IRA Planning For Baby Boomers

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Part 1

Required Minimum Distributions

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Required Beginning Date (RBD)

- IRA owners (including SEP & SIMPLE IRAs)
  - April 1 of year following year client turns 72
    - April 1 year following year client turns 70 ½ for clients reaching 70 ½ prior to 1/1/2020
- Plan participants
  - ***Generally*** April 1 of year following year client turns 72
    - April 1 year following year client turns 70 ½ for clients reaching 70 ½ prior to 1/1/2020
  - May be extended in certain circumstances

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Plan RBD Exceptions

- Still Working Exception
  - Plan must "allow"
  - Participant must own 5% or less of company
    - Aggregation rules apply
    - Test occurs in participant's 72 year
  - What defines "still working?"
  - Strategy to delay RMDs
- 403(b) "Old Money" Exception
  - Applies to 12/31/1986 balance
  - Distributions not required until client reaches 75

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Your RMD is *Your* Problem

"Who calculates the amount of the RMD?

Although the IRA custodian or retirement plan administrator may calculate the RMD, the IRA or retirement plan account owner is ultimately responsible for calculating the amount of the RMD."

- From IRS webpage: Retirement Plans FAQs regarding Required Minimum Distributions

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Calculating the RMD

- Select the right life expectancy factor
  - New life expectancy tables go into effect January 1, 2022
- Use the right prior-year-end balance. Begin with year-end statement and adjust for:
  - Outstanding rollovers/transfers
  - Excess QLAC payments

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Calculating the RMD

- Uniform Lifetime Table
  - Most IRA owners
- Joint Life Table
  - Sole spouse beneficiary >10 years younger for full year
  - Marital status determined January 1
- Single Life Table
  - **NEVER** used by an IRA owner

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RMD Aggregation Rules

- IRAs
  - Calculate RMD on each account individually
  - IRA RMDs can be added together and taken from any one or combination of IRA accounts (this includes SEP and SIMPLE IRAs)
  - Special rules generally apply to annuitized IRA annuities

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RMD Aggregation Rules

- Employer Plans
  - Calculate RMD for each plan individually
  - RMDs must be taken from each plan
  - Employer plan RMDs ***cannot*** be aggregated
    - 403(b) exception

****Under no circumstances can an RMD from one type of retirement account be taken from a different type of retirement account***

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RMD Aggregation Rules

- Annuities
  - Pre-annuitization - IRA or 403(b) annuities can be aggregated
  - Post-lifetime annuitization – The annuity payment IS the RMD
    - Possible exception in year of annuitization
  - Grey area – Period-certain (only) annuitization

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RMD Aggregation Rules

- No aggregating between spouses
- No aggregating between RMDs for a client's own account(s) and an inherited account
- No aggregating inherited RMDs for accounts of different decedents

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Qualified Charitable Distributions (QCDs)

- IRA owners and IRA beneficiaries who are <u>actually</u> age 70 ½ or older
  - Not available from plans!
- Limited to $100,000 per person annually
- Can be used to satisfy all or a portion of a client's RMD
- No charitable contribution deduction, but QCD amount is not added to AGI

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Qualified Charitable Distributions (QCDs)

- Can only be made from the taxable portion of IRAs, Roth IRAs and inactive SEP and SIMPLE IRAs
- Must be sent directly from client's IRA to charity or via check payable to the charity
  - No split gifts
  - No private grant-making foundations
- QCD amount would have to be entirely deductible if it were made with non-IRA funds

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Qualified Charitable Distributions (QCDs)

- Reporting is done by taxpayer
  - Line 4a: QCD amount
  - Line 4b: $0, "QCD"
- Help mitigate costs tied to AGI / MAGI
- Took on greater importance due to TCJA's increase of the standard deduction
- BE MINDFUL OF THE SECURE ACT ANTI-ABUSE RULE

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Qualifying Longevity Annuity Contracts (QLACs)

- FMV excluded from a retirement account owner's prior year-end balance for RMD calculation purposes
- Distributions must begin in the month after attainment of age 85
- May be purchased with the lessor of 25% of retirement funds or $135,000
  - 25% limit is applied to each employer plan separately
  - 25% limit is applied in aggregate to IRAs
- Limited death benefit options
  - Return of premium
  - Life annuity

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Qualifying Longevity Annuity Contracts (QLACs)

- Must be fixed annuities
- May not offer any commutation benefit, cash surrender value or similar feature
- Can be purchased with IRA, 401(k), 403(b) and governmental 457(b) plan funds
- QLAC overpayments must be returned by the end of the year following the year the premium payment was made

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Correcting RMD Errors

- Calculate and take missed RMDs
- File Form 5329 for each year of RMD shortfall
- Attach a statement providing reasonable cause

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A Problem That Won't Go Away

- Robert K. Paschall et ux. v. Commissioner; 137 T.C. No. 2; Nos. 10478-08, 25825-08, July 5, 2011
- No statute of limitations if you haven't filed Form 5329!!

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Other RMD Concerns

- Liquidity issues
  - How will you pay the RMD
  - Certain strategies, like use of an LLC, can be used to help
- Timing within the distribution year
- "First-money-out rule"
  - An RMD is considered the first money distributed from an account
- Rollovers vs. Transfers

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PART 2

Roth IRA Conversions

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Do We Look At Roth Accounts Correctly?

John Doe

- $500,000 mortgage
- $1MM house
- $1MM cash in bank
- $1MM IRA

- Net Worth: $2.5MM?

Jane Doe

- $500,000 mortgage
- $1MM house
- $1MM cash in bank
- $1MM Roth IRA

- Net Worth: $2.5MM?

How do these two clients have the same net worth!?

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Why Roth IRAs?

- No lifetime required minimum distributions
  - Non-spouse beneficiaries do have RMDs
  - Recent budget proposals have called for RMDs
- Tax-free distributions during retirement
- Reduce the number of retirement projection variables
- Tax diversification
- "Tax insurance"

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Roth IRA Conversion Basics

- Pretax portion of conversion is added to client's income in year of conversion
- Conversion year is dictated by when funds *leave* the distributing account
- Anyone with an eligible account can convert!
  - No minimum or maximum income
  - No minimum or maximum age
  - No filing status restrictions

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Roth IRA Conversion Basics

- What cannot be converted to a Roth IRA?
  - Inherited IRAs (including inherited SEP IRAs and inherited SIMPLE IRAs)
  - SIMPLE IRAs during the first two years
  - Non-governmental 457(b) plans

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Less Obvious Roth IRA Conversion Candidates

- Those who plan to move to a state with higher income tax
- Those who expect large inheritances that may generate income
- Clients that may be hit with the "tax torpedo"

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Less Obvious Roth IRA Conversion Candidates

- Individuals who may find themselves subject to the "widow's penalty"
  - Similar income, lower brackets
  - Lower thresholds all around
- Clients whose estates may owe state estate tax
  - No IRD or similar deduction for state estate taxes paid
- Clients who may want to access retirement funds before distributions are qualified
  - Roth IRA ordering rules are favorable
  - No 10% penalty on non-qualified distributions upon earlier of attainment of 59 ½ OR more than five years after the conversion

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Roth Conversion Planning Post-TCJA

- Roth IRA conversions can no longer be recharacterized
- Eliminates certain strategies
  - Cherry-picking the winners/losers
  - "Old-school" Roth conversion cost averaging
  - Convert now and decide how much to keep later

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Roth Conversion Planning Post-TCJA

- Makes pre-conversion planning MUCH more important
- 3 key steps BEFORE making any Roth conversion
  - Get a rough estimate of the conversion's potential impact on your client's tax bill
  - Make sure you have a reasonable expectation that the benefits of "pre-paying" taxes via a Roth IRA conversion make sense in the client's overall plan
  - Develop a strategy for paying the additional taxes your client will owe as a result of the conversion

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Life After a Conversion

- Revisit asset allocation strategy:
  - Is a rebalance necessary
  - How do you value $100,000 IRA investment in risky asset vs. $100,000 Roth IRA investment in the same asset
- Revisit asset location strategy
  - Should assets be shifted to maximize long-term tax-efficiency
- Revisit retirement spenddown plan
  - Standard thinking is to spend from your taxable accounts first and your tax-free accounts last, but that’s not always best!

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Post-Death Payouts

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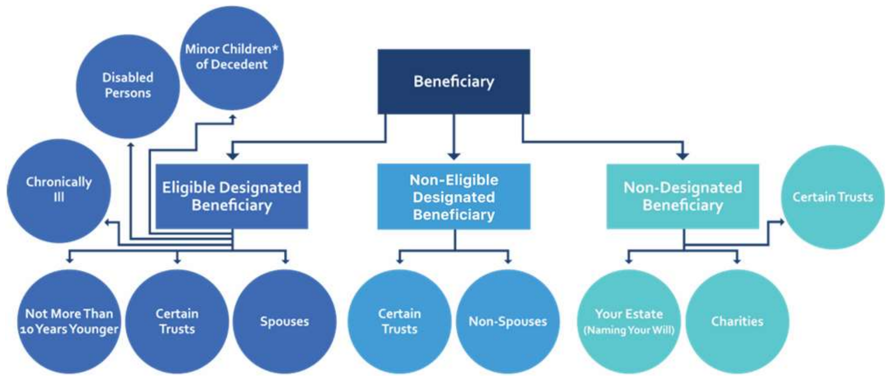
The IRA Beneficiary “Family Tree” Post-SECURE Act



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‘Death’ of the Stretch

- New rules only apply to Designated Beneficiaries
  - No direct change to rules for Non-Designated Beneficiaries
- General rule is a new 10-Year Rule (for Non-Eligible Designated Beneficiaries
  - Similar to 5-Year Rule for NDBs when death occurs prior to RBD
  - All funds must be distributed by the end of the 10th year after death
  - No RMDs during years 1-9

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'Death' of the Stretch

- Applies to IRAs and most plans for deaths occurring on or after January 1, 2020
- 3 exceptions:
  - Governmental plans for deaths occurring on or before January 1, 2022
  - Applies to plans maintained per Collective Bargaining Agreement for deaths occurring on or after January 1, 2022 (unless CBA ends sooner)
  - Annuitized annuities (life/joint life expectancy) and annuities in which a future lifetime income option has already been irrevocably selected

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'Death' of the Stretch

- Eligible Designated Beneficiaries (EDBs) are also exempt from the SECURE Act's changes
- The 5 types of EDBs are:
  - Surviving spouses
  - Disabled persons
  - Chronically ill persons
  - A beneficiary not more than 10 years younger than the decedent
  - The ***decedent's*** minor child

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'Death' of the Stretch

- What can ***beneficiaries*** do to mitigate the impact?
  - Wait until the end of the 10-Year Rule to take a distribution?
  - Strategically time distributions by beneficiaries?
  - Turn the 10-Year Rule into an 11-Year Rule?

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'Death' of the Stretch

- What can *retirement account owners* do to mitigate the impact?
  - Name more beneficiaries?
  - Treat beneficiaries unequally?
  - More Roth conversions during lifetime?
  - Use life insurance?
  - Use charitable remainder trusts to 'recreate' the stretch?
  - Bypass a spouse at the first death to create two separate 10-Year windows (which may overlap)?
  - Roll money into plans with a delayed effective date?

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RMDs for Non-Designated Beneficiaries

- Death before RBD
  - Account must be emptied within 5 years
  - No requirement for distributions in years 1 - 4

- Death after RBD
  - THERE IS NO 5-YEAR RULE
  - RMDs calculating using decedent's remaining single life expectancy

NOT CHANGED BY THE SECURE ACT

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Trusts as IRA Beneficiaries

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Reasons to Name a Trust as an IRA Beneficiary

- The primary reason to name a trust as the beneficiary of an IRA should be some form of control
- Common scenarios where a trust might be considered include:
  - Situations involving beneficiaries who are:
    - Minors
    - Disabled
    - Incompetent
    - Unsophisticated
  - Concerns when there is a second marriage

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Reasons to Not Name a Trust as a Beneficiary

- To save money on income taxes
  - 2021 top Federal income tax rate begins at:
    - $523,601 for Single filers
    - $628,301 for Married-joint filers
    - $13,051 for Trusts and Estates
- To save money on estate taxes
- "Because my attorney told me so"

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See-Through Trusts

- Also known as look-through trusts
- Use oldest applicable trust beneficiary's life expectancy to calculate RMDs
- No separate account treatment for trust beneficiaries
- Must meet certain requirements

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See-Through Trust Requirements

- Regulation 1.401(a)(9)-4, A-5
  - Valid under state law
  - Irrevocable at death
  - Trust beneficiaries are identifiable
  - Proper documentation is provided to the custodian by October 31st of the year following the year of death

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'Death of the Stretch'

- Impact to trust beneficiaries
  - General rule is still that trusts are Non-Designated Beneficiaries
  - Trusts can still be treated as Designated Beneficiaries if they meet the "See-Through Trust" rules
  - Certain "See-Through Trusts" may be treated as EDBs
- Conduit trusts benefiting a single EDB should be able to receive EDB treatment

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'Death of the Stretch'

- Discretionary Trusts will generally **not** qualify for EDB treatment
- Exception: Applicable Multi-Beneficiary Trusts
  - All trust beneficiaries must be designated beneficiaries
  - At least one trust beneficiary must be an EDB because they are either:
    - Disabled
    - Chronically ill

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'Death of the Stretch'

- Applicable Multi-Beneficiary Trust divided into separate trusts for each beneficiary immediately upon the death of the owner
  - The separate trust FBO the disabled/chronically ill beneficiary will be treated as an EDB
- Applicable Multi-Beneficiary Trust in which no individual other than a disabled person and/or a chronically ill person will receive any benefit until the death of all disabled and/or chronically ill persons
  - The trust will be treated as an EDB

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Two Types of See-Through Trusts

- Conduit Trusts
- Discretionary Trusts
  - Also known as accumulation trusts

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Conduit Trusts

- No less than the RMD required to be distributed to trust beneficiaries each year
- Trust beneficiaries pay income tax on RMDs at their own personal rates
  – Trust gets DNI deduction
- Only income beneficiaries of the trust are looked at to consider oldest age for RMDs

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Conduit Trusts

- Advantages of conduit trusts include:
  – Potentially more tax efficient than discretionary trusts
  – Any remainder beneficiary can be used without ruining the stretch IRA
- Disadvantages of conduit trusts include:
  – Less post-death control

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Discretionary Trusts

- Inherited IRA distributions may be accumulated in the trust
- Distributions held in the trust are taxed at trust tax rates
  - Consider using the 65-day rule to aid in tax planning
- Current and potential future trust beneficiaries considered for RMD calculations
  - Current beneficiaries
  - Remaindermen

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Discretionary Trusts

- Advantages of discretionary trusts include:
  - Greater control over trust assets
  - Easier to keep assets away from:
    - Creditors
    - Ex-spouses
- Disadvantages of discretionary trusts include:
  - Greater possibility of conflict between trustee and trust beneficiaries
  - Distributions may be taxed at trust tax rates
  - Non-designated remaindermen beneficiaries will cause stretch to be blown

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Discretionary Trusts

- Consider Roth conversions during owner's lifetime
  - Inherited IRAs cannot be converted
  - Inherited plans can be converted
- Inherited Roth IRA distributions are generally tax free (even to trusts!)

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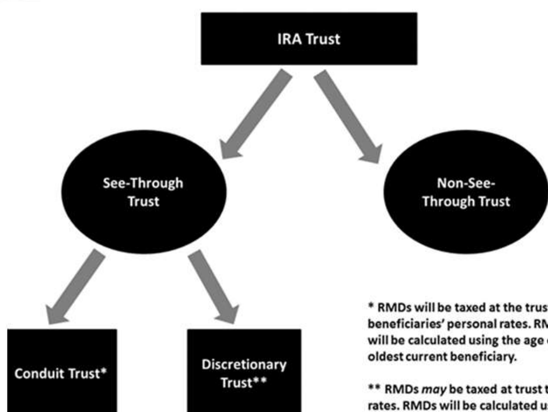
Conduit vs. Discretionary Trusts



* RMDs will be taxed at the trust beneficiaries' personal rates. RMDs will be calculated using the age of oldest current beneficiary.

** RMDs *may* be taxed at trust tax rates. RMDs will be calculated using the age of the oldest current or future trust beneficiary.

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PART 5

Spousal Beneficiary Planning

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Spousal Beneficiary Options*

1) Remain as a beneficiary of the inherited account (with special rules)

2) Complete a spousal rollover

3) Elect to treat the deceased spouse's account as their own

* Spouse must be sole beneficiary

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Remaining a Beneficiary

- No 10% penalty on pre-59 ½ distributions
- Properly titled inherited IRA is established
- Funds must be moved directly
- No RMDs until deceased spouse would have been 72 (provided deceased spouse was not 70 ½ prior to January 1, 2020)
- Special rule for successor beneficiaries

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Spousal Rollover

- Often makes sense if surviving spouse is ≥ 59 ½
- Irrevocable election
- Treated as though money was always in the surviving spouse’s IRA
- No deadline to complete

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Choosing the Right Option

- The #1 mistake made by spouse beneficiaries is failing to properly choose between:
  - Remaining a beneficiary
  - Doing a spousal rollover
- **Hint: Use the "99% Rule"**

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The "99% Rule"

- "If the surviving spouse is under 59 ½, then setting up an inherited IRA is almost always the correct option. Once the spouse turns 59 ½, a spousal rollover can be completed."
- "If the surviving spouse is 59 ½ or older, a spousal rollover is almost always the right move."

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Potential Exceptions to the "99% Rule"

- Scenario #1
  - Much younger spouse (<12 years younger)
  - Deceased spouse would already be 72 or older (as long as they would not have been 70 ½ prior to January 1, 2020)
  - Surviving spouse does not anticipate needing inherited IRA money until they are at least 59 ½
- Scenario #2
  - Older spouse
  - Younger spouse would not yet be 72 (as long as they would not have been 70 ½ prior to January 1, 2020)
  - Spouse beneficiary doesn't need/want to take distributions

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