Convert an IRA to a charitable remainder trust

SECURE Act promises new life insurance opportunities

Aimed at increasing access to tax-advantaged accounts and preventing older Americans from outliving their assets, the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) is far-reaching retirement savings legislation that took effect in January 2020.

One significant provision eliminated stretch IRAs as an estate planning tool by requiring full distribution of an IRA to beneficiaries within 10 years, following the year of the employee or IRA owner's death.

Now is the time to talk about your estate plans and discuss new options to help pass your legacy to your beneficiaries without also passing a big tax bill.

Replicate a stretch IRA using a charitable remainder trust

Using a charitable remainder trust (CRT) can help lengthen the time period for payments to the beneficiary and provide tax advantages. The annuity payment from the trust is made to the beneficiary, and it replaces the distribution that would have been made from the IRA. A charitable remainder unitrust (CRUT) is the preferred vehicle because of its flexibility — regarding both design and payout options.

Considerations

IRA owners can fund a CRT by either using their entire IRA distribution or over a period of years. The unitrust is preferred because it allows the owner to make contributions after the first year, and the beneficiary is not required to make withdrawals. While the IRA distribution to fund a CRUT is considered taxable income, the IRA owner can offset the cost with an income tax deduction.

The proceeds of the trust can be used to pay income to the IRA owner's beneficiaries. The beneficiaries receive a lifetime payout with the remainder going to a charity. Payouts to the beneficiary are considered taxable income.

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Life insurance strategies to improve the CRUT

Two life insurance strategies can be used to provide tax advantages.

1 **Life insurance within the CRUT.** Payouts from all CRTs are subject to the tiering rule, which determines how distributions to the beneficiary are taxed — particularly where there is a mix of income types. Supposing a CRT has property that generates ordinary income, capital gains and tax-free income, the tiering rule defines how the distribution is taxed to the beneficiary:

1. Distributions come out first as ordinary income
2. Capital gains
3. Tax-free income
4. Tax-free return of principal

If all the IRA assets are taxable assets, the proceeds can be used to buy a life insurance policy within the CRUT. Not only is there no tax on that conversion but assets distributed to the beneficiary are also income tax-free.

2 **Life insurance outside of a CRUT in a wealth replacement trust (WRT).** The WRT has been a vehicle used for many years. The idea is simple. The remainder of the CRT goes to charity. To replace this amount for loved ones, the payee of the beneficiary can take a part of the CRT's distribution and purchase a life insurance policy. The life insurance policy distributions will be income tax-free.

How the CRUT strategy works

Meet Paula

Age 60, IRA owner

Paula has learned how the SECURE Act's new withdrawal requirements will affect her niece's taxes. Her financial professional recommends that she consider transferring her IRA balance to a CRUT and purchasing a life insurance policy within it.

Paula has $1 million in her IRA that she uses to fund a CRUT and purchase a life insurance policy within it. Betty is the beneficiary of the trust. At least $100,000 must be reserved for the charity. If Paula dies before year 20, any amount above the $100,000 remainder can be distributed tax-free to Betty.

Advantages for Paula

- Paula's estate gains a tax advantage
- Paula will receive a 10% income tax deduction

Advantages for Betty

- Betty receives an income supplement during her life expectancy
- Betty may receive a higher amount of tax-free income than if she were the IRA beneficiary

With the use of a CRT as payee of the IRA distribution, you can have a flexible strategy that surpasses the simple 10-year payout.

Contact your financial professional to run an illustration on this concept.

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