to $2,600
- 10% on income over $2,600
Charitable Remainder Trusts

Overview

• Charitable Remainder Trust (CRT)

Donor receives an immediate income tax deduction for present value of the remainder interest (must be at least 10% of the value of the assets originally contributed)

At the end of the trust term, the charity receives the residual assets

Warning: Charitable Intent Required
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.
  - Run the Exhaustion Test
  - 10% Charitable Remainder Test

*Warning:*
A CRAT generally requires a greater Charitable Intent because of the exhaustion Test
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.
- **10% Charitable Remainder Test**
- **Life or term-of-years**

IRA  →  Charitable Remainder Trust  →  Beneficiary or Trust f/b/o a Beneficiary
Consider an out of state accumulation trust as a beneficiary of the CRT.
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
Charitable Remainder Trusts

**Taxation of Distributions**

- Traditional IRA Distributions are Tier I Income
- Interest Earned on post-distribution investment portfolio is Tier I Income
- Qualified Dividends earned on post-distribution investment portfolio is Tier II Income
- Long-Term Capital Gains earned on post distribution portfolio is Tier II Income
- IRA Basis is Tier IV return of capital
Charitable Remainder Trusts

Example

• Assumptions
  – 50-year old beneficiary
  – 6% rate of return: 2% yield, 4% growth
  – 10% turnover rate
  – Tax rates: 37% on immediate distribution; 32% 5-year distribution; 24% 10-year distribution; 22% lifetime distribution & all CRT models
  – May 2019 interest rates
Charitable Remainder Trusts

Example

Net to Beneficiary

- Immediate Distribution
- 5-Year Distribution
- 10-Year Distribution
- Lifetime Distribution
- 20-Year CRUT
- Lifetime CRUT
- 20-Year CRAT
Charitable Remainder Trusts

Example
State Income Tax Planning

• Review State Law of the IRA Owner
  – Will the home state tax the out of state 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 (watch out for throwback)
# State Income Tax Planning

## 5th 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 2019 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. §§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(5)</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 §17782</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 CA non-contingent beneficiaries vs. CA contingent beneficiaries and non-CA beneficiaries</td>
</tr>
<tr>
<td>Colorado</td>
<td>Colo. Rev. Stat. §§39-22-103(10)</td>
<td>4.63%</td>
<td>If the trust is administered in CO</td>
</tr>
<tr>
<td>Connecticut</td>
<td>Conn. Gen. Stat. §12-701(4)(a)(4)(C)(D)(a)(5)(a)(6)</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>30 Del. C. §§101(18)(a); 30 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>5.75%</td>
<td>If there is trust property located in GA or the trustee is “managing funds for the benefit of a resident of” GA (but Sup. Ct. of U.S. says statute is unconstitutional to tax just because of resident beneficiary per <em>Kaestner</em>)</td>
</tr>
<tr>
<td>Hawaii</td>
<td>Haw. Rev. Stat. §§335-1; Form N-40 Inst.</td>
<td>11.00%</td>
<td>If there is a HI trustee or if the trust is administered in HI, but only if there’s a Hawaii beneficiary</td>
</tr>
<tr>
<td>Idaho</td>
<td>Idaho Rev. and Tax. §§3-3015(2)</td>
<td>6.93%</td>
<td>If there are three or more of: (1) Grantor is ID resident; (2) Trust governed by ID law; (3) Trust has real or tangible personal property located in ID; (4) Trust has ID trustee; and/or (5) Administration of trust in ID</td>
</tr>
</tbody>
</table>

https://www.oshins.com/state-rankings-charts
## State Income Tax Planning

<table>
<thead>
<tr>
<th>State</th>
<th>Statute/Code</th>
<th>Tax Rate</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois</td>
<td>35 IL Comp. Stat. 5/1501 and 5/2055 C-1(D)</td>
<td>4.95%*</td>
<td>If the trust is set up by the Will of an IL resident or settlor was an IL resident at time trust became irrevocable --- Note that there is also a 1.50% “replacement tax” assessed in addition to the regular state income tax</td>
</tr>
<tr>
<td>Indiana</td>
<td>Ind. Admin Code §45-1-3.1.1-12</td>
<td>3.23%</td>
<td>If the trust is administered in IN</td>
</tr>
<tr>
<td>Iowa</td>
<td>Iowa Admin Code R701-89.3(1)(2)</td>
<td>8.53%</td>
<td>Depends on “relevant facts of each case” --- Relevant facts include residence of trustees, location of administration, location of evidence of intangible assets of the trust, etc. --- Must read rules carefully</td>
</tr>
<tr>
<td>Kansas</td>
<td>Kan. Stat. Ann. §§79-32, 109(d)</td>
<td>4.60%</td>
<td>If the trust is administered in KS</td>
</tr>
<tr>
<td>Kentucky</td>
<td>Ky. Rev. Stat. Ann. §386B.1-460; Instr. to Form 74A</td>
<td>5.00%</td>
<td>If the principal place of administration of the trust is in KY</td>
</tr>
<tr>
<td>Louisiana</td>
<td>La. Rev. Stat. Ann. §47:280.10(3)</td>
<td>6.00%</td>
<td>If the trust is set up by the Will of a LA resident; or an inter vivos trust set up by resident of any jurisdiction if trust instrument provides that the trust shall be governed by LA law, or if silent then taxed if administered in LA</td>
</tr>
<tr>
<td>Maine</td>
<td>Me. Rev. Stat. Ann. Tit. 36 §51024(H)(1)(c)</td>
<td>7.15%</td>
<td>If the trust is set up by the Will of a ME resident or settlor was a ME resident</td>
</tr>
<tr>
<td>Maryland</td>
<td>Md Code Ann. Tax-Gen. §§10-1010X(109d)</td>
<td>5.75%</td>
<td>If the trust is set up by the Will of a MD resident or settlor “is a current resident of” MD or the trust is principally administered in MD --- Also note the 1.25% to 3.20% county tax</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>Mass Regs. Code tit. 830, 622.10c.1; Form 2 Inst.</td>
<td>5.10%</td>
<td>If the trust is set up by the Will of a MA resident and there is MA beneficiary; Or if settlor was a MA resident at time of creation of inter vivos trust or at any time during year in which income is computed or who died as MA resident and there is MA beneficiary, but only if MA trustee --- Also note the 12.00% tax for short-term capital gains and gains for sales of collectibles (with 50% income tax deduction for collectibles)</td>
</tr>
<tr>
<td>Michigan</td>
<td>Mich Comp. Laws §206.18.11G; Form ML-1041</td>
<td>4.25%</td>
<td>If the trust is set up by the Will of a MI resident; or settlor was a MI resident at time trust became irrevocable</td>
</tr>
<tr>
<td>Minnesota</td>
<td>Minn Stat. §290.01, Subd. 7</td>
<td>9.85%</td>
<td>If the trust is set up by the Will of a MN resident that died post-12/31/1995 or trust that became irrevocable post-12/31/1995; or for pre-1/1/1996 irrevocable trusts if the majority of discretionary investment distribution decisions are made in MN or the books or records located in MN</td>
</tr>
<tr>
<td>Mississippi</td>
<td>Miss. Code Ann. §27-7-541; Miss. Form 81-110 Instructing</td>
<td>5.00%</td>
<td>If the trust is administered in MS</td>
</tr>
<tr>
<td>Missouri</td>
<td>RSMo §134.3312-1-13</td>
<td>5.40%</td>
<td>If the trust is set up by the Will of a MO resident or settlor was a MO resident at time trust became irrevocable, and a MO resident is a beneficiary on the last day of the tax year</td>
</tr>
<tr>
<td>Montana</td>
<td>MT Code §72-38-103(14); Fiduciary Tax Return</td>
<td>6.90%</td>
<td>If principal place of administration is in MT --- Principal place of administration is the usual place where day-to-day activities carried on by the trustee which is generally trustee’s residence or usual place of business</td>
</tr>
</tbody>
</table>
# State Income Tax Planning

<table>
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<tr>
<th>State</th>
<th>Code Reference</th>
<th>Rate</th>
<th>Description</th>
</tr>
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<tr>
<td>Nebraska</td>
<td>2714(a)(1)</td>
<td>6.84%</td>
<td>If the trust is set up by the Will of a NE resident; or if settlor of inter vives trust was a NE resident at time such person may no longer exercise the power to revest title to the trust property in himself or herself</td>
</tr>
<tr>
<td>Nevada</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>New Hampshire</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>New Jersey</td>
<td>NJSA 45A:1-</td>
<td>10.75%</td>
<td>If the trust is set up by Will of NJ resident or if settlor of a trust was a NJ resident at time of transfer to irrev. trust or at time a rev. trust became irrevocable, but not if no NJ assets, no NJ source income and no NJ resident trustee</td>
</tr>
<tr>
<td>New Mexico</td>
<td>NM Stat Ann.</td>
<td>4.90%</td>
<td>If the trustee is a NM resident; or if the principal place from which the trust is managed or administered is in NM</td>
</tr>
<tr>
<td>New York</td>
<td>N.Y. Tax Law</td>
<td>8.82%</td>
<td>If the trust is set up by the Will of a NY resident or settlor was a NY resident at time trust became irrevocable or when transfer made to trust, but foregoing doesn’t apply if no NY trustees, all corpus outside of NY and all income non-NY sourced; Also, no Incomplete Gift Non-grantor Trusts</td>
</tr>
<tr>
<td>New York City</td>
<td>N.Y. Tax Law</td>
<td>3.876%</td>
<td>If the trust is set up by the Will of a NY City resident or settlor was a NY City resident at time trust became irrevocable or when transfer made to trust, but foregoing doesn’t apply if no NY City trustees, all corpus outside of NY City and all income non-NY City sourced; Also, no Incomplete Gift Non-grantor Trusts</td>
</tr>
<tr>
<td>North Carolina</td>
<td>N.C. Gen. Stat.</td>
<td>5.25%</td>
<td>If there is a NC beneficiary (but Sup. Ct. of U.S. says statute is unconstitutional per <em>Kaestner</em>)</td>
</tr>
<tr>
<td>North Dakota</td>
<td>N.D. Admin.</td>
<td>3.22%</td>
<td>If the trust “has a relationship to the state sufficient to create nexus” --- This includes, but is not limited to: (1) If there is a ND beneficiary; (2) If there is a ND trustee; (3) If there are ND situs assets; (4) If there is administration in ND; and/or (5) If the “laws of this state are made applicable to the trust”</td>
</tr>
<tr>
<td>Ohio</td>
<td>Ohio Rev. Code</td>
<td>4.997%</td>
<td>If the trust is set up by the Will of OH resident; or settlor of an inter vivos trust was an OH resident at time trust became irrev. and at least one of “qualifying beneficiaries” is OH resident during all or some portion of taxable yr.</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>Okla. Stat. tit. 68</td>
<td>5.25%</td>
<td>If the trust is set up by the Will of an OK resident; or settlor of inter vivos trust was an OK resident at time such trust irrevocable; or if there is no OR trustee; or if the trust is administered in OR</td>
</tr>
<tr>
<td>Oregon</td>
<td>Or. Rev. Stat.</td>
<td>9.90%</td>
<td>If there is an OR trustee; or if the trust is administered in OR</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>72 P.S., tit. 61, Sec. 101.1</td>
<td>3.07%</td>
<td>If the trust is set up by the Will of a PA resident; or if settlor of inter vivos trust was a PA resident at time of creation of trust or at time of transfer to trust</td>
</tr>
</tbody>
</table>
### State Income Tax Planning

<table>
<thead>
<tr>
<th>State</th>
<th>Code</th>
<th>Tax Rate</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rhode Island</td>
<td>R.I. Gen. Laws 44-35.3(6)(2)</td>
<td>5.99%</td>
<td>If the trust is set up by the Will of a RI resident; or a RI settlor of a revocable trust upon becoming irrevocable; or a settlor of an irrevocable trust if the settlor was a RI resident at time of creation of trust or at time of transfer to trust, but in each of these situations only to the extent that the beneficiaries are RI residents</td>
</tr>
<tr>
<td>South Carolina</td>
<td>S.C. Code Ann. 412-6-305</td>
<td>7.00%</td>
<td>If the trust is administered in SC</td>
</tr>
<tr>
<td>South Dakota</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>Tennessee</td>
<td>Tenn. Code Ann. 46-7-2-110(a)</td>
<td>2.00%</td>
<td>(int./div. only)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>If there is a TN beneficiary (but Sup. Ct. of U.S. says statute is unconstitutional per Kaestner)</td>
</tr>
<tr>
<td>Texas</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>Utah</td>
<td>Utah Code Ann. 135-37-108(D)</td>
<td>4.95%</td>
<td>If the trust is set up by the Will of a UT resident; or if a trust is administered in UT</td>
</tr>
<tr>
<td>Vermont</td>
<td>32 V.S.A. 4381(11)(X-B)</td>
<td>8.75%</td>
<td>If the trust is set up by the Will of a VT resident; or if settlor of a trust was a VT resident at time of transfer to irrevocable trust or was a VT resident at the time a revocable trust became irrevocable</td>
</tr>
<tr>
<td>Virginia</td>
<td>Va. Code Ann. 55.1-1302</td>
<td>5.75%</td>
<td>If the trust is set up by the Will of a VA resident; or if a trust was created by a settlor who was a VA resident; or a trust which is being administered in VA</td>
</tr>
<tr>
<td>Washington</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
<tr>
<td>Washington, D.C.</td>
<td>D.C. Code 47-1809.01, 1809.02</td>
<td>8.95%</td>
<td>If the trust is set up by the Will of a D.C. resident; or if a trust was created by a settlor who was a D.C. resident</td>
</tr>
<tr>
<td>West Virginia</td>
<td>W. Va. Code 41-21-36c</td>
<td>6.50%</td>
<td>If the trust is set up by the Will of a WV resident; or if a trust was created by a settlor who was a WV resident</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>Wis. Stat. 771.14(2) (3)(c)</td>
<td>7.65%</td>
<td>If the trust is set up by the Will of a WI resident; or if settlor of a post-10/28/1999 inter vivos trust was a WI resident at time trust became irrevocable; or if irrevocable inter vivos trust administered in WI pre-10/29/1999</td>
</tr>
<tr>
<td>Wyoming</td>
<td><em><strong>No tax</strong></em></td>
<td>0%</td>
<td><em><strong>No tax</strong></em></td>
</tr>
</tbody>
</table>

*This Non-Grantor Trust State Income Tax Chart created in June 2019. For informational purposes only. Do not rely solely on the short summary. Always read the statute. Copyright © 2015-2019 by Steve Oshins - soshins@oshins.com / www.oshins.com / (702) 341-6000, ext. 2. All rights reserved.*
Secure Act

Life Insurance Strategies
Life Insurance

• Four Strategies
  – IRA Roth Conversion Hedge
  – IRA Relocation
    • Policy on Owner
    • Policy on Spouse
    • Second-to-die policy
  - Income Tax Replacement
  - Roth Conversion Subsequent to Owner’s Death by spouse
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 income tax 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 – Roth Hedge

• Example:
  – Mary is a 60-year old divorcee and has $2,000,000 in her qualified plans.
  – Mary’s accountant projects her retirement tax-rate to be no greater than 24% with opportunities to undertake Roth Conversions.
Life Insurance – Roth Hedge

• Example (cont.):
  – With the stretch, RMDs to her only child would generally be subject to a 22%-24% rate.
  – However, with a 10-year rule about 50% of amortized distributions would be subject to a 32% rate.
  – Mary’s simple tax-risk of early death is about $80,000 [$2,000,000 x 50% x (32% - 24%)]

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Life Insurance – Roth Hedge

• Example (cont.):
  – A more complex calculation could also consider the value of the loss of the qualified accounts:
    ➢ Terminal Tax Deferral
    ➢ Tax-free Compounding of Yield
    ➢ No Roth RMDs During Life
    ➢ Post-mortem Roth Earnings
Life Insurance – Roth Hedge

• Note that the tax-cost of early death will decrease with age for many people
Life Insurance – Roth Hedge

• Therefore, a policy structure with a declining death benefit would best offset the risk
• A whole or universal life product with a term rider may therefore be the best fit
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

The mathematical theory is similar to a Roth conversion

<table>
<thead>
<tr>
<th></th>
<th>Traditional IRA</th>
<th>Roth IRA</th>
<th>Life Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Account Balance</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Less: Income Taxes @ 40%</td>
<td></td>
<td>(400,000)</td>
<td>(400,000)</td>
</tr>
<tr>
<td>Net Balance</td>
<td>$1,000,000</td>
<td>$600,000</td>
<td>$600,000</td>
</tr>
<tr>
<td>Growth Until Death</td>
<td>300.00%</td>
<td>300.00%</td>
<td>300.00%</td>
</tr>
<tr>
<td>Account Balance @ Death</td>
<td>$3,000,000</td>
<td>$1,800,000</td>
<td>$1,800,000</td>
</tr>
<tr>
<td>Less: Income Taxes @ 40%</td>
<td>(1,200,000)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Net Account Balance to Family</td>
<td>$1,800,000</td>
<td>$1,800,000</td>
<td>$1,800,000</td>
</tr>
</tbody>
</table>
Income Tax Replacement

• Simple Approach – Single person or married couple
  – Project value at time of death
  – Acquire insurance to equal the future income tax
  – Manage Tax Brackets over the ten year post-mortem withdrawal period
Roth Conversion Subsequent to Owner’s Death by surviving spouse

• Determine the likely IRA value at first spouse’s death
• Acquire Insurance to pay the Roth conversion taxes at first spouse’s death
• Conversions over 1-11 years
Appendix:

Charitable Planning with IRAs at Death
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