PFP Section

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Large IRAs: Wealth Transfer Planning Strategies for Your Clients

Your Presenter

Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished)

Outline

- Changes to watch for during a Biden Administration
- The SECURE Act’s New Post-Mortem Payout Rules
- Estate Tax Considerations
- Solutions to Analyze

Changes to watch for during a Biden Administration

Changes to Watch for During a Biden Administration

- Restoration of the 39.6% marginal tax rate
- An increased taxation of capital gains
- Limitations on itemized deductions
- A decrease in the estate tax exemption & an increase in the estate tax rate

Changes to Watch for During a Biden Administration

- The final budget proposal provided to Congress by the Obama Administration for FY2016 proposed several limitations on IRAs:
  - Limit accruals in retirement accounts to about $3,400,000 (in 2015 dollars)
  - Limit Roth Conversions to pre-tax dollars
  - Repeal the NUA exclusion

The SECURE Act's new post-mortem payout rules

The SECURE Act's"10-Year" Rule for Post-Mortem Distributions

- Basically, requires all IRAs, Roth IRAs, and Qualified Plans to be distributed within 10 years of death.

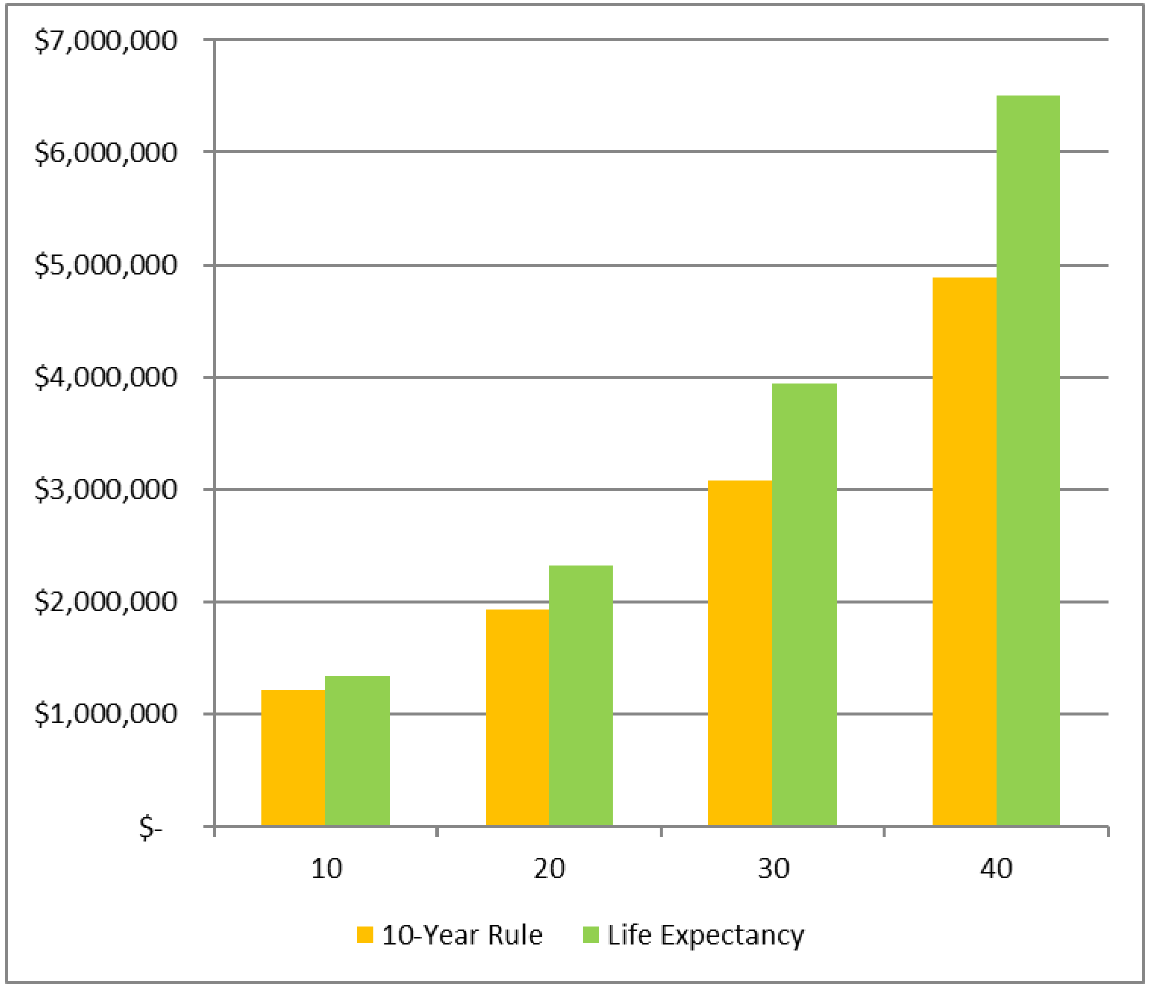
- <u>EFFECTIVE DATE</u>: Deaths which occur after 12/31/19

Post-Mortem Distributions - Example

Ten-Year vs. Life Expectancy

Age of (Oldest Trust) Beneficiary	40
IRA Balance	$ 1,000,000
Pre-Tax Growth Rate	6.00%
After-Tax Growth Rate	4.75%
Average Income Tax Rate - Life Expectancy Rule	24.00%
Average Income Tax Rate - Ten Year Rule	28.00%
Distributions Occur at Beginning or End of Period?	End
Lump-Sum Distribution or Amortize Payments?	Amortize

Post-Mortem Distributions - Example



Post-Mortem Distributions

- 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

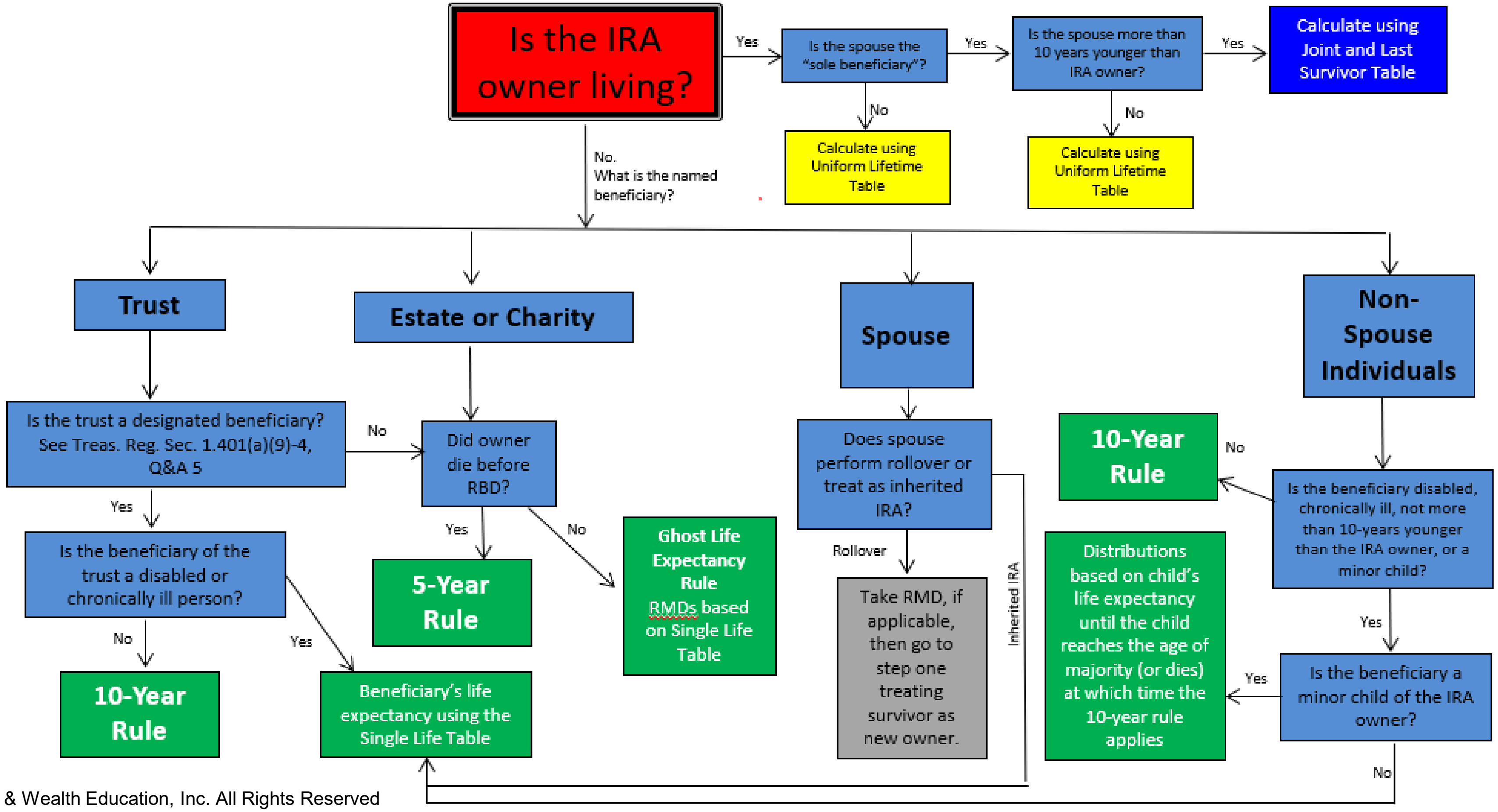
§§ 401(a)(2)(E)(ii)

Secure Act Beneficiary RMD Summary

Tax Terminology	Designated Non-Eligible Beneficiary	Surviving Spouse	Eligible Minor Child	Person Less Than 10 Years Younger	Disabled or Chronically Ill Person
Outright Beneficiary	10-Year Rule	Life Expectancy Rule	Life Expectancy Rule (Until Majority then 10-Year Rule)	Life Expectancy Rule	Life Expectancy Rule
Conduit Trust	10-Year Rule	Life Expectancy Rule	Life Expectancy Rule (Until Majority then 10-Year Rule)	Life Expectancy Rule	Life Expectancy Rule
Designated Beneficiary Trust	10-Year Rule	10-Year Rule	10-Year Rule	10-Year Rule	Life Expectancy Rule
Non-Designated Beneficiary Trust	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule	Before RBD: 5-Year Rule
	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule	After RBD: Ghost Life Expectancy Rule

TRADITIONAL IRA RMD FLOWCHART

For Deaths After Effective Date of SECURE Act



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 are advisable if the client has both a traditional IRA and a Roth IRA – this avoids "trapping" the taxable IRA income.

Ten Year Rule - Roth vs. Traditional IRA

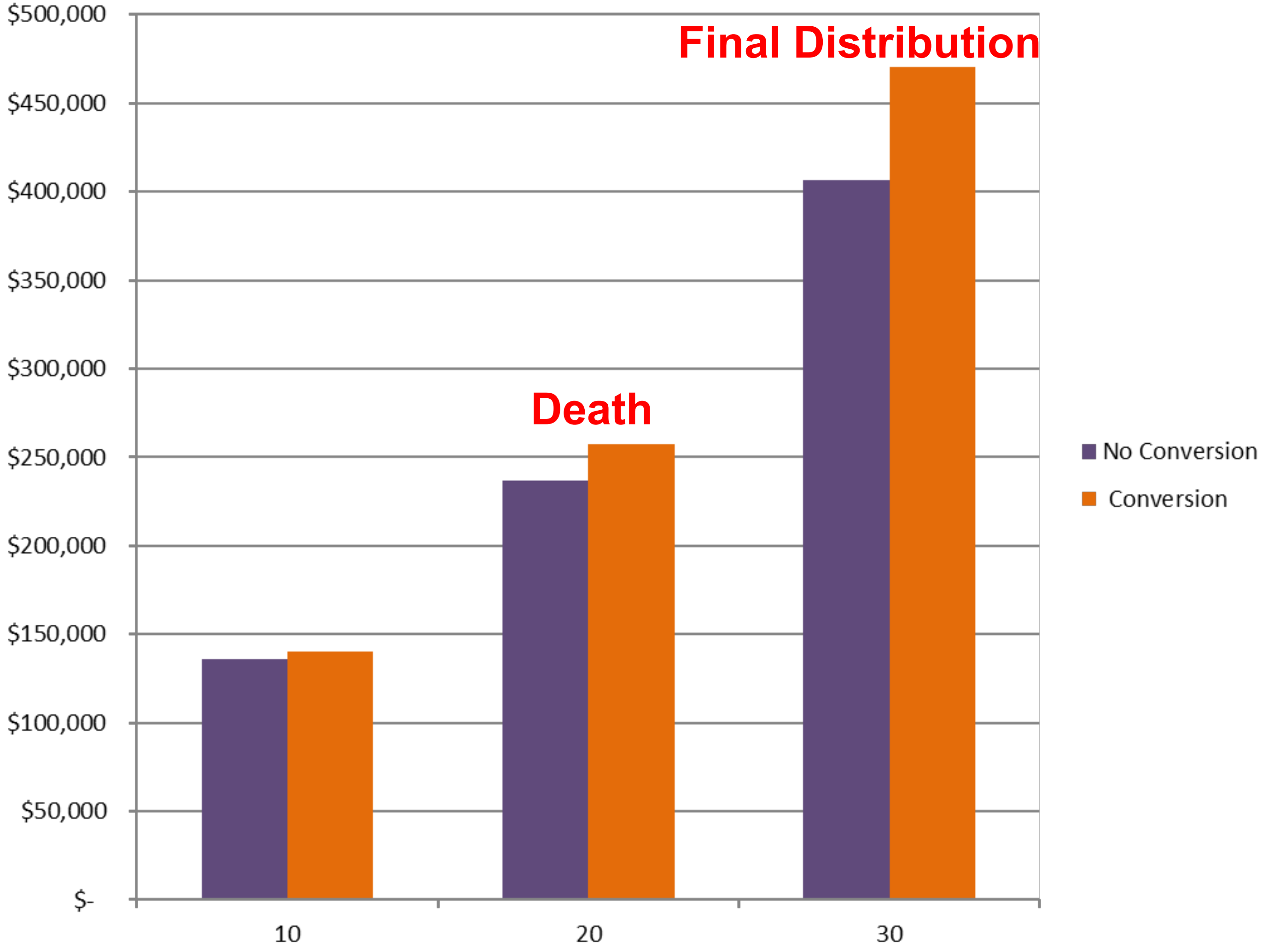
- If minimizing income taxation is the only concern, Roth distributions after death should generally be deferred until the end of the ten-year period – *"The Roth Reprieve."*

- 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.

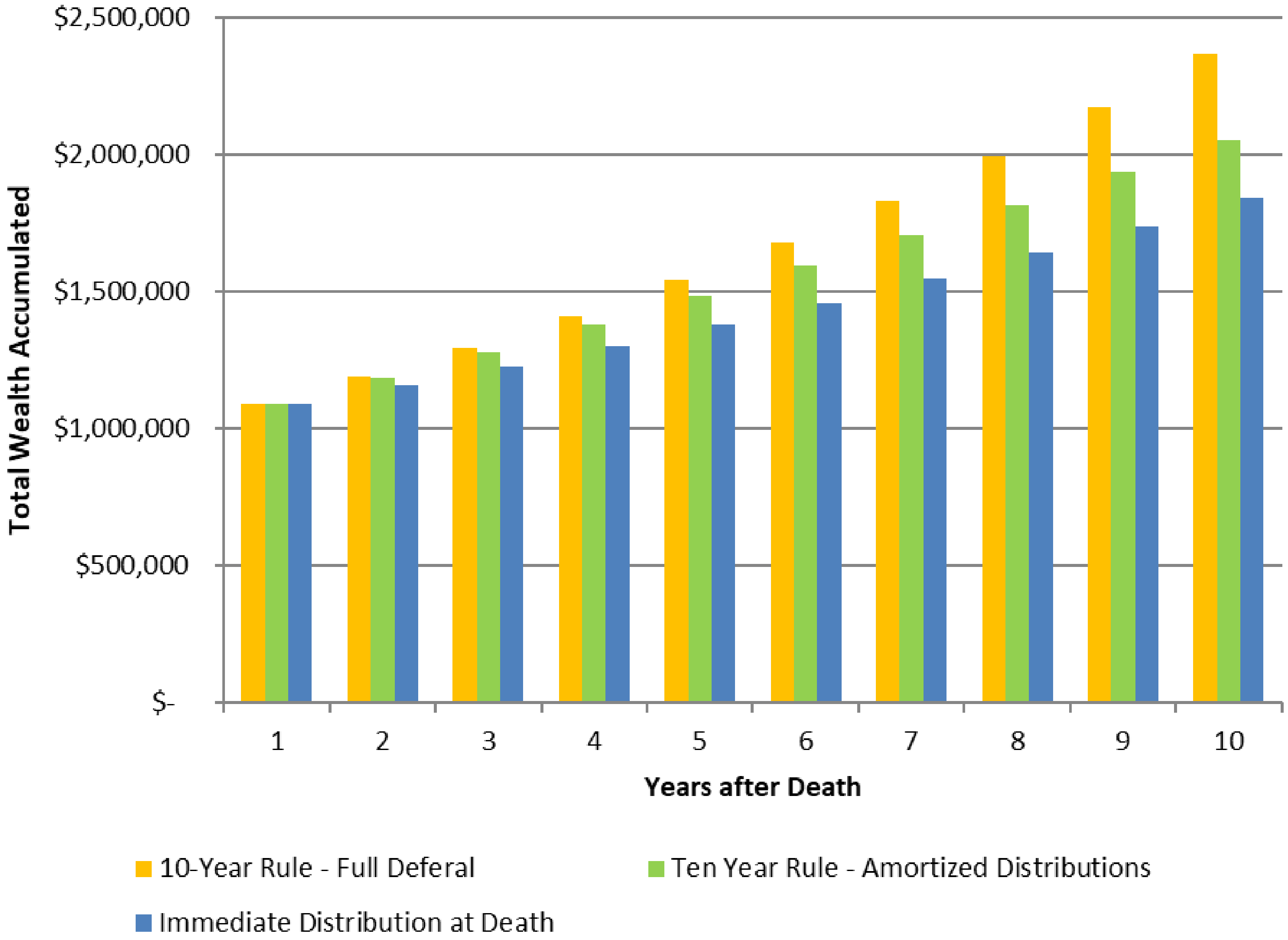
The Roth Reprieve



The Roth Reprieve

- Consider the following example:
  - Connie dies and leaves her $3,000,000 Roth IRA to her three children equally
  - Each child has a different understanding of the rules, but is responsible and good investor
  - Derek distributes the IRA immediately and reinvests the money in a brokerage account
  - Daniel computes a 10-year level amortization schedule and makes annual transfers from the inherited IRA to his brokerage account
  - David waits the full 10-years to transfer the funds in the IRA to his brokerage account
  - Assume a 6% pre-tax return and a 9% before tax return

The Roth Reprieve



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.

Multi-Generation Spray Trust

Multi-Generation Spray Trust

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

WARNING: Don't forget about the "kiddie" tax

Form **1041** Department of the Treasury—Internal Revenue Service

U.S. Income Tax Return for Estates and Trusts **2020** OMB No. 1545-0092

▶ Go to www.irs.gov/Form1041 for instructions and the latest information.

A Check all that apply:
- ☐ Decedent's estate
- ☐ Simple trust
- ☐ Complex trust
- ☐ Qualified disability trust
- ☐ ESBT (S portion only)
- ☐ Grantor type trust
- ☐ Bankruptcy estate—Ch. 7
- ☐ Bankruptcy estate—Ch. 11
- ☐ Pooled income fund

For calendar year 2020 or fiscal year beginning , 2020, and ending , 20

Name of estate or trust (If a grantor type trust, see the instructions.)

Name and title of fiduciary

Number, street, and room or suite no. (If a P.O. box, see the instructions.)

City or town, state or province, country, and ZIP or foreign postal code

C Employer identification number

D Date entity created

E Nonexempt charitable and split-interest trusts, check applicable box(es). See instructions.
- ☐ Described in sec. 4947(a)(1). Check here if not a private foundation . . ▶ ☐
- ☐ Described in sec. 4947(a)(2)

B Number of Schedules K-1 attached (see instructions) ▶

F Check applicable boxes: ☐ Initial return ☐ Final return ☐ Amended return ☐ Net operating loss carryback ☐ Change in trust's name ☐ Change in fiduciary ☐ Change in fiduciary's name ☐ Change in fiduciary's address

G Check here if the estate or filing trust made a section 645 election . . . ▶ ☐ Trust TIN ▶

Income	1	Interest income	1
	2a	Total ordinary dividends	2a
	b	Qualified dividends allocable to: **(1)** Beneficiaries **(2)** Estate or trust	
	3	Business income or (loss). Attach Schedule C (Form 1040)	3
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	5
	6	Farm income or (loss). Attach Schedule F (Form 1040)	6
	7	Ordinary gain or (loss). Attach Form 4797	7
	8	Other income. List type and amount	8
	9	**Total income.** Combine lines 1, 2a, and 3 through 8 ▶	9
Deductions	10	Interest. Check if Form 4952 is attached ▶ ☐	10
	11	Taxes	11
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions	12
	13	Charitable deduction (from Schedule A, line 7)	13
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions	14
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e)	15a
	b	Net operating loss deduction. See instructions	15b
	16	Add lines 10 through 15b ▶	16
	17	Adjusted total income or (loss). Subtract line 16 from line 9 (17)	
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20
	21	Exemption	21
	22	Add lines 18 through 21 ▶	22
Tax and Payments	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23
	24	**Total tax** (from Schedule G, Part I, line 9)	24
	25	2020 net 965 tax liability paid from Form 965-A, Part II, column (k), line 4	25
	26	**Total payments** (from Schedule G, Part II, line 19)	26
	27	Estimated tax penalty. See instructions	27
	28	**Tax due.** If line 26 is smaller than the total of lines 24, 25, and 27, enter amount owed	28
	29	**Overpayment.** If line 26 is larger than the total of lines 24, 25, and 27, enter amount overpaid	29
	30	Amount of line 29 to be: **a Credited to 2021** ▶ ; **b Refunded** ▶	30

Sign Here Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of fiduciary or officer representing fiduciary | Date | EIN of fiduciary if a financial institution | May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only Print/Type preparer's name | Preparer's signature | Date | Check ☐ if self-employed | PTIN

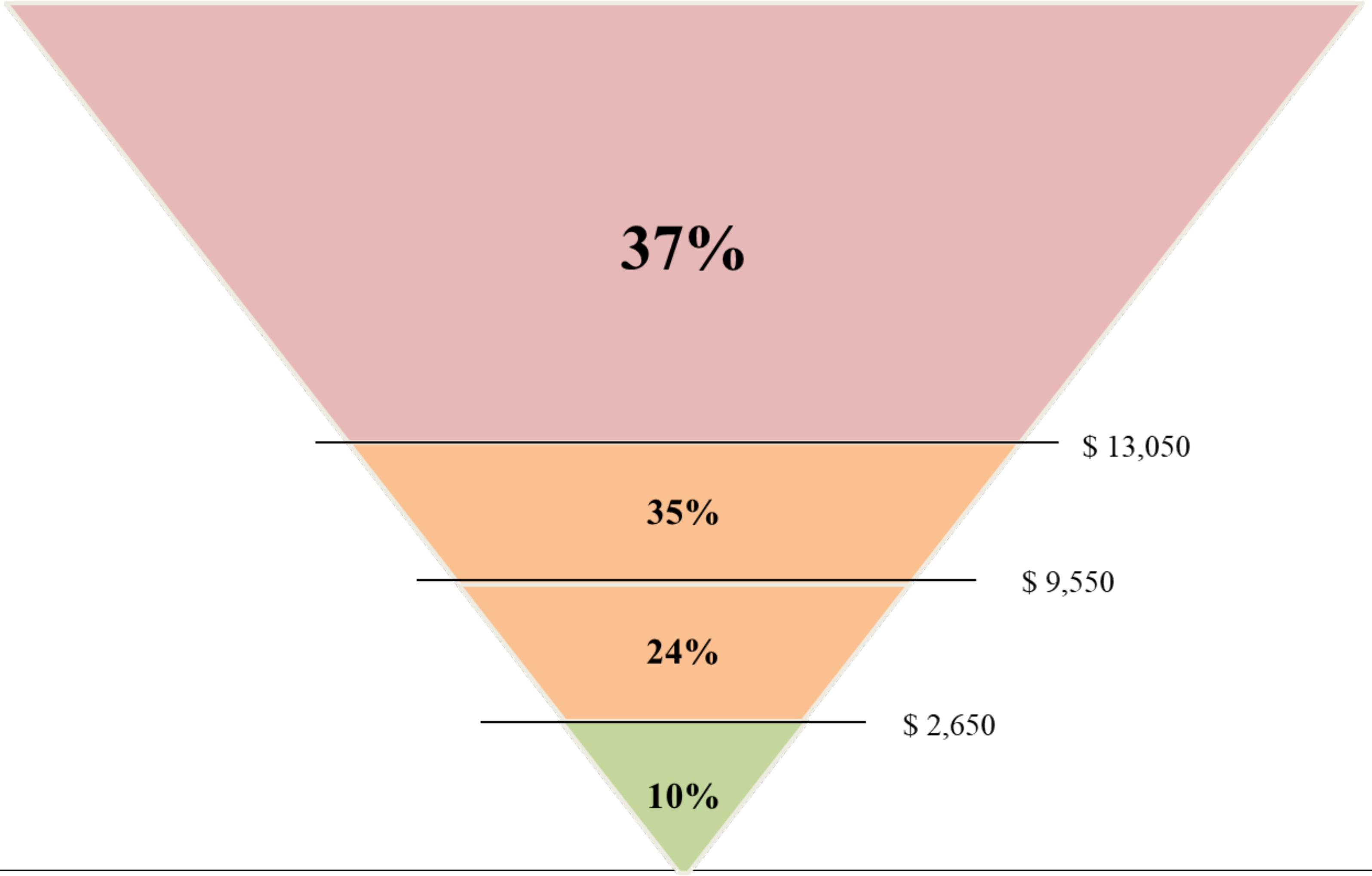
Firm's name ▶ | Firm's EIN ▶

Firm's address ▶ | Phone no.

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form **1041** (2020)

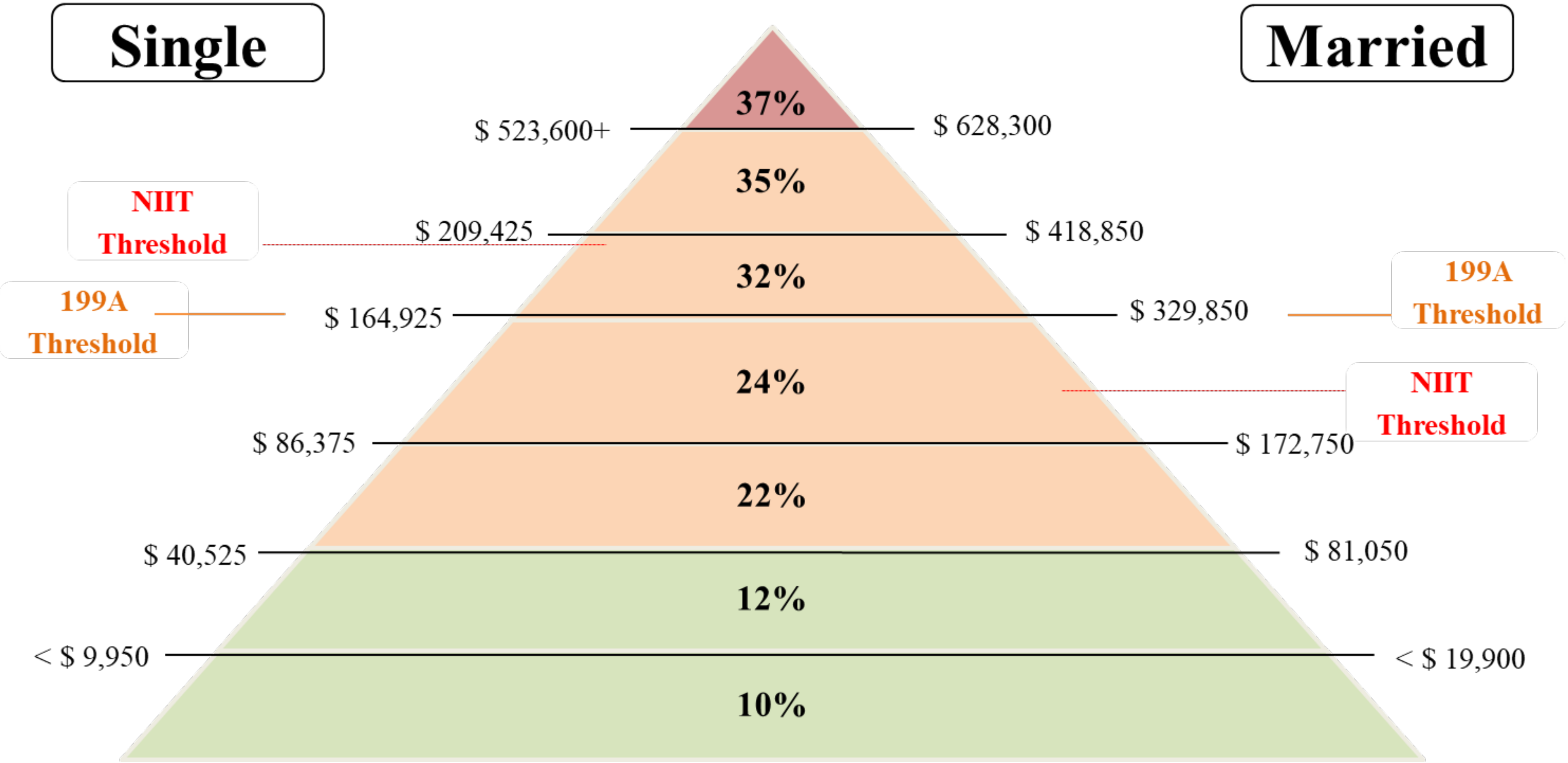
Foundational Concepts

2021 Ordinary Income Tax Rates for Estates & Trusts



Foundational Concepts

2021 Ordinary Income Tax Rates for Individuals



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 state and federal income tax law
  - Determines who is taxed on the income

Foundational Concepts - Typical Types of “Income” Under Traditional Fiduciary Accounting

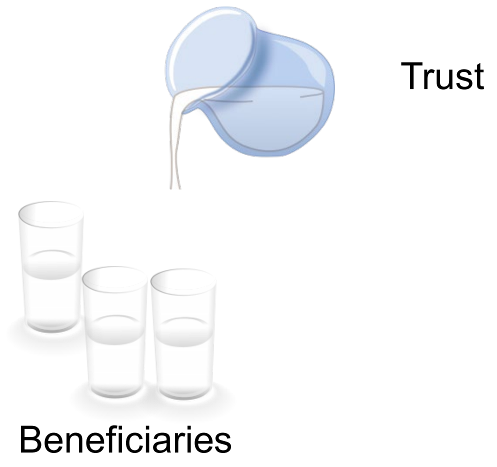
- Interest
  - Taxable
  - Tax-exempt
- Dividends
- Rents (net of expenses)
- Royalties
- Partnership or S-corporation distributions

Foundational Concepts - Typical Types of “Principal” Under Traditional Fiduciary Accounting

- IRA value as of date of death
- Increases in asset value (i.e. growth)
- Realized long-term capital gain
- Realized short-term capital gain
- Proceeds from covered call writing

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, etc.) of the taxable income in beneficiaries' hands.



IRC § 661

Foundational Concepts - Distributable Net Income (DNI)

Trust/Estate

DNI acts as a ceiling for purposes of the allowable deduction

DNI

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) – Computation of DNI

Taxable income

+ Income distribution deduction

+ Exemption

+ Net tax-exempt income

+ Capital losses*

< Capital gains* >

<Extraordinary/stock dividends >

= Distributable Net Income (DNI)

* Except in the year of termination

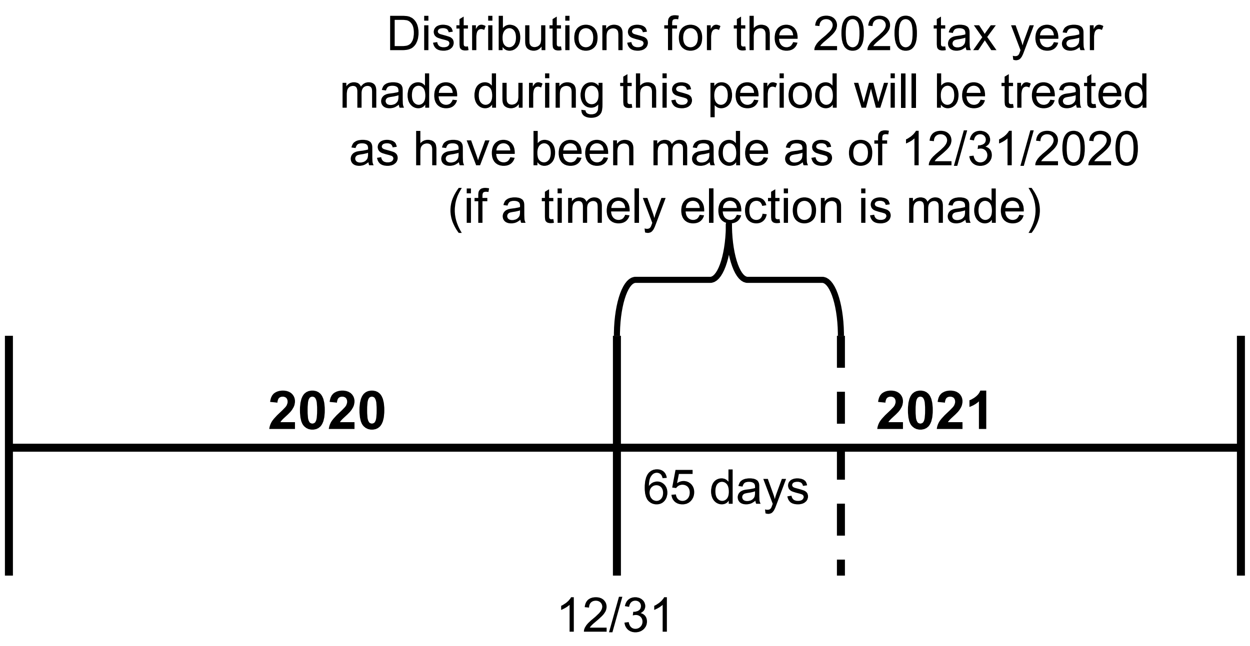
Foundational Concepts - “65-Day” Rule (IRC §663(b))

- Applies to estates and complex trusts

- Allows fiduciary to treat distributions made within 65 days after year-end to be treated as if they were made as of December 31st of the prior year
  - Limited to DNI (reduced by distributions made during the prior year)

- Election must be made by the due date of the tax return
  - Election is irrevocable
  - Annual election

Foundational Concepts - “65-Day” Rule (IRC §663(b))



Estate tax considerations

Estate Tax Considerations

- Funding a GST-Exempt Trust
  - Fractional formula on the beneficiary designation form (to avoid the *Kenan* issue)
  - Apportion estate tax to non-exempt property (to avoid using GST-exempt trust assets to pay estate tax)
  - Allocate GST exemption to the receiving trust

Estate Tax Considerations

- Note, the same amount GST exemption must be allocated for a Traditional IRA or a Roth IRA – the Roth is therefore much more efficient

		Traditional IRA	Roth IRA
Value of Assets		$ 1,000,000	$ 1,000,000
Less: Income Tax	37%	(370,000)	-
Net to Trust		$ 630,000	$ 1,000,000
GST Exemption Allocated		$ 1,000,000	$ 1,000,000

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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

	Traditional IRA	Roth IRA
IRA balance	$ 1,000,000	$ 1,000,000
Less: Federal and state income taxes on Roth IRA conversion (40%)	-	(400,000)
Taxable Estate	$ 1,000,000	$ 600,000
Federal estate tax (40%)	$ 400,000	$ 240,000
State death tax (10%)	100,000	60,000
Total estate taxes	$ 500,000	$ 300,000
Post-death traditional IRA balance	$ 1,000,000	
Less: IRC §691(c) deduction	(400,000)	
Post-death traditional IRA balance subject to income tax	$ 600,000	
Federal and state income taxes on IRA distributions (40%)	$ 240,000	$ -
Net IRA balance to beneficiaries	**$ 260,000**	**$ 300,000**

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)

Frozen-in-Time

Estate Tax Considerations

- "Fading" IRC § 691(c) deduction example

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

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).

Estate Tax Considerations

- Distributing an IRA – to Make Tax-Free Gifts
  - Deceptively, it can make sense to distribute an IRA during the clients lifetime to make exemption gifts to a trust
  - This is especially true in the current “use-it or lose-it” era of exemption gift planning

Estate Tax Considerations - Exemption Reduction Math – “Use It or Lose It”

2021 gifts use this portion of the exemption first.

Old Exemption

$5,850,000

2021 gifts use this portion of the exemption second.

Lost if not used before the law changes.

2018 Exemption Increase

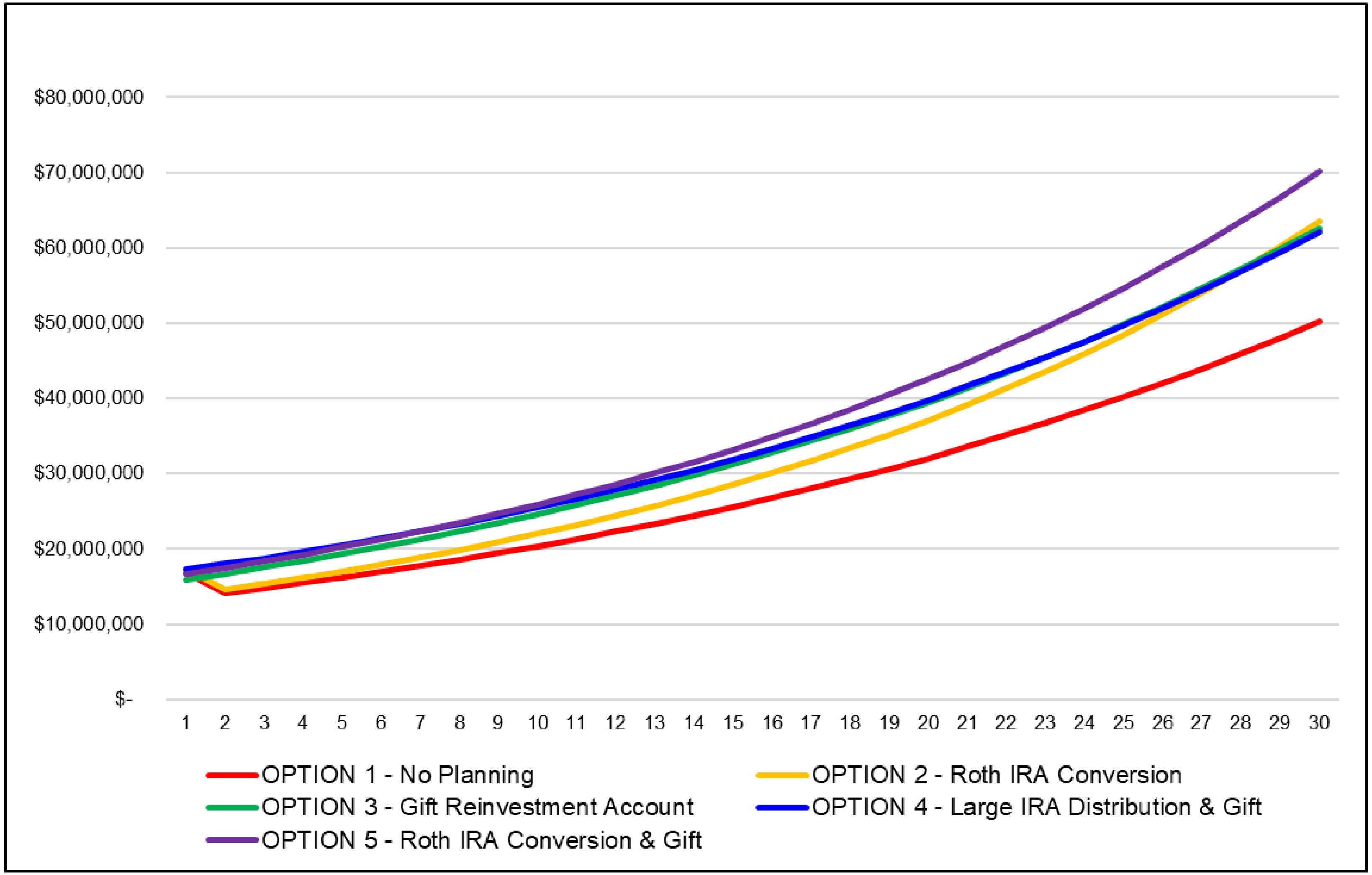
$5,850,000

2021 Estate Tax Exemption $11,700,000

Estate Tax Considerations - Example

GENERAL ASSUMPTIONS	
Current Year	2021
Uday's Age	73
INVESTMENT ASSUMPTIONS	
FMV of Traditional IRA	$ 15,000,000
Growth Rate	6.00%
FMV of Reinvestment Account	$ 11,700,000
Cost Basis	$ 8,000,000
Yield Rate	2.00%
Growth Rate	4.00%
Annual Portfolio Turnover	10.00%
TAX ASSUMPTIONS	
Ordinary Income Tax Rate (2021)	45.00%
Capital Gains Tax Rate (2021)	25.00%
Ordinary Income Tax Rate (2022 & Later)	50.00%
Capital Gains Tax Rate (2022 & Later)	30.00%
Estate Tax Exemption (2021)	$ 11,700,000
Estate Tax Exemption (2022)	$ 3,500,000
% Increase in Estate Tax Exemption (2023 & Later)	1.00%
Estate Tax Rate	40.00%

Estate Tax Considerations - Example



Roth conversions

Roth Conversions - Reasons to Convert

1. Taxpayers have special favorable tax attributes, including a high basis ratio, charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), etc. These attributes reduce the effective tax rate of the conversion.

2. Suspension of the minimum distribution rules at age 72 provides a considerable advantage to the Roth IRA holder. This allows for additional tax-free deferral.

Roth Conversions - Reasons to Convert

3. Taxpayers benefit from paying income tax before estate tax compared to the income tax deduction obtained when a traditional IRA is subject to estate tax. This is because the IRC § 691(c) deduction is inefficient.

4. Taxpayers who can pay the income tax on the IRA from non-IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields. This is because of the ability to move funds from a “taxable” to a “tax-free” tax asset class.

Roth Conversions - Reasons to Convert

5. Taxpayers who want to leave IRA assets to their family, are well advised to consider making a Roth IRA election for that portion of their overall IRA funds. This is because no distributions are required for ten years after death, generally.

6. Post-death distributions to beneficiaries are tax-free and make funding a GST-exempt trust much more efficient. This is possibly the most advantageous aspect of a Roth IRA conversion.

Roth Conversions - Reasons to Convert

7. Because the highest federal tax bracket is more favorable for married couples filing joint returns than for single individuals and because individual brackets are compressed compared to married individuals a Roth Conversion before the first spouse's death may be prudent.

8. 199A Qualified Business Income Deduction. A conversion may be beneficial for business owners because Roth IRA qualified distributions are not considered taxable income for purposes of computing the limits on the deduction.

Roth Conversions - Reasons to Convert

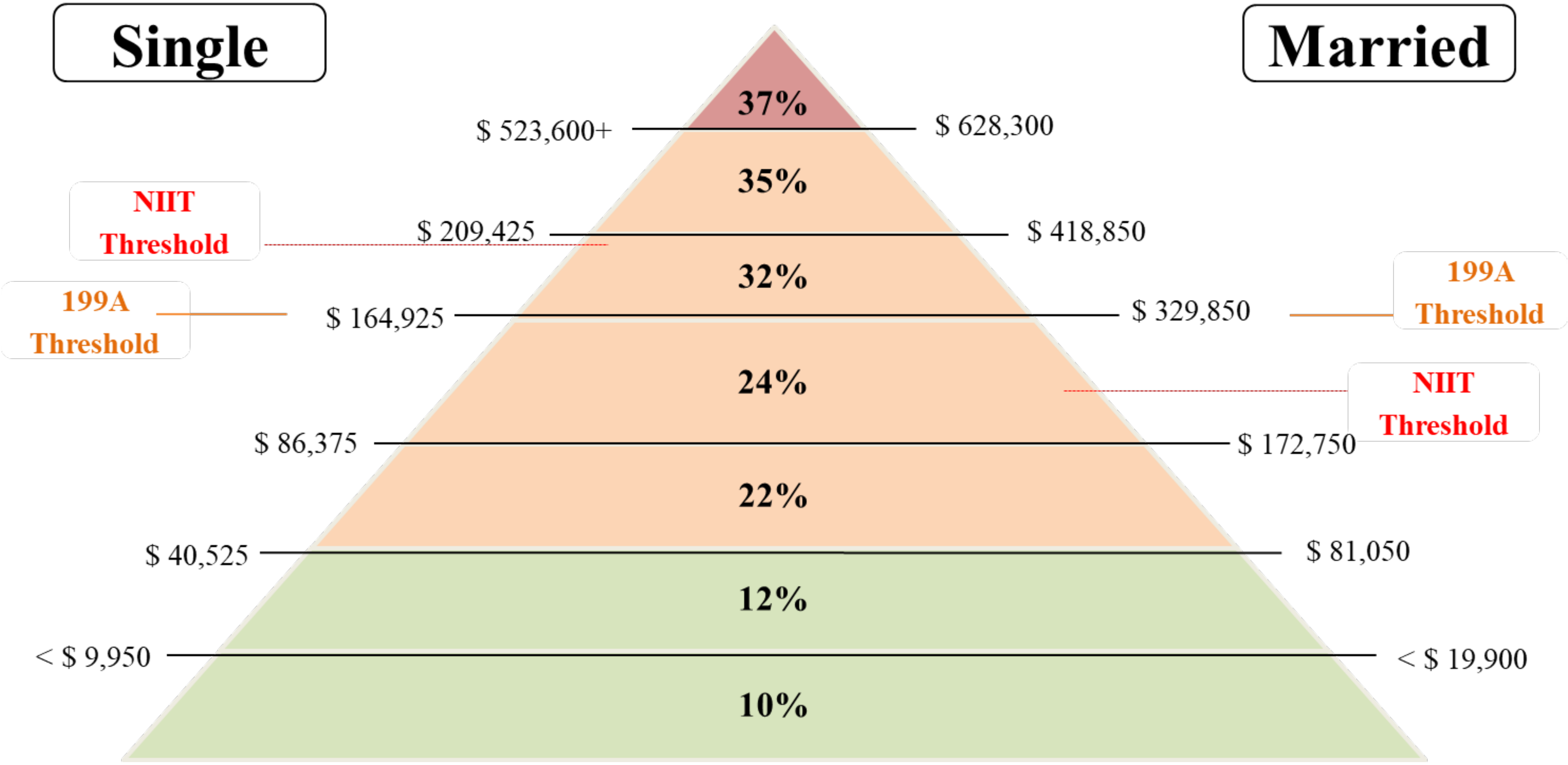
9. 3.8% Net Investment Income Tax. A conversion may be beneficial for taxpayers because Roth IRA qualified distributions are neither net investment income nor MAGI.

10. Tax rates are historically very low. Higher tax rates in the future means more tax will be paid on taxable IRA distributions than the tax that would be paid on a conversion at a lower rate

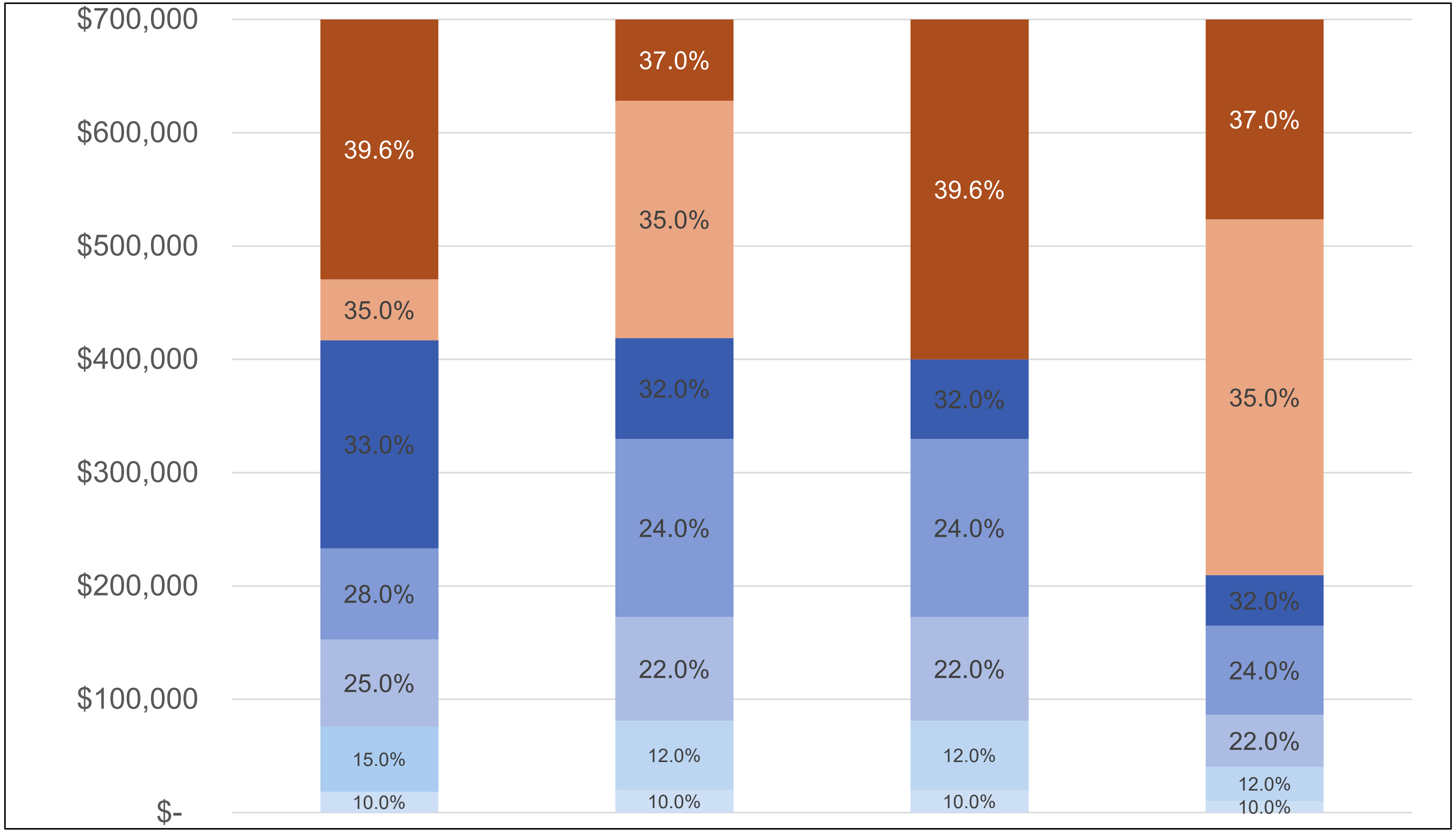
Roth Conversions

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

2021 Tax Brackets



2021 Tax Brackets



Taxation of Roth IRA Distributions

	Distribution within 5 years	Distribution beyond 5 years
Age < 59½	Income Tax: Yes (earnings only) 10% Penalty: Yes (earnings & taxable portion of prior conversion amounts)	Income Tax: Yes (earnings only) 10% Penalty: Yes (earnings only)
Age ≥ 59½	Income Tax: Yes (earnings only) 10% Penalty: No	Income Tax: No 10% Penalty: No

Taxation of Roth IRA Distributions - “Ordering Rules”

Step 1: **Gross Distribution**

Step 2: **Net contributions**[1]

Step 3: **Conversion amounts > 5 years**[2] **(taxable portion)**

Step 4: **Conversion amounts > 5 years**[2] **(non-taxable portion)**

Step 5: **Conversion amounts <= 5 years**[2] **(taxable portion)**

Step 6: **Conversion amounts <= 5 years**[2] **(non-taxable portion)**

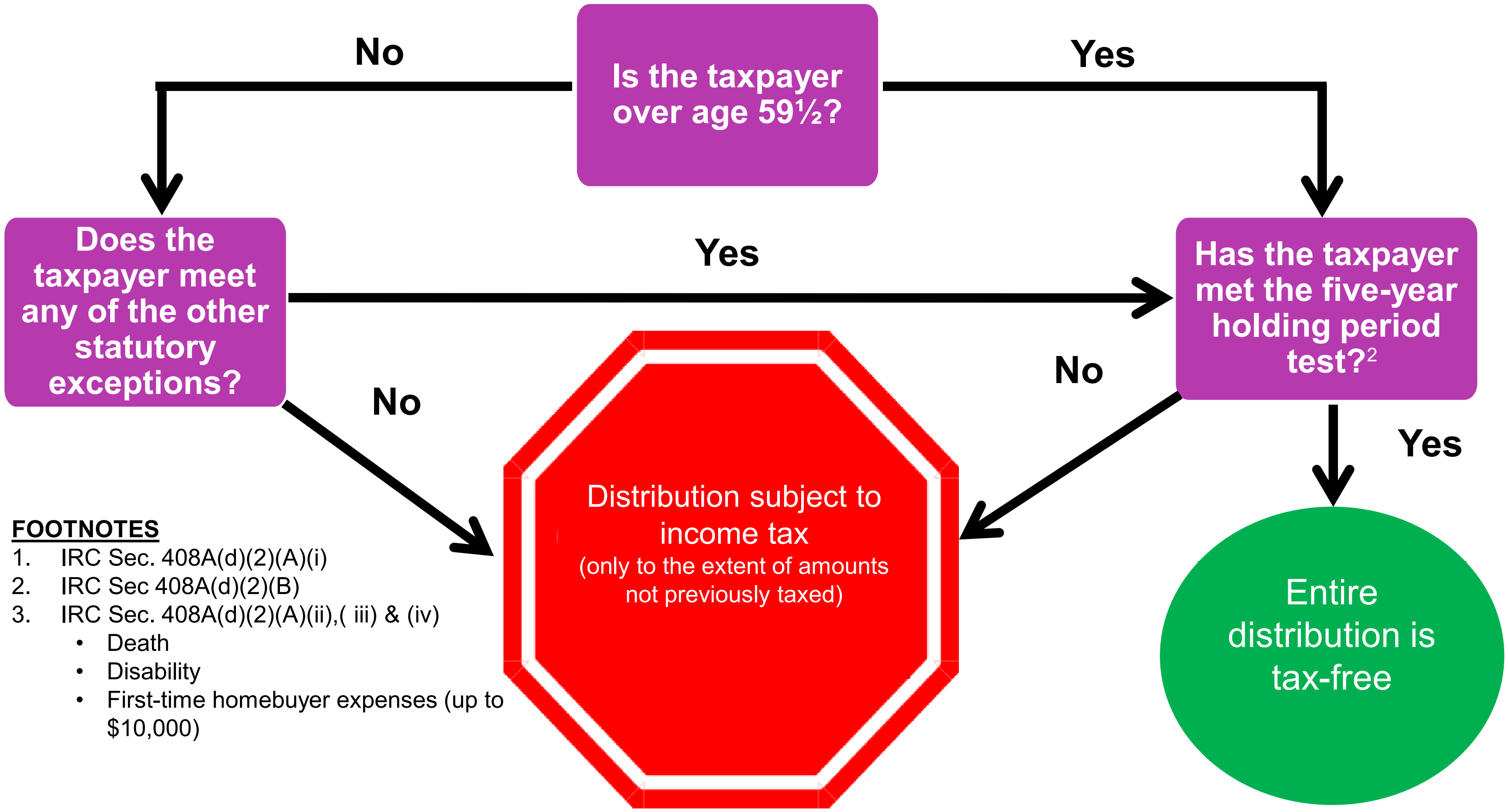
“Earnings”

10% early withdrawal penalty applies (Unless exception applies)

<u>FOOTNOTES</u>:

1. “Net contributions” is: (a) the sum of all prior Roth IRA contributions *reduced by* (b) the sum of all prior Roth IRA distributions (i.e., “basis first” rule)
2. Distributions attributable to prior conversion amounts are determined on a “first-in, first-out” (“FIFO”) basis with the taxable portion of each prior year conversion coming out first followed by the non-taxable portion

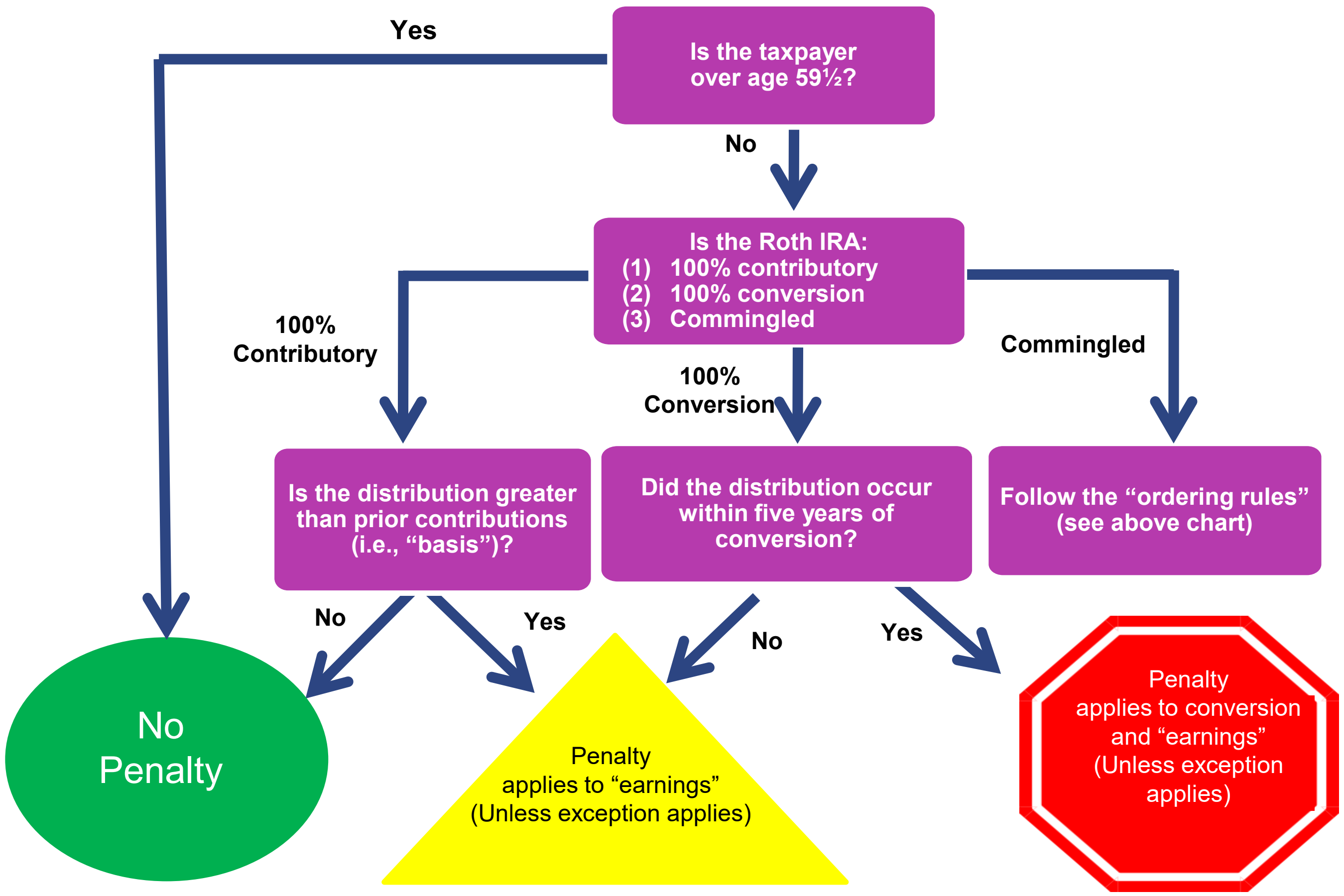
Taxation of Roth IRA Distributions - “Seasoning Rule”



FOOTNOTES

1. IRC Sec. 408A(d)(2)(A)(i)
2. IRC Sec 408A(d)(2)(B)
3. IRC Sec. 408A(d)(2)(A)(ii),(iii) & (iv)
    - Death
    - Disability
    - First-time homebuyer expenses (up to $10,000)

Taxation of Roth IRA Distributions - “Penalty Box Rules”



Exceptions to 10% early withdrawal penalty :

1. Death
2. Disability
3. Series of substantially equal periodic payments
4. Medical expenses greater than 7.5% AGI
5. Health insurance premiums for unemployed individuals
6. Higher education expenses
7. First-time homebuyer expenses (up to $10K)

Roth Conversions - Taxation of Roth IRA Conversions

- When a traditional IRA has non-deductible contributions, a portion of the conversion to a Roth IRA will be non-taxable "basis" to the IRA owner
- In determining the non-taxable portion of a Roth IRA conversion, all traditional IRAs and IRA distributions during the year (including outstanding rollovers) must be combined for apportioning "basis"
  - See IRS Form 8606

Roth Conversions - Taxation of Roth IRA Conversions – "Basic Apportionment" Formula

Current year non-deductible IRA contributions	$	6,000
Prior year non-deductible IRA contributions		54,000
Total non-deductible IRA contributions	$	60,000
FMV of all IRAs	$	100,000
Total value of IRAs, distributions, and Roth IRA conversions	$	100,000
"Basis apportionment" factor		**60%**
Gross Roth IRA IRA conversion	$	100,000
Non-taxable portion		(60,000)
Taxable Roth IRA conversion	$	40,000

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 x B x C = D; A x C x B = D).

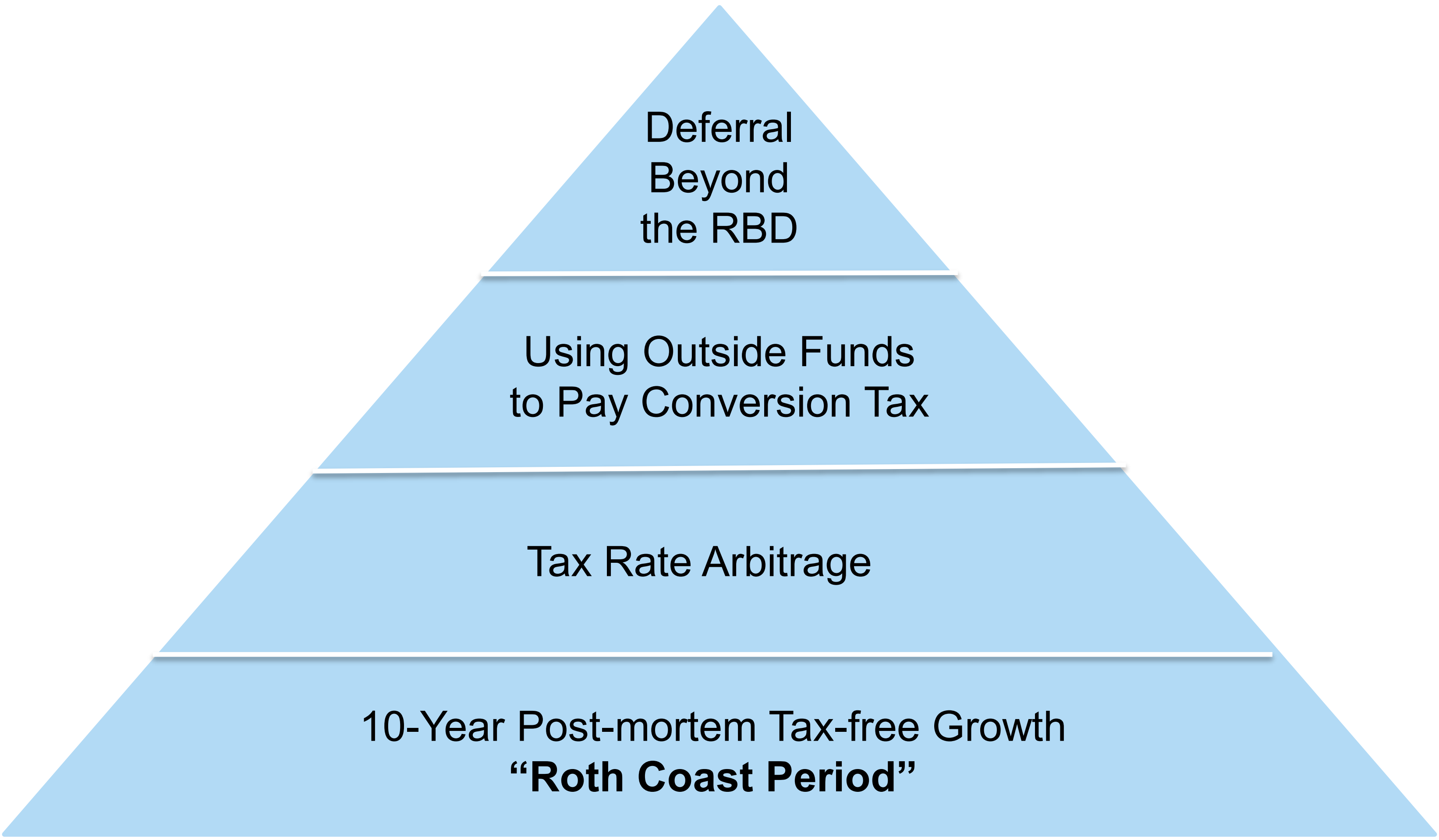
Mathematics of Roth IRA Conversions

	Traditional IRA	Roth IRA	Life Insurance
Current Account Balance	$ 1,000,000	$ 1,000,000	$ 1,000,000
Less: Income Taxes @ 40%	-	(400,000)	(400,000)
Net Balance	**$ 1,000,000**	**$ 600,000**	**$ 600,000**
Growth Until Death	300.00%	300.00%	300.00%
Account Balance @ Death	$ 3,000,000	$ 1,800,000	$ 1,800,000
Less: Income Taxes @ 40%	(1,200,000)	-	-
Net Account Balance to Family	**$ 1,800,000**	**$ 1,800,000**	**$ 1,800,000**

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

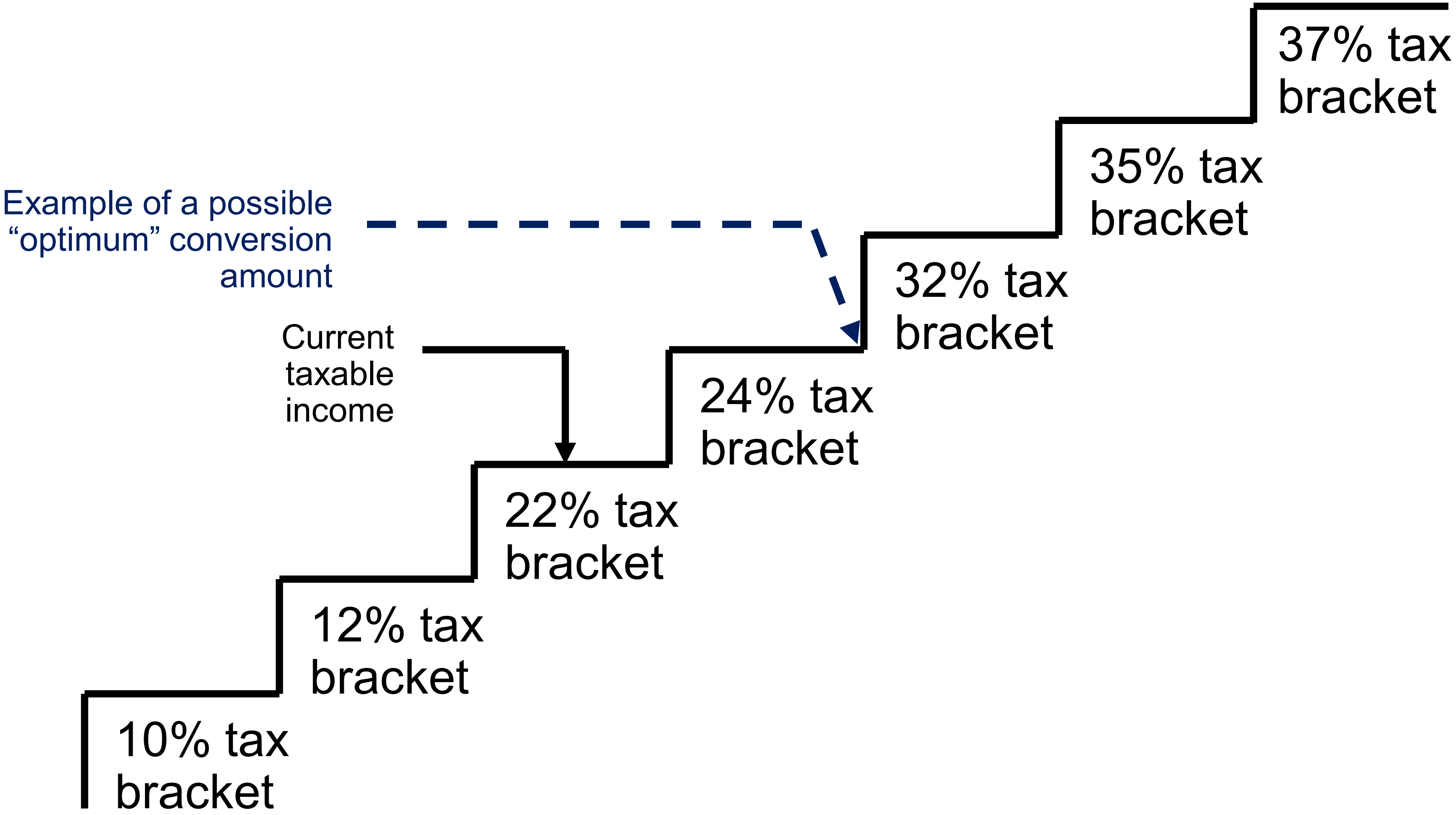


Mathematics of Roth IRA Conversions

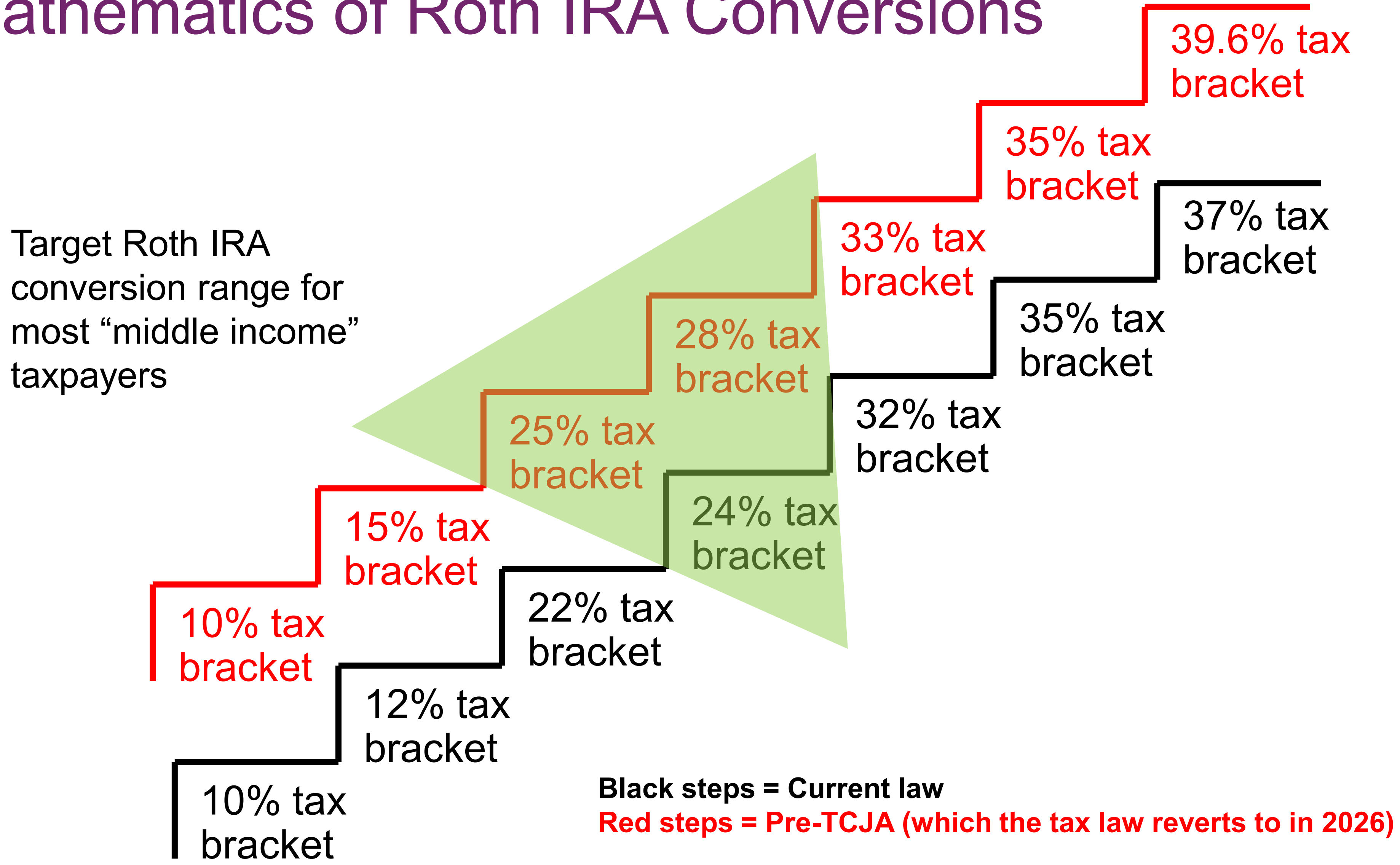
- The key to successful Roth IRA conversions is usually to avoid large jumps in brackets (e.g., converting at a 32% rate when distributions will likely be subject to a 24% rate will often be ineffective).

- Although brackets are the primary consideration, there are others: capital gains, AMT, NIIT, 199A, etc.

Mathematics of Roth IRA Conversions



Mathematics of Roth IRA Conversions



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
  - Strategic considerations
  - Opportunistic considerations

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.

		Rate @ Conversion						
		10%	**12%**	**22%**	**24%**	**32%**	**35%**	**37%**
Rate @ Distribution	**10%**	0.00	-0.04	-0.24	-0.28	-0.43	-0.49	-0.53
	12%	0.04	0.00	-0.20	-0.24	-0.39	-0.45	-0.49
	22%	0.24	0.20	0.00	-0.04	-0.20	-0.26	-0.30
	24%	0.28	0.24	0.04	0.00	-0.16	-0.22	-0.26
	32%	0.43	0.39	0.20	0.16	0.00	-0.06	-0.10
	35%	0.49	0.45	0.26	0.22	0.06	0.00	-0.04
	37%	0.53	0.49	0.30	0.26	0.10	0.04	0.00

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						
		10%	12%	22%	24%	32%	35%	37%
Rate @ Distribution	10%	0.00	-0.04	-0.24	-0.28	-0.43	-0.49	-0.53
	15%	0.10	0.06	-0.14	-0.18	-0.33	-0.39	-0.43
	25%	0.30	0.26	0.06	0.02	-0.14	-0.20	-0.24
	28%	0.35	0.31	0.12	0.08	-0.08	-0.14	-0.18
	33%	0.45	0.41	0.22	0.18	0.02	-0.04	-0.08
	35%	0.49	0.45	0.26	0.22	0.06	0.00	-0.04
	39.6%	0.58	0.54	0.35	0.31	0.15	0.09	0.05

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.

		Rate @ Conversion						
		10%	12%	22%	24%	32%	35%	37%
Rate @ Distribution	10%	0.00	-0.08	-0.46	-0.54	-0.85	-0.97	-1.04
	12%	0.08	0.00	-0.39	-0.46	-0.77	-0.89	-0.97
	22%	0.46	0.39	0.00	-0.08	-0.39	-0.50	-0.58
	24%	0.54	0.46	0.08	0.00	-0.31	-0.43	-0.50
	32%	0.85	0.77	0.39	0.31	0.00	-0.12	-0.19
	35%	0.97	0.89	0.50	0.43	0.12	0.00	-0.08
	37%	1.04	0.97	0.58	0.50	0.19	0.08	0.00

Roth Conversions

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

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

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

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

		Rate @ Conversion						
		10%	12%	22%	24%	32%	35%	37%
Rate @ Distribution	10%	0.03	-0.01	-0.18	-0.21	-0.35	-0.40	-0.44
	12%	0.07	0.03	-0.14	-0.17	-0.31	-0.36	-0.40
	22%	0.26	0.23	0.06	0.02	-0.11	-0.17	-0.20
	24%	0.30	0.27	0.10	0.06	-0.07	-0.13	-0.16
	32%	0.46	0.42	0.25	0.22	0.08	0.03	0.00
	35%	0.52	0.48	0.31	0.28	0.14	0.09	0.06
	37%	0.56	0.52	0.35	0.32	0.18	0.13	0.10

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

		Rate @ Conversion						
		10%	12%	22%	24%	32%	35%	37%
Rate @ Distribution	10%	0.03	-0.01	-0.18	-0.21	-0.35	-0.40	-0.44
	15%	0.12	0.09	-0.08	-0.11	-0.25	-0.30	-0.34
	25%	0.32	0.29	0.12	0.08	-0.05	-0.11	-0.14
	28%	0.38	0.35	0.18	0.14	0.00	-0.05	-0.08
	33%	0.48	0.44	0.27	0.24	0.10	0.05	0.02
	35%	0.52	0.48	0.31	0.28	0.14	0.09	0.06
	39.6%	0.61	0.57	0.40	0.37	0.23	0.18	0.15

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.

		Rate @ Conversion						
		10%	12%	22%	24%	32%	35%	37%
Rate @ Distribution	10%	0.10	0.04	-0.25	-0.31	-0.55	-0.63	-0.69
	12%	0.17	0.11	-0.18	-0.24	-0.47	-0.56	-0.62
	22%	0.56	0.50	0.21	0.15	-0.08	-0.17	-0.23
	24%	0.64	0.58	0.29	0.23	0.00	-0.09	-0.15
	32%	0.95	0.89	0.60	0.54	0.30	0.22	0.16
	35%	1.06	1.00	0.71	0.65	0.42	0.33	0.27
	37%	1.14	1.08	0.79	0.73	0.50	0.41	0.35

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

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

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 inside funds
- Taxpayer is age 70 and RMDs begin in the first period

		Rate @ Conversion						
		10%	**12%**	**22%**	**24%**	**32%**	**35%**	**37%**
Rate @ Distribution	**10%**	0.05	0.01	-0.21	-0.25	-0.42	-0.48	-0.52
	12%	0.09	0.05	-0.16	-0.21	-0.37	-0.44	-0.48
	22%	0.29	0.25	0.04	0.00	-0.17	-0.23	-0.27
	24%	0.33	0.29	0.08	0.04	-0.13	-0.19	-0.23
	32%	0.50	0.46	0.25	0.20	0.04	-0.03	-0.07
	35%	0.56	0.52	0.31	0.27	0.10	0.03	-0.01
	37%	0.60	0.56	0.35	0.31	0.14	0.08	0.03

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
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- 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.

		Rate @ Conversion						
		10%	**12%**	**22%**	**24%**	**32%**	**35%**	**37%**
Rate @ Distribution	**10%**	0.34	0.25	-0.16	-0.24	-0.58	-0.70	-0.78
	12%	0.41	0.33	-0.09	-0.17	-0.50	-0.62	-0.71
	22%	0.79	0.70	0.29	0.21	-0.12	-0.25	-0.33
	24%	0.86	0.78	0.37	0.28	-0.05	-0.17	-0.25
	32%	1.16	1.08	0.67	0.58	0.25	0.13	0.05
	35%	1.28	1.19	0.78	0.70	0.37	0.24	0.16
	37%	1.35	1.27	0.86	0.77	0.44	0.32	0.23

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
- 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.

Rate @ Distribution	Rate @ Conversion: 10%	12%	22%	24%	32%	35%	37%
10%	0.08	0.04	-0.14	-0.17	-0.32	-0.37	-0.41
12%	0.12	0.08	-0.10	-0.13	-0.28	-0.33	-0.37
22%	0.32	0.29	0.11	0.07	-0.07	-0.13	-0.16
24%	0.37	0.33	0.15	0.11	-0.03	-0.09	-0.12
32%	0.53	0.49	0.31	0.28	0.13	0.08	0.04
35%	0.59	0.55	0.37	0.34	0.19	0.14	0.10
37%	0.63	0.60	0.42	0.38	0.24	0.18	0.15

Roth Conversions

- 20-year analysis period
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- Tax paid with outside 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.

		Rate @ Conversion						
		10%	**12%**	**22%**	**24%**	**32%**	**35%**	**37%**
Rate @ Distribution	**10%**	0.44	0.38	0.07	0.01	-0.24	-0.33	-0.39
	12%	0.52	0.46	0.15	0.09	-0.16	-0.25	-0.31
	22%	0.89	0.83	0.52	0.46	0.22	0.12	0.06
	24%	0.97	0.91	0.60	0.54	0.29	0.20	0.14
	32%	1.27	1.21	0.90	0.84	0.59	0.50	0.44
	35%	1.38	1.32	1.01	0.95	0.71	0.61	0.55
	37%	1.46	1.40	1.09	1.03	0.78	0.69	0.63

Charitable Planning & IRAs

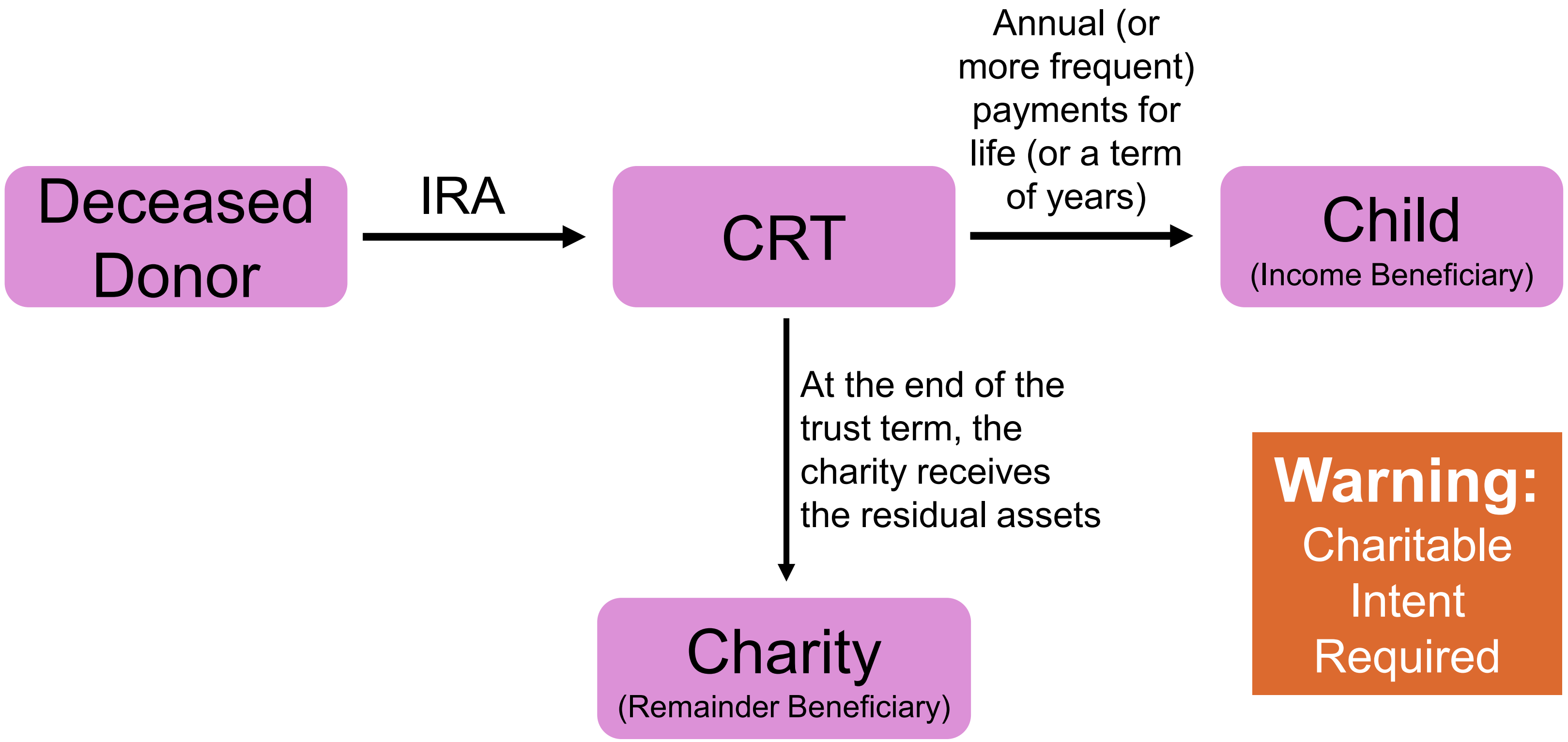
Basics -Types of Gifts

- Outright gifts
  - Qualified Charitable Distributions (QCDs) from an IRA
    - Taxpayer must be age 70½ or older.
    - Distribution must be direct to charity.
    - Distribution cannot exceed $100,000.
    - Distribution can count towards RMD.
    - Distributions to donor advised funds & supporting organizations do not qualify.
    - Income is never recognized by the taxpayer and no deduction is claimed on the return.
    - Generally more or equally as tax efficient as a distribution from the IRA and then a contribution to charity because QCDs are not subject to the other limits on deductions for charitable contributions.

IRC § 408(d)(8)

Charitable remainder trusts

Charitable Remainder Trusts - Overview



Charitable Remainder Trusts - Types of CRTs

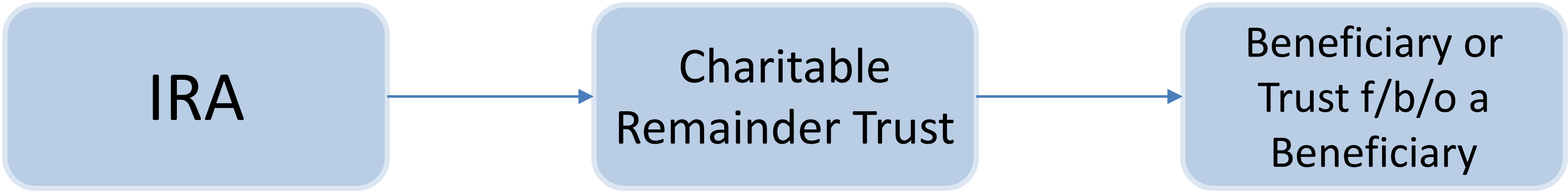
- Charitable Remainder Annuity Trust (CRAT)
  - The beneficiaries receive a fixed percentage of the initial trust value or a stated amount annually or more frequently.
  - The amount paid doesn't change from year to year.
  - The annual payment must be 5-50% of the fair market value of the assets at 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 Trusts

Types of CRTs

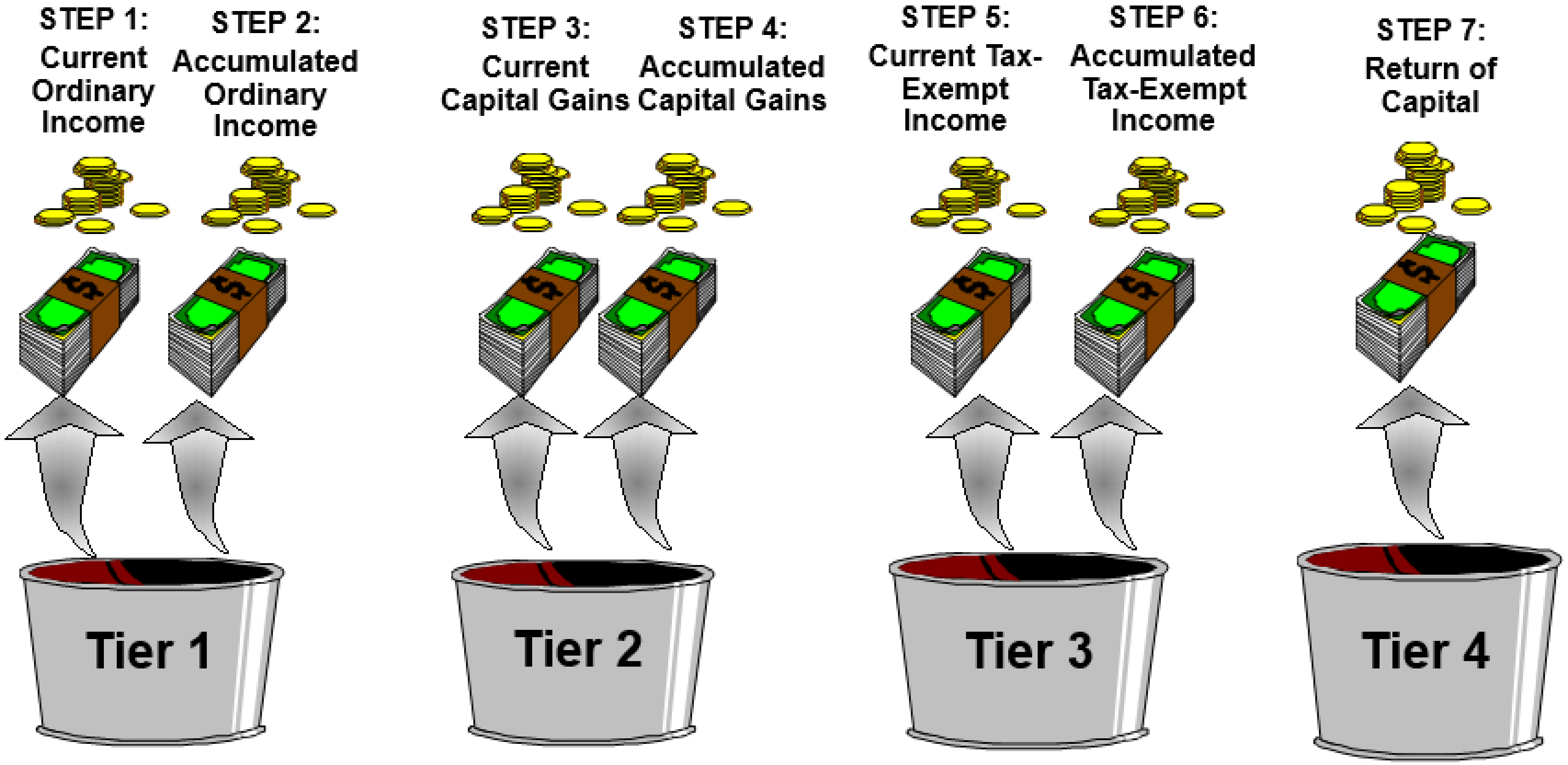
- Charitable Remainder Unitrust (CRUT)
  - Income beneficiaries receive a stated percentage of the trust's assets revalued each year.
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn.
- 10% Charitable Remainder Test
- Life or term-of-years



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.

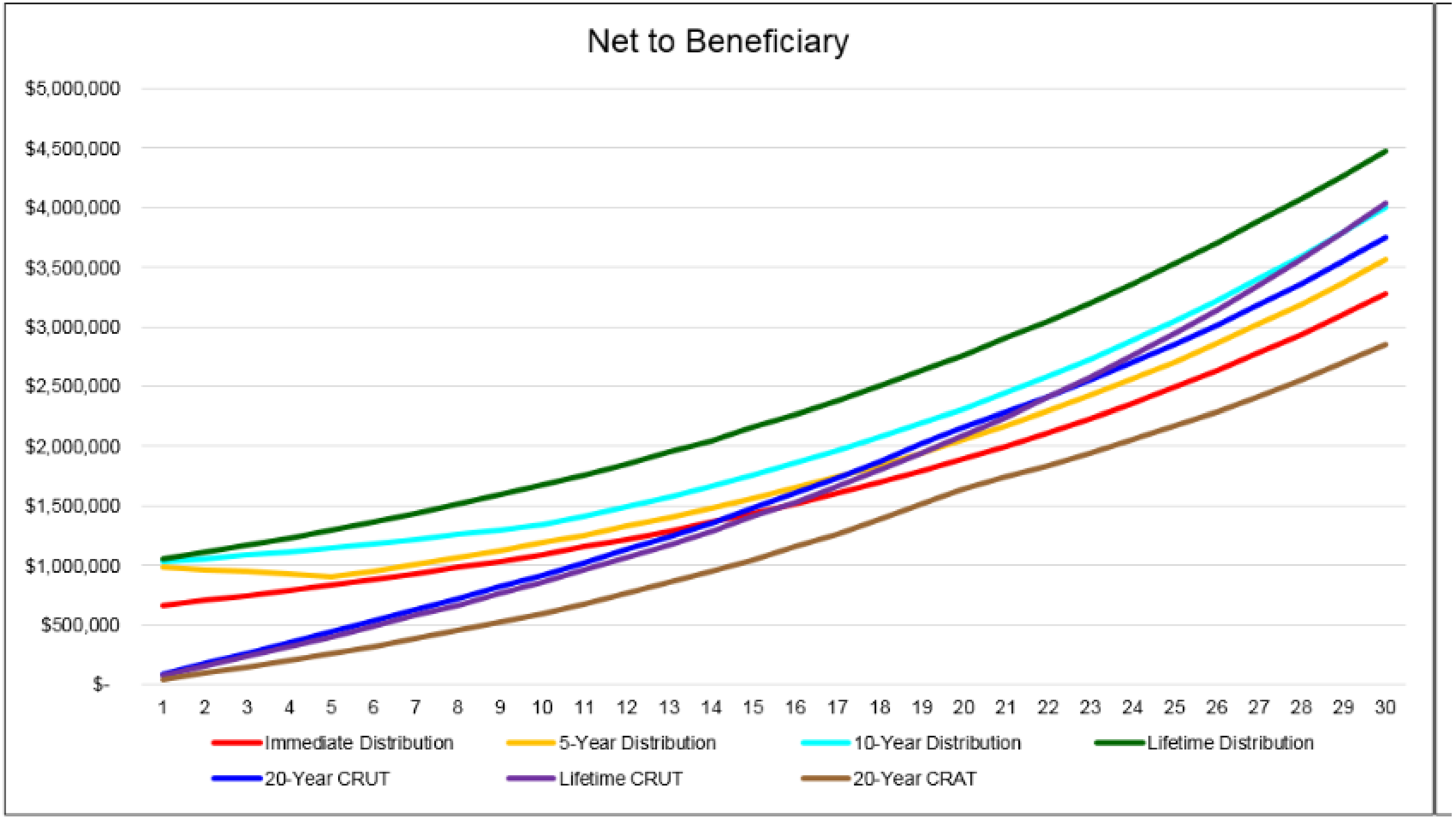
Charitable Remainder Trusts - Taxation of Distributions



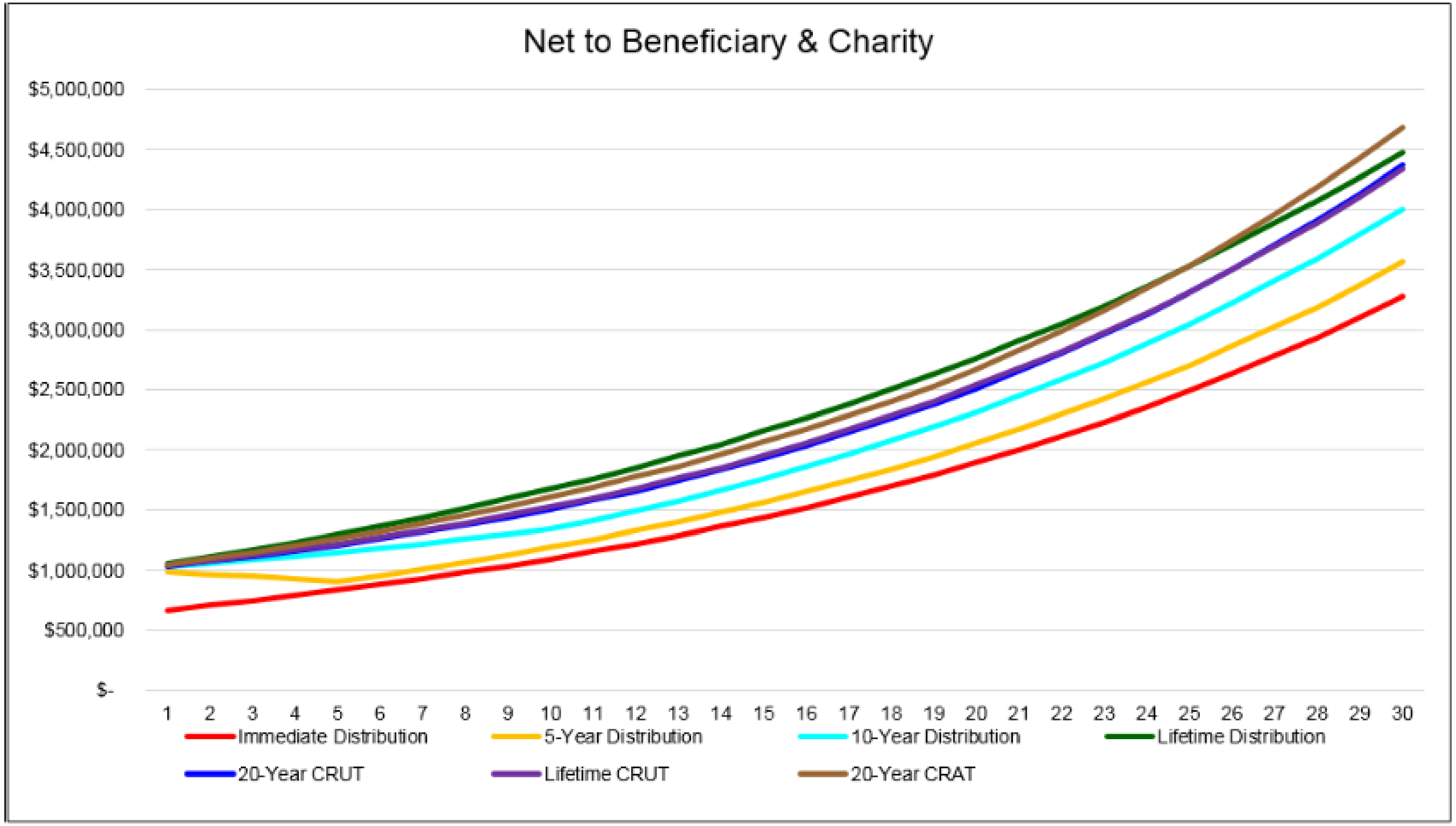
Charitable Remainder Trusts - Example

- 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
  - 2.8% Section 7520 rate

Charitable Remainder Trusts - Example



Charitable Remainder Trusts - Example



State income tax planning

State Income Tax Planning

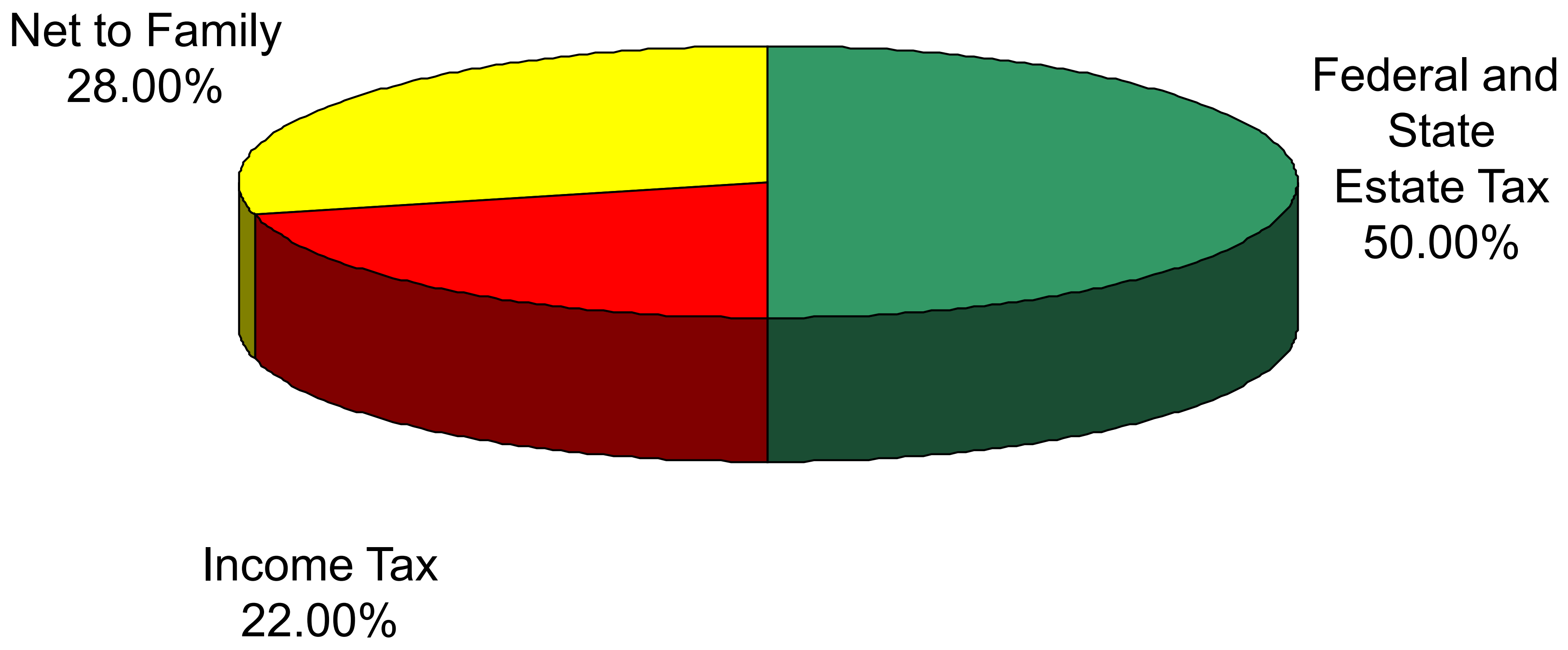
- Review State Law of the IRA Owner.
  - Will the home state tax the out of state IRA Trust?
  - Does the home state have a throwback rule?
- Design a beneficiary form to be payable to non-grantor trust in states with no income tax.
- The payments “trapped” in the trust will avoid state income taxes (watch out for throwback).

Life Insurance

IRAs & Life Insurance - Estate Liquidity

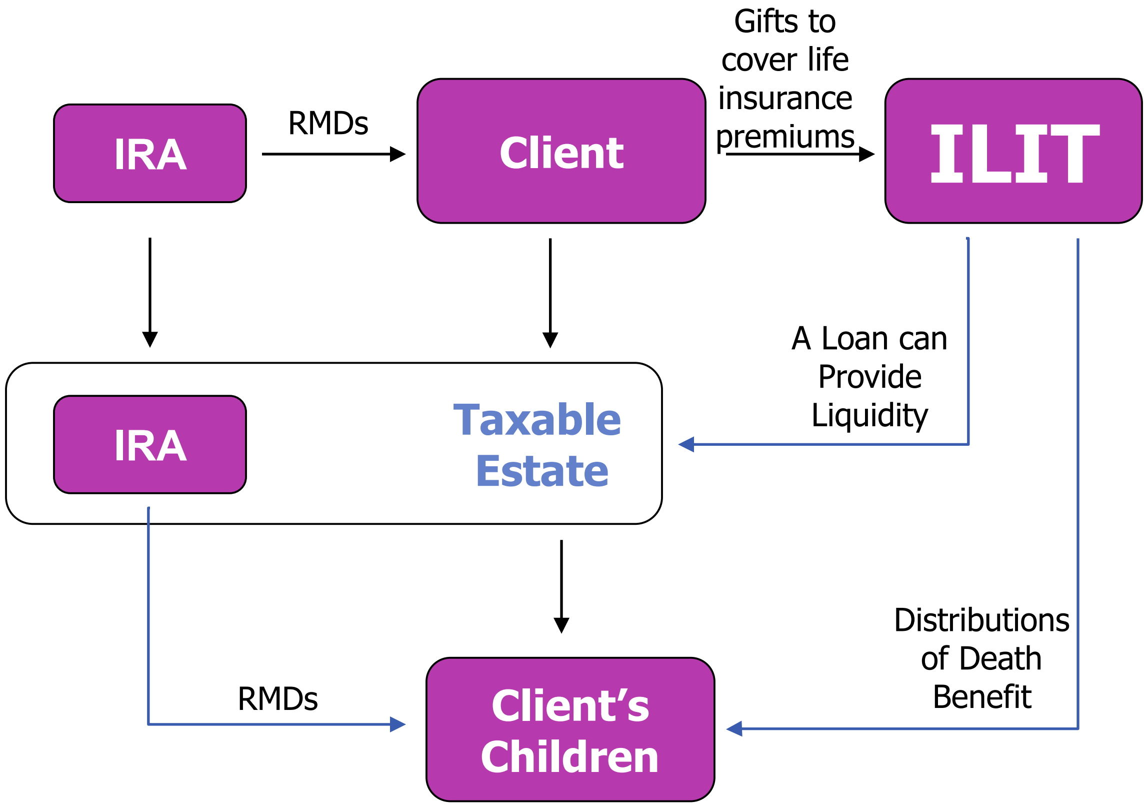
- Issue
  - Perhaps the single biggest issue with “inherited IRAs” is encountered when the IRA funds are needed to satisfy the estate tax
  - The payment of the estate tax using IRA funds, in turn, causes additional income tax to be incurred at higher income tax rates.
  - As a result, between 60% to 70% of IRA could be lost to taxes.
  - This is known as the “Inherited IRA Tax Spiral”.

IRAs & Life Insurance – Liquidity Issues



IRAs & Life Insurance – Liquidity Issues

- SOLUTION:
  - Use life insurance to provide liquidity
  - Help select clients establish a Irrevocable Life Insurance Trust (ILIT)



IRAs & Life Insurance - Re-investment of Excessive RMDs

- Issue: RMDs are not required to satisfy living expenses – New Investment Needed.
- Goal: Maximize after-tax funds left for Children
- Solution: Use excessive RMDs to purchase life insurance.
- Why it can work:
  - Life insurance death benefits are generally not subject to income taxation. IRC § 101(a)(1).
  - RMDs often drive a high marginal tax rate which decreases the after-tax return of other investments.

IRAs & Life Insurance

Facts Assumed

•Beginning Age: 69

•Ending Age: Death

•Pre-tax Growth Rate: 6%

•After-tax Growth Rate: 5%

•Traditional IRA Balance: $2,100,000

•Permanent Marginal Tax Rate: 39.6%

Options Compared

•Do Nothing – Re-invest RMDs in taxable brokerage account.

•Buy Life Insurance – Fund a life insurance policy & invest RMDs in excess of premium in taxable brokerage account.

IRAs & Life Insurance

Actual Keebler Client Ledger

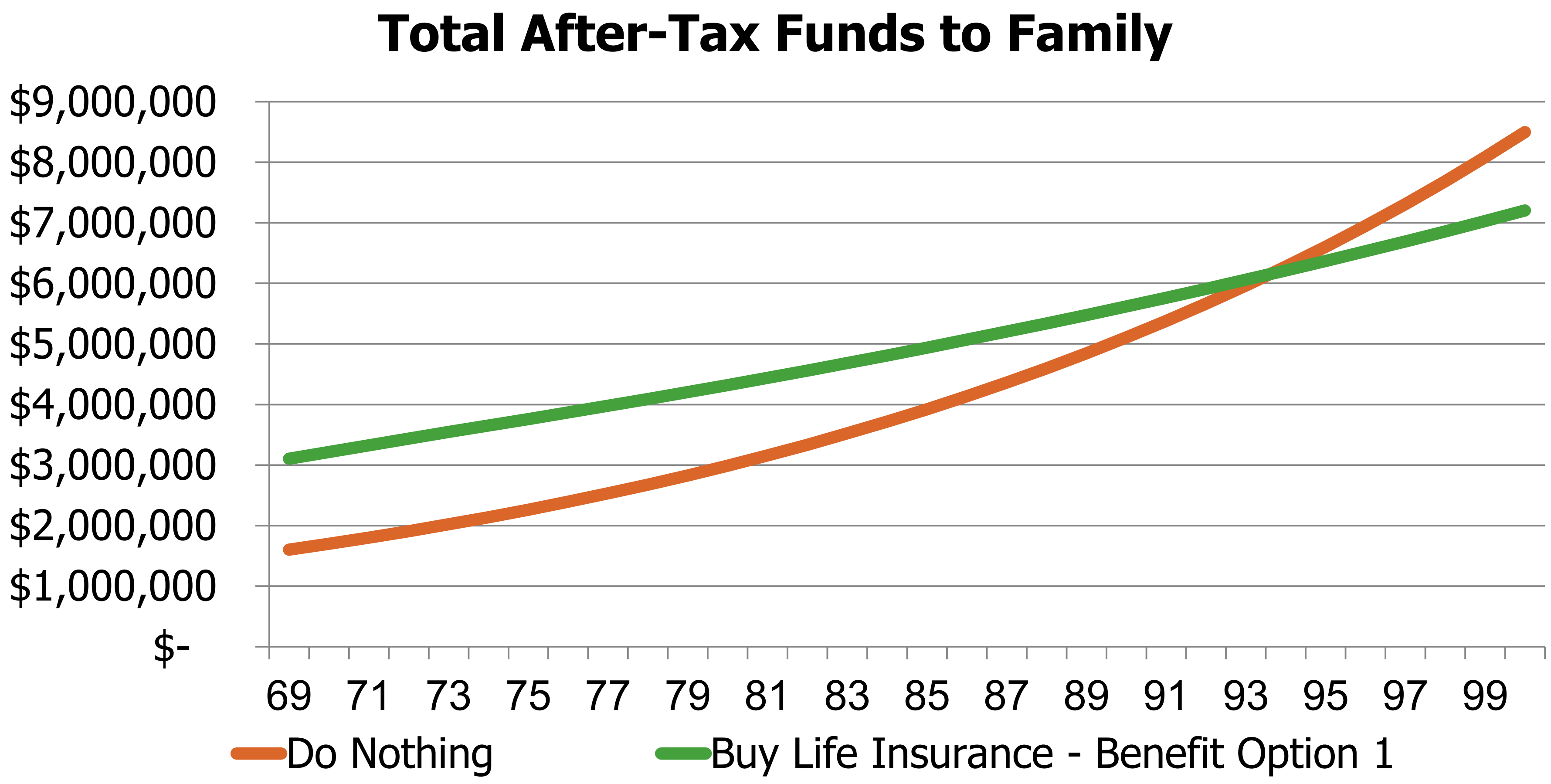
Premium	$75,000 per year for life

Benefit Option 1: Non-Guaranteed

Age	Death Benefit
69	$ 1,575,000
70-100	Benefit increases by $75,000 annually
101	$ 0

Example is based on a universal life insurance product, female, age 68, non-smoker, $1,500,000 policy face value.

IRAs & Life Insurance



Questions

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Upcoming Events

Date	Topic	Speaker(s)
May 20 and more dates	AICPA Town Hall Series with the latest on PPP, tax issues, etc. Free with CPE for AICPA members	Erik Asgeirsson, Lisa Simpson, and guests
May 18th	Large IRAs: Wealth transfer planning strategies for your clients	Bob Keebler, CPA/PFS, MST, AEP (Distinguished)
June 21st and 29th	Education planning for the next decade: Practical success strategies	Ross Riskin, DBA, CPA/PFS, CCFC, MS Tax
July 12th and 19th	Financial Independence: Rethinking Retirement Free with CPE for PFP/PFS members	Sue Stevens, CPA/PFS, CFP®, CFA, CAP Jean-Luc Bourdon, CPA/PFS, CFP®
July 24th and 25th	Building your tax and financial planning advisory business workshop	Ted Sarenski, Susan Tillery, Ellen Bruno, Scott Sprinkle, Jean-Luc Bourdon, Michael Goodman, Joel Bruckenstein, Tom Tillery, Brooke Salvini, Dirk Edwards
July 26th through 28th	Advanced Personal Financial Planning Conference @ ENGAGE	Many

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