



## Son of SECURE: The “Charitable Stretch Remainder Trust”

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## The SECURE Act

- SECURE = Setting Every Community Up for Retirement Enhancement
- Quick Passage in December of 2019
- Passed as Section 401 of H.R. 1994
- Most provisions effective January 1, 2020
- Big changes to tax-qualified plans!



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## Ten Key Changes

1. Raised RMD age from 70½ to 72
2. Removed maximum age to contribute to traditional IRA
3. More part-time employees qualify for 401(k) plans
4. Enhanced Auto-Enrollment for 401(k) plans
5. Helps small businesses offer retirement plans
  - a. Tax credit raised from \$500 to \$5,000
  - b. New \$500 credit for startup costs of 401(k) and SIMPLE IRA plans
  - c. Collaboration of unrelated businesses allowed starting in 2021



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## Ten Key Changes

- 6. Withdrawals allowed for birth and adoption expenses
- 7. Annuity information and options for 401(k) plans
- 8. Easier access for graduate students and foster parents
- 9. Prohibits “credit cards” to access 401(k) loans
- 10. “Stretch IRAs” for lifetime eliminated

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## QCD Complications

- Any pre-tax amount you’ve contributed to a traditional IRA after age 70½ will directly reduce your allowable QCD.
- The rules require a “LIFO” treatment that ensures post-age-70½ contributions will be used to reduce future QCDs.
- Example:
  - If you contribute \$7,000 to a traditional IRA and later donate \$10,000 in a QCD, you will lose the deduction for \$7,000 of that QCD.
  - The remaining \$3,000 of your donation will still qualify as a QCD.

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## “Stretch IRA” Old Rules

For deaths prior to 2020, we had these familiar rules:

- Surviving Spouse as beneficiary = Rollover Option
- Nonspouse individual = May stretch over life expectancy
- Trust as beneficiary:
  - No separate shares = Age of oldest beneficiary
  - Separate shares = Age of each beneficiary for his/her trust
  - “Conduit trust” = Pass income to and tax beneficiary
  - “Accumulation trust” = Retain income, tax trust

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## Ding-Dong, The Stretch is Dead(?)

- SECURE Act has been heralded as death of the stretch IRA
- But the stretch is only “mostly dead”
- Stretch is limited to 10 years for deaths 2020 and later
- There are exceptions to the 10-year rule
- There’s also a charitable option to stretch payments longer



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## Exceptions to 10-Year Rule

- Exception for “eligible designated beneficiaries”
  - 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



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### 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



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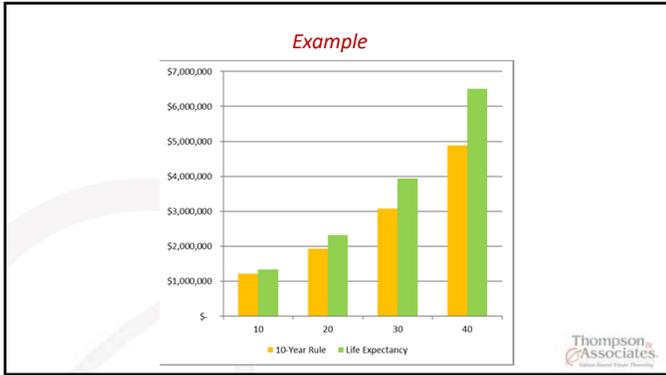
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## The Conduit Trust Trap

- A conduit (“safe-haven”) trust requires all distributions from the IRA to the trust to be distributed to the beneficiaries as received
- This worked well under the life expectancy rules
- However, it can be a disaster under the ten-year rule

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    graph LR
      IRA[IRA] -- "$142,387 Distribution" --> Trust[Trust]
      Trust -- "$142,387 Distribution" --> Beneficiary[Beneficiary]
    
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## The Conduit Trust Trap

Years after Death	Age	RMD		
		Pre-2020 Method	10-Year Rule Options	
			Equal Schedule	Full Deferral
0	30	\$18,762	\$142,378	\$0
1	31	\$20,100	\$142,378	\$0
2	32	\$21,535	\$142,378	\$0
3	33	\$23,072	\$142,378	\$0
4	34	\$24,720	\$142,378	\$0
5	35	\$26,486	\$142,378	\$0
6	36	\$28,379	\$142,378	\$0
7	37	\$30,409	\$142,378	\$0
8	38	\$32,584	\$142,378	\$0
9	39	\$34,917	\$142,378	\$0
10	40	\$37,417	\$142,378	\$1,967,151

Assumes \$1,000,000 IRA at death & a 7% growth rate

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## It's All About That...Tax

- 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

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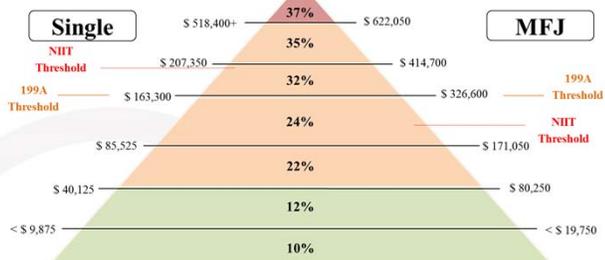
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### 2020 Ordinary Income Tax Rates



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### 2017 Married, 2020 Married, 2020 Single



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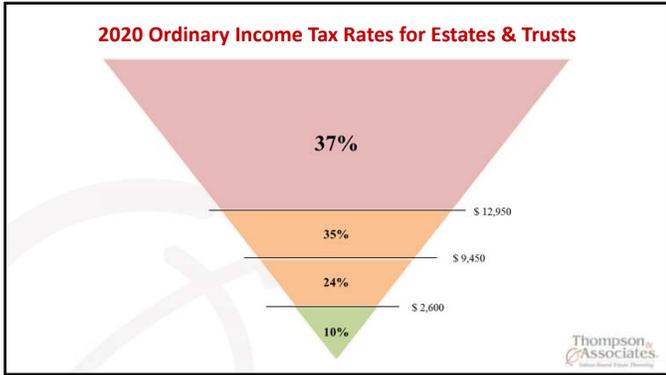
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- Some Options That May Soften the Blow**
- Spousal Rollovers
  - Roth Conversions (perhaps with life insurance)
  - Multi-generational Spray Trusts
  - IRA Trusts for state income tax savings
  - IRAs payable to CRTs
- Following is just a brief overview**
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## Spousal Rollover

- Spousal Rollover rules remain intact
- Spouse inheriting retirement account may:
  - Rename the account in his or her name
  - Transfer the funds to his or her own existing account
  - Disclaim to allow passing to contingent beneficiaries
- Result: Treated as survivor's own account

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## New Spousal Rollover Trap!

- Prior to SECURE Act, a spousal rollover was generally the best practice to preserve the IRA
- For some it may now be better to begin distributions earlier to minimize exposure to higher tax brackets
- For those situations, a disclaimer may be best

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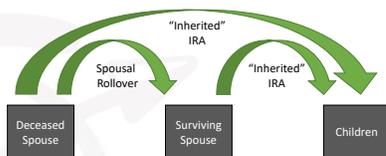
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## THE NEW SPOUSAL ROLLOVER TRAP

*New Best Practice??*



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## Roth Conversions

**WHAT:** Transfer funds from traditional IRA to Roth IRA

**WHY:** Taxable withdrawals to nontaxable withdrawals

- Traditional IRA = Tax-Deferred Growth
- Roth IRA = Tax-Free Growth

**HOW:** Three options (incrementally or all at once):

- Receive IRA funds and deposit to Roth IRA within 60 days
- Direct rollover (a.k.a., trustee to trustee rollover)
- Same trustee transfer (i.e., internal transfer to Roth IRA)

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## Roth Conversions

**ISSUES - Bear in mind:**

- **This triggers current income taxes!**
- If under 59½ the 10% penalty applies
- New Roth funds may not be taken for five years

**Life insurance might help:**

- Roth Conversion Hedge (using a declining policy to cover increased tax exposure due to new 10-year rule)
- IRA Relocation (using funds from IRA conversion to fund a whole life policy with deferred growth similar to Roth IRA)

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## Multi-generational Spray Trust

- Use an accumulation trust with "sprinkle powers"
- Spread income across a large number of taxpayers (lowering the effective rate)
- Retain ability to accumulate income as prudent
- Watch for Kiddie Tax Issues (IRC §1(g))



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## State Income Tax Planning

- Review state law of the IRA owner
  - Will the home state tax the IRA Trust?
  - Does the home state have a throwback rule?
- Design a beneficiary form to be payable to a nongrantor trust in states with no income tax
- The payments trapped in the trust will avoid state income taxes

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## The Law of Unintended Consequences:

The SECURE Act left the “Charitable Stretch Remainder Trust” as the only real option to stretch retirement accounts for most beneficiaries.

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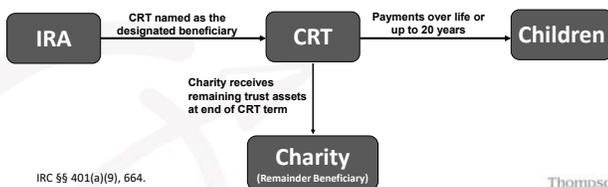
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## Charitable Remainder Trusts

Testamentary CRT is now the strongest “stretch IRA” option



IRC §§ 401(a)(9), 664.

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## Two Basic Types of CRTs

### Charitable Remainder Unitrust ("CRUT")

- Income stream based upon annual value
- Income changes with investment performance
- Assets can be added to the CRUT later

### Charitable Remainder Annuity Trust ("CRAT")

- Income is a set amount at beginning.
- Investment performance does not affect payout
- No additions to the CRAT allowed

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## CRUT and CRAT Shared Rules

1. Trust must be *irrevocable* under state law
2. Must provide for payment of annuity *or* unitrust amount (5% - 50%)
3. Income to at least one noncharitable beneficiary annually
4. Prohibit payments other than the annuity or unitrust amount and the remainder to charity

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## CRUT and CRAT Shared Rules

5. Remainder to Sec. 170(c) charities only
6. No restriction on investment
7. Function exclusively as a CRT
8. Provide for proration of income based on actual days in short year
9. Provide in instrument for a term:
  - Life or lives
  - Years up to 20

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## Examples of Permissible Terms

### Simple Terms:

- Life of Beneficiary (alive at trust inception)
- Specified years not to exceed 20

### Alternative Terms, such as shorter of:

- Beneficiary's life, or
- 20 years

### Mixed Terms:

- Beneficiary for life, then
- Successor for shorter of life or 20 years (assumes both alive at inception)

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## Additional CRT Payout Rules

Two additional payout restrictions apply:

1. 10% Charitable Interest Test
  - Charitable deduction must be at least 10% of initial trust value
2. 5% Probability Test
  - Less than 5% probability of trust exhaustion (only CRATs payable for life/lives)

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## Income Beneficiaries

- Legally recognized “persons” permitted
  1. Individual
  2. Trust or Estate
  3. Association
  4. Company
  5. Corporation
  6. Partnership
- **Pets.** A pet is not a permissible beneficiary.

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## Income Beneficiaries

- **Named Classes**
  - Life Term. All individuals must be alive at inception
  - Term of Years. May include afterborn members
- **Charitable organizations.** Permitted, but there is no added tax benefit and it messes with the accounting (later slide).



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## Remainder Beneficiaries

### Remainder beneficiaries

- Entire remainder must pass only to charities
- Multiple beneficiaries, successive or concurrent
- Trust must provide for alternative remaindermen
- Donor may retain power to change remaindermen (N/A to testamentary CRT)



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## Distribution and Tax Matters

- Decedent's estate receives estate tax charitable deduction!
- Character of Income to Beneficiaries Controlled by IRC §664(b):
- Four-Tier accounting required
  1. Ordinary Income
  2. Capital Gains
  3. Tax-Free Income
  4. Trust Corpus



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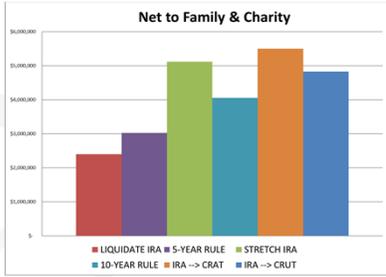
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# Charitable Stretch Remainder Trust

*Example*



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