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FIRST COVENANT TRUST & ADVISORS

Inherited IRAs and the SECURE Act

The Setting Every Community Up for Retirement Enhancement (SECURE) Act was passed in late 2019, with the goal of increasing participation in workplace retirement plans. SECURE also acknowledges that more Americans are working past "traditional" retirement age, and includes a number of changes to current rules to allow older workers to continue to save for retirement while working into their later years. Among the major changes in the SECURE Act are:

- Eliminated age limit for making deductible IRA contributions
- Delayed required minimum distributions (RMDs) to age 72
- Enabled multiple employer retirement plans (MEPs), even if employers have no other connection (or nexus) to one another
- Created tax credits to incentivize small businesses to begin retirement plans
- Created tax credits to incentivize plans to adopt "auto-enrollment" (eligible participants are automatically enrolled and must opt-out and "auto-increase" (the default payroll deferral is gradually increased absent objection from the participant) features

However, the law creates new challenges for non-spouse beneficiaries inheriting IRAs. Previously, a beneficiary taking only RMDs could "stretch" the tax deferral a long time—25-35 years for beneficiaries inheriting in their 50s, and longer than that for younger beneficiaries. The SECURE Act replaced this stretch with a 10-year rule for most beneficiaries. "Eligible Designated Beneficiaries" can still stretch IRAs as under old law. These EDBs are spouses, disabled or chronically ill individuals, the deceased's minor children (who switch to the 10 year rule upon reaching majority), or those not more than 10 years younger than the decedent. Under the 10-year rule, no annual distributions are required, but the IRA must be fully distributed by the end of the tenth year. Since distributions from traditional IRAs are taxed as ordinary income, this RMD acceleration amounts to a substantial tax increase for beneficiaries inheriting larger IRAs.

CONDUIT TRUST IMPACT

Post SECURE, estate plans leaving IRAs to trusts should be revisited. Many plans utilizing trusts as IRA beneficiaries use conduit trusts to achieve "look-through" treatment. This is beneficial because look-through trusts (without life expectancies) may stretch inherited IRAs based on the life expectancy of the beneficiary. So-called conduit trusts got their nickname because they require RMDs received by the trustee to be distributed out of the trust in the same year. Because of the long stretch discussed earlier, the distributions expected to be required in any particular year were relatively small. Under the SECURE Act, there is, in essence, only one required minimum distribution in year 10. The trustee's job of balancing distribution decisions and tax efficiency is more difficult. Furthermore, accelerating IRA RMDs means plans assuming small annual required distributions will need

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to be revised. Accumulation trusts may need to be utilized instead, despite the increased taxes (due to the compressed trust income tax brackets) of retaining IRA distributions in trust.

PLANNING OPTIONS

New planning may help mitigate this tax impact for clients with larger IRAs. The tax increase for their beneficiaries can be significant because 1) taxes are accelerated and 2) larger RMDs push beneficiaries into higher income tax brackets. This is a "double whammy" of paying higher taxes sooner. There is no silver-bullet panacea, and planning is very fact-specific. A few possibilities are presented here.

- Make Roth conversions over time. Tax is paid on the amounts converted, but withdrawals from the Roth after that are tax free, eliminating the beneficiary's tax problem. The key is matching conversions to lower tax brackets. Often, the ideal timing for these conversions is between retirement and age 72. Clients in their 60s aren't subject to the 10% early withdrawal penalty, post-retirement income levels are lower, and lower tax brackets can be "filled" with conversion amounts.
- Convert to ILIT. IRA owners who are insurable take funds from a traditional IRA and fund a life insurance policy, preferably owned by an irrevocable life insurance trust (ILIT). If the right policy is purchased the premium can be variable. This allows flexible IRA withdrawals as part of a bracket management strategy. This works well for IRA owners with taxable estates, as death benefits of ILIT-owned policies are not included in the individual's taxable estate. Because these conversion/bracket-management strategies take time, dying early results in higher income taxes (because there haven't been enough years to strategically empty a traditional retirement account). Using life insurance can replace funds lost to taxes as a result of an early demise.
- Accelerate non-spouse beneficiaries. This is helpful when the surviving spouse will have sufficient assets without the entire IRA. Some portion is left to non-spouse beneficiaries at the death of the first spouse. This effectively creates a 20-year stretch, and should lower overall taxes in a couple of ways: First, spreading income over more tax returns more fully utilizes lower brackets. Second, non-spouse beneficiaries may withdraw funds in smaller tranches, which minimizes "spikes" in a beneficiary's marginal tax rate.
- Add beneficiaries. More beneficiaries means more tax returns for RMDs to be spread across, lowering overall taxes. The tax-tail should not wag the dog, but if a plan includes a number of beneficiaries, include those people as beneficiaries of retirement accounts. One way to achieve this is through a multigenerational "sprinkle" or "spray" trust, allowing a trustee to manage distributions tax-efficiently.
- Name charities. For the charitably inclined, make charitable gifts directly from your IRA. A variation on this, which includes both charitable and non-charitable beneficiaries, is to leave the IRA to a charitable remainder trust. The charitable trust withdraws from the IRA tax free, pays a stream of income to non-charitable beneficiaries (either based on a lifetime or a term of years) and distributes the remainder to charity. This strategy is best when other assets may be used by the non-charitable beneficiaries in the event of a significant expense. Unlike with many trusts, the trustee of the charitable trust cannot make additional discretionary distributions to a non-charitable beneficiary, regardless of need.

Virginia Groover is First Covenant's fiduciary accountant. She graduated from ETSU with a Masters in Accountancy.

NEWS FROM OUR TEAM

Congrats to Dee Ann Lechner, who received her Accredited Trust Operations Professional certification. This certification is industry-focused, covering fiduciary practices, trust operations and audit preparation.

PART 2: CONTINUITY

In the last issue, we began a series designed to answer this question. Using a professional fiduciary is not always the right fit, but doing so can bring a lot of value to the table more often than one may think, and for reasons you may not have considered. The last article highlighted the value a team of professionals with education and experience in fields related to trust administration can bring, relative to even the best individual. This installment focuses on the ability of an entity, which is not subject to the foibles of the human condition, to provide continuous service as trustee.

For any trust, but especially with respect to dynasty trusts, an entity as trustee ensures continuity of the trustee function. Any individual, even if young, could vacate the office due to death or incapacity on any given day. Even if an individual serves well over a long tenure, there is less likelihood that future individual trustees will also do a good job. Just as many small businesses fail in the third generation because of changes in family dynamics, so can trusteeship fail in future generations because the wrong person takes hold of the reigns. Contrast this with a corporate entity where systems and processes are in place for safeguarding that a corporate trustee will continue to perform its duties into the future, regardless of the health of any particular individual. Among the things providing this continuity are internal overlap of personnel over the years/generations. Given the environment of liability in which the trustee works, the entity has incentive to invest in the training and education of the persons working as members of its team. This stems not from any one trust, but because a corporate trustee is working in trust administration daily—thus the threat of liability from unrelated trusts provides (in the aggregate) a benefit to these and all trusts administered by the corporate trustee.

If you are designing trusts that are anything but short-term, consider the benefit of ensuring the stability in the office of trustee that only a corporate trustee can bring.

Game of Thrones captured the attention of millions around the globe. Even if you haven't watched the series, I want to share with you a great lesson hidden in this eventful tale: estate planning (and lack thereof). Estate planning could have changed the outcome of the entire story. Ned Stark had an "illegitimate" son, Jon Snow, who was actually adopted by Ned in secret. However, because Ned passed away before revealing this secret, Jon's illegitimacy disqualified him as heir to the throne. If Ned and his wife, Catelyn, had thought to do some estate planning, naming Jon as a descendant would have prevented many of the tragedies and hardships that fell upon the Starks. Catelyn attempted some planning by making a verbal agreement with Brienne of Tarth to protect their four under-age children in the event of their death. Unfortunately, the children were never informed of this, nor had they met Brienne. Thus, when Ned and Catelyn passed away, another avoidable hardship struck: the children thought they had no one to look after them. As time passed, Brienne found the children and tried to explain she took an oath to protect them. However, the children, having been traumatized by losing their family and being separated, are scared and skeptical of Brienne. If the Starks had thought about estate planning, Jon could have kept the kingdoms at peace and his family together during his reign. Some simple estate planning can go a long way!

First Covenant's Account Manager Candace Smith serves as the first point of contact for clients. She helps to manage client and beneficiary expenses, administer estates and trusts, secure homes, and coordinates distributions and sales.

First Covenant Trust & Advisors
801 C Sunset Drive, Suite 100
Johnson City, TN 37604
423.232.0456

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No Place Like a Good *Home* For Trusts

At the climactic apex of the Wizard of Oz, Dorothy Gale famously repeats "There's no place like home." At the risk of revealing a spoiler, this incantation magically transports her from the unpredictable, chaotic and often dangerous Oz and returns her home to Kansas and the care of her Auntie Em. The film ends with Dorothy's panegyric to the value and importance of home.

As Dorothy discovered, a good home can make a big difference. This is also true for trusts. Steve Oshins, a Nevada-based trust attorney, ranks various jurisdictions on aspects of importance to trusts and their creators and beneficiaries. In the latest versions of these rankings, South Dakota and Tennessee—First Covenant's home states—rank high on his lists, as summarized below:

	South Dakota	Tennessee
Dynasty Trust Ranking	1st	3rd
Trust Decanting Ranking	1st	4th
Asset Protection Ranking	2nd	5th
Trust Taxation	No Tax	No Tax

A separate analysis of asset protection jurisdictions for Trusts & Estates Magazine placed states into tiers based on 3 factors: Discretionary Support statutes, Domestic Asset Protection Trust statutes, and Anti-Alter Ego statutes. Their research also indicated that South Dakota and Tennessee are strong DAPT jurisdictions.

Jurisdiction	Discretionary Support statute	DAPT statute	Anti-Alter Ego statute
South Dakota	1st tier	1st tier	1st tier
Tennessee	1st tier	2nd tier	1st tier

A study by SmartAsset researched IRS data on trusts per household, trust income and deductions, and compiled a list of the most popular states for trusts. South Dakota was second on the list, because of the number and larger size of the trusts sitused in that state. The lack of income tax attracts larger trusts to South Dakota. Tennessee has recently completed a phase-out of its income tax, and is now a "no tax" state for trusts as well.

David A. Greene, JD, CPA is the Senior Trust Officer at First Covenant. He enjoys teaching and speaking. If you are interested in having David speak to your firm, clients, or an event, please contact us.