ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning for Your Retirement Savings

WHAT'S INSIDE?

Join the Retirement Planning Conversation

Bankruptcy and Lawsuits: *Are Your Retirement Assets Protected?*

Retirement accounts carry a number of different protections. These layers of defense shield IRA owners and company plan participants from bankruptcy and general (non-bankruptcy) creditors.

However, not every retirement account possesses the same safeguards. In addition, levels of protection vary widely from state to state. In the current environment with so many small businesses on the brink of closing and struggling employees in limbo, increased bankruptcy filings could be around the corner. It is imperative to understand which accounts hold what protections, and how retirement assets are shielded from those anxious to get a piece of the nest egg.

ERISA Plans: The Gold Standard

Most employer-sponsored retirement plans, such as a 401(k)s, fall under the Employee Retirement Income Security Act of 1974 (ERISA) guidelines and receive creditor protection at the federal level. ERISA offers the "gold standard" of protection up to an unlimited amount against both bankruptcy and non-bankruptcy general creditor claims.

Example 1: Mark is a very successful contractor who flips houses. He has a 401(k) plan set up for him and the employees of his sole proprietorship. Mark's current plan balance is $1,500,000.

Recently, there was an accident at one of Mark's construction sites, and he is being sued personally. Even if Mark loses the lawsuit, the assets in his 401(k) remain protected by ERISA up to an unlimited amount. Additionally, if Mark were to declare bankruptcy, his 401(k) would be off limits to bankruptcy creditors.

The same does not hold true for solo 401(k) plans. Often, business owners worried about potential lawsuits keep their retirement funds in their "solo-K," because they believe them to be fully creditor-proof vs. an IRA. But solo 401(k) plans are not covered by ERISA and have no creditor (non-bankruptcy) protection under that law. Plan balances will only receive non-bankruptcy creditor protection available under applicable state law.

These plans do, however, receive full bankruptcy protection under the Bankruptcy Code. This is also the case with other non-ERISA company plans such as SEP and SIMPLE IRAs, non-ERISA 403(b) plans and 457(b) governmental plans.

Bankruptcy and IRAs

Traditional and Roth IRA contributions and earnings are protected from

Executive Summary

Bankruptcy and Lawsuits: *Are Your Retirement Assets Protected?*

- ERISA offers the "gold standard" of protection up to an unlimited amount against both bankruptcy and non-bankruptcy general creditor claims.
- Solo 401(k) plans are not covered by ERISA and have no creditor (non-bankruptcy) protection under that law.
- Traditional and Roth IRA contributions and earnings are protected from bankruptcy up to $1,362,800. (Rollovers from plans do not count against this cap.)
- General creditor protection for IRAs, Roth IRAs and IRA-based company plans like SEPs and SIMPLEs is based on individual state law.
- The U.S. Supreme Court ruled unanimously that inherited IRAs are not protected in bankruptcy under federal law.
- Retirement dollars being rolled over are shielded in bankruptcy as long as bankruptcy was declared while the assets were still in the plan or IRA.
- Inside claims within an IRA can be mitigated with the use of a limited liability company (LLC).

RMD Relief is Here — *Act Now!*

- IRS Notice 2020-51 extended the 60-day rollover deadline until August 31, 2020 and waived the once-per-year IRA rollover rule.
- The amount rolled over can include any withholding on the RMD as long as the individual has funds available to make up the difference.
- The once-per-year IRA rollover rule does not apply to conversions, so multiple unwanted RMDs can be converted to a Roth IRA.
- IRS Notice 2020-51 allows rollovers of RMDs that would normally be in violation of the once-per-year IRA rule to be deemed "repayments."
- RMDs by non-spouse IRA beneficiaries can be repaid by August 31, as long as they go back to the same IRA.
- The new relief in IRS Notice 2020-51 is specifically limited to RMDs.

Trimming the Tax Paid by IRA Trusts

- There are many reasons for having IRAs payable to a trust, from asset protection to possibly extending tax deferral under the SECURE Act.
- Mastering these six principles can make IRA trusts less taxing: 1) DNI deduction; 2) "trust accounting income" differs from "federal gross income;" 3) "pecuniary" bequests can pose problems; 4) separate share rules; 5) charitable bequests from IRA trusts have their own rules; and 6) distributions *of* the IRA differ from distributions *from* the IRA.

bankruptcy up to an inflation-adjusted cap, currently $1,362,800.

Is this a sufficient limit? If the maximum amount was contributed to an IRA each year from 1975 to 2020, there would be $141,500 in contributions ($158,500 if the IRA owner qualified for age-50 catch-up contributions available beginning in 2002). It is unlikely that the earnings, even for those who contributed the maximum each year, would push an IRA balance over $1,362,800.

But what about rollovers from plans to IRAs? Do these dollars count against the $1,362,800 cap? They do not. Former company plan assets (previously protected by ERISA while in the plan) rolled to an IRA will obtain unlimited bankruptcy protection under the Bankruptcy Code. As an added bonus, rollovers from SEP and SIMPLE plans also do not count against the $1,362,800 cap.

Example 2: Sheila was an attorney with a $2,000,000 balance in her company's ERISA 401(k) plan and a $700,000 balance in her IRA (which is composed entirely of contributions and earnings).

In April of this year, Sheila retired from her law firm, and, in May, rolled her 401(k) into her IRA. Sheila's IRA is completely shielded from bankruptcy. The Bankruptcy Code protects her $2,000,000 401(k) rollover up to an unlimited amount, and the $1,362,800 cap is enough to cover her original IRA balance.

Note that in this example, Sheila did not need to keep her 401(k) and IRA dollars separate to retain the maximum bankruptcy protections. However, from an administrative standpoint, it could make sense for some individuals to keep rollover assets separate via a conduit IRA to avoid confusion.

Lawsuits and IRAs

General creditor protection (e.g., when a person wins a judgment in court against the account owner) for IRAs, Roth IRAs and IRA-based company plans like SEPs and SIMPLEs is based on individual state law. These state-level non-bankruptcy protections vary widely. As such, it is important to understand your client's state's coverage, especially before advising the client to roll over ERISA plan dollars into an IRA.

As mentioned, ERISA-covered plans enjoy full bankruptcy and general creditor protection. While all former plan dollars remain protected in bankruptcy by the Bankruptcy Code after a rollover to an IRA, these same dollars do not retain unlimited general creditor (non-bankruptcy) protection. Assets rolled from an ERISA plan to an IRA will now fall under the applicable state-level protections. These state safeguards may be comparable to ERISA levels, or they may be significantly less so.

Example 3: Dr. Kapp changed employers and is deciding what to do with his $400,000 401(k) plan. His profession exposes him to malpractice lawsuits. If Dr. Kapp rolls the assets from his work plan to an IRA, the $400,000 will be fully protected in bankruptcy. However, he will be limited to the general creditor (non-bankruptcy) protections offered under state law.

Instead, Dr. Kapp elects to roll his former plan assets into the 401(k) plan offered by his new employer. That way, he ensures the $400,000 will retain 100% ERISA protection from both bankruptcy claims and any malpractice judgments against him.

Inherited IRAs and Bankruptcy

In a landmark decision released June 12, 2014, Clark v. Rameker, the U.S. Supreme Court ruled unanimously that inherited IRAs are not protected in bankruptcy under federal law. Since only "retirement funds" are protected under the Bankruptcy Code, the primary issue before the Court was whether an inherited IRA is a "retirement" account.

The Court reasoned that the following characteristics of inherited IRAs are not those of a retirement account: beneficiaries cannot add money to inherited IRAs; beneficiaries of inherited IRAs must generally begin to take RMDs, regardless of how far away they are from retirement; and beneficiaries can take total distributions of their inherited accounts at any time and use the funds for any purpose without a penalty.

Based on these factors, the Supreme Court decided that inherited IRAs do not contain "retirement funds," and, as a result, the favorable bankruptcy protection afforded to such funds under the Bankruptcy Code does not extend to them.

Bankruptcy Timing and Rollovers in Transit

IRAs and retirement accounts protected under the bankruptcy law are generally shielded only as long as the funds remain qualified. Creditors will sit patiently until retirement dollars are withdrawn to snatch them as unprotected assets.

However, these funds remain safeguarded as long as they are qualified dollars. If funds are withdrawn, the law protects these dollars while they are out of the IRA in transit to the new IRA or retirement account. This protection applies to 60-day rollovers as well as trustee-to-trustee transfers.

An individual only receives this protection if bankruptcy paperwork was officially filed while the funds were still in the retirement account. Timing is key. Funds already out on rollover when bankruptcy is declared lose all protection.

Creditors will sit patiently until retirement dollars are withdrawn to snatch them as unprotected assets.

IRAs and the LLC Shield

While IRAs enjoy specific levels of protection against "outside" claims (i.e., claims brought personally against the IRA owner), what happens when a claim is brought against an investment within the IRA? Such "inside" claims can not only devastate the IRA but could also put an IRA owner's personal non-qualified assets at risk. Inside claims can be mitigated with the use of a limited liability company (LLC).

Example 4: Blake owns a self-directed IRA worth $500,000 that invests entirely in a local jet ski rental and watersports company. He did not use an LLC within the IRA to acquire the rental business. Blake has other personal assets worth $1.5 million.

Last summer, a jet ski renter had an accident and suffered a catastrophic injury. After almost a year of litigation, the renter won a $2 million judgment against the IRA.

All of Blake's IRA assets could be reached because the claim arose from activities of the IRA investment. His personal assets could also be at risk.

If Blake's IRA had been invested in an LLC that subsequently purchased the watersports company within the IRA, the LLC structure would have protected both the IRA assets and Blake's personal assets against the $2 million judgment.

Advisor Takeaway

Understanding the levels of bankruptcy and non-bankruptcy protections afforded to both workplace retirement plans and IRAs is a must. Also, be keenly aware of "outside" vs. "inside" claims and how to mitigate certain risks with an LLC. In our litigious society with the ever-present and looming possibility of bankruptcy, under the watchful eye of SEC Reg BI, educating clients on available safeguards will become increasingly important. ■

RMD Relief is Here — *Act Now!*

Required minimum distribution (RMD) relief is here, and it will help almost everyone looking to return an unneeded 2020 RMD. IRS Notice 2020-51 not only extends the 60-day rollover deadline, but it also waives other rollover rules. Here is what you need to know about this unprecedented relief and its fast-approaching August 31 deadline.

CARES Act Waived 2020 RMDs

The CARES Act waived 2020 RMDs from IRAs and defined contribution plans for both account owners and beneficiaries. This was relief for many who had seen their retirement savings battered by the turmoil the coronavirus unleashed on the markets.

However, by the time the CARES Act passed on March 27, 2020, many retirement account holders had already taken, or started taking, their 2020 RMDs. Those who took unneeded RMDs wanted to return them, but the bulk of the unwanted distributions did not qualify for a rollover due to missing the 60-day deadline or running afoul of the once-per-year rollover rule.

Then, on April 9, 2020, the IRS released Notice 2020-23. This was broad tax relief that extended a number of tax deadlines. It was not specifically tailored to help those who had taken unwanted RMDs, but it did provide some relief for those who found themselves in that predicament. However, many others were left out. Excluded were those who took RMDs in January, those who took multiple monthly RMD distributions, and nonspouse beneficiaries who took 2020 RMDs from inherited IRAs.

> IRS Notice 2020-51 not only extends the 60-day rollover deadline, but it also waives other rollover rules.

Unprecedented Relief for Return of 2020 RMDs

On June 23, 2020, the IRS released Notice 2020-51. This extraordinary relief is geared specifically at those who took unneeded 2020 RMDs and want to return those funds to their retirement account. The Notice extends the deadline for returning 2020 RMDs already taken until August 31, 2020. This provides relief for those who missed the 60-day deadline and will help those who took RMDs in January 2020. These rollovers can be made to any IRA or to a workplace plan that accepts rollovers.

Example 1: Jack took his 2020 RMD from his 401(k) plan back in January before the CARES Act became law. Jack can roll over these funds to the 401(k) plan (if it accepts rollovers) or to an IRA by August 31, 2020.

The amount that is rolled over can include any withholding on the RMD, as long as the individual has funds available to make up the difference.

Example 2: Naomi took her 2020 RMD in February. Her RMD for the year was $10,000, and she chose to have 10% ($1,000) withheld from the distribution and $9,000 paid to her. Naomi can roll over $10,000 ($9,000 paid to her + $1,000 withholding). The taxes withheld could then be credited to her when she files her 2020 taxes.

The relief also covers those who took an unneeded RMD and would like to convert those funds to a Roth IRA. RMDs cannot normally be converted. But since 2020 RMDs are waived, those funds would be eligible for conversion. The once-per-year IRA rollover rule does not apply to conversions, so even multiple unwanted RMD distributions can be converted to a Roth IRA.

Example 3: Ming took her 2020 RMDs from her IRA in January, February, and March 2020. She can deposit all those funds to her Roth IRA as a conversion by August 31, 2020.

Notice 2020-51 does not just provide relief from the 60-day rollover rule. In an unprecedented move, the IRS went even further by waiving other rollover rules that many have thought were written in stone and could only be changed by Congress.

As part of the relief, the IRS is allowing repayments of RMDs that would be in violation of the once-per-year rule. The IRS is specifically calling these returns "repayments" — *not rollovers* — and is requiring that the funds be repaid by August 31, 2020 to the same IRA from which they were distributed.

Example 4: Danny has his RMDs from his IRA set up to be paid out monthly. In 2020, he took payments in January, February, and March. Danny can repay all of these distributions to the IRA from which they were made. Danny cannot roll over all of these distributions to another IRA.

The rollover rules have never been kind to nonspouse IRA beneficiaries. Nonspouse beneficiaries have never been allowed to return a distribution paid to them, regardless of the circumstances. This was always considered a mistake that could not be fixed.

To the surprise of many, the IRS is making an exception with its 2020 RMD relief and allowing repayments of RMDs by nonspouse IRA beneficiaries by August 31, as long as it goes back to the same IRA. This would include any 2020 year-of-death RMDs that an IRA owner did not take prior to death that would normally be required to be taken by the beneficiary.

While nonspouse beneficiaries of IRAs can return unwanted RMDs, nonspouse plan beneficiaries are not offered the same relief. Those beneficiaries must keep any 2020 RMDs that they take.

Example 5: Eli inherited a 401(k) plan and an IRA from his mother in 2019. In March 2020, he took RMDs from the inherited plan and the inherited IRA. Eli can repay the IRA RMD back to the inherited IRA by August 31, 2020. He **cannot** return the 401(k) RMD to the 401(k) or roll it over to an IRA.

What about a 2020 RMD taken by an IRA owner who died later in 2020? Can this RMD be returned? The IRS relief does not directly address this situation.

The IRS relief is very broad and could be argued that a beneficiary repaying an RMD taken by the IRA owner would be included. But this is not clear. Even if this repayment was permitted, it could have income or estate tax planning ramifications that should be carefully evaluated.

Regarding income tax purposes, for example, it might pay to keep that RMD income on the decedent's final tax return if the tax would be lower, possibly due to heavy medical expenses that could offset the tax bill. For estate planning, returning an RMD could change a beneficiary's share. There may also be administrative challenges to returning an unwanted RMD to the IRA of a deceased person. Financial institutions will most likely want legal clearance first.

While the main focus of Notice 2020-51 is on the return of 2020 RMDs, the Notice also provides some guidance on other issues raised by the CARES Act waiver of 2020 RMDs. For instance, it confirms that for individuals taking 72(t) payments based on the RMD method, a return of a payment in 2020 would still be considered a modification of the payment plan that would trigger penalties. The Notice also clarifies that neither the five-year rule nor the ten-year payout rule for beneficiaries will be extended when an IRA owner dies in 2020.

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Example 6: Monica inherits an IRA from her grandmother in 2020. The 2020 waiver of RMDs does not give her an extra year to empty this inherited IRA. The 10-year rule applies, and the account must still be emptied by December 31, 2030.

Excluded from the Relief

Is anyone out of luck, even with the new expansive IRS relief? Yes. Those who converted an RMD to a Roth IRA and now have some buyer's remorse will not find any help from the new IRS relief.

Some individuals who were unable to roll over multiple RMDs due to the once-per-year rollover rule converted those distributions to a Roth IRA because the once-per-year rule does not apply to conversions. Now that the IRS has waived the once-per-year rule, they are wondering if they can undo these conversions and just return the funds to an IRA.

Unfortunately, the answer is no. The Tax Cuts and Jobs Act of 2017 did away with the ability to recharacterize or undo a conversion, and nothing in the new IRS relief changes that.

Example 7: Maya took monthly RMD distributions from her IRA in January, February, and March. After the CARES Act, she rolled over her March distribution back to her IRA. She converted the other distributions to a Roth IRA.

Now that the once-per-year rule has been waived for repayment of 2020 RMDs, she would rather repay those funds to her IRA. Unfortunately, for Maya there is no way to undo the conversion and return those funds to her IRA.

The new relief, while broad, also does not include any help with the "same property" rule that applies to IRA rollovers. Some people took their 2020 RMDs in-kind, withdrawing shares of stock and transferring those shares to their taxable accounts. If they now want to return those unwanted RMDs, they must return the same number of shares to their IRA, even if the value has changed. They cannot substitute cash to complete the rollover.

Example 8: Scott took his 2020 RMD in January as an in-kind distribution of stock. He can roll over the same shares of stock to his IRA by August 31, 2020.

Also left out is anyone looking to return funds that are not an RMD. The relief is specifically limited to RMDs.

Example 9: Alex took what he thought was his 2020 RMD of $8,000 in January. In August, the IRA custodian contacted him to inform him that the calculation was done incorrectly and that his RMD was only $7,500.

Alex can roll over only the RMD amount of $7,500 by August 31, 2020. He cannot roll over the $500 that was not part of the RMD.

RMD Relief Ends August 31

The relief offered by IRS Notice 2020-51 is only temporary. After the August 31, 2020 deadline, it will go away, and we will return to the standard rollover rules for everyone, even those who are looking to return unneeded 2020 RMDs.

That means a 60-day deadline will be back, along with the return of the once-per-year rule and the prohibition of repayment options for nonspouse beneficiaries. Those who cannot comply with these rules by August 31, 2020 will be out of luck when it comes to returning a 2020 RMD. The opportunity is now, and the clock is ticking. ■

Trimming the Tax Paid by IRA Trusts

Guest Expert

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Do you have clients whose IRAs are payable to a trust? There are many reasons for such a plan, from asset protection to possibly extending tax deferral under the SECURE Act.

However, high trust tax rates may take a huge bite from future IRA distributions. Fortunately, mastering six principles can make IRA trusts less taxing.

Suppose a client names a trust as beneficiary of his $1 million IRA. After the IRA owner's death, that bag full of tax-deferred income (an IRA now held in a trust) must navigate the complex world of *fiduciary* income tax.

Disaster can ensue when these two complicated vehicles — *trusts and retirement accounts* — collide. Traditional IRA distributions are normally 100% taxable, but there can be a huge difference between the rate paid by the trust and that faced by a human trust beneficiary.

Trust income currently is subject to the tax code's top 37% rate with just $12,950 of taxable income, regardless of the trust beneficiaries' income. Humans don't reach that top rate until they have $518,400 of taxable income ($622,050 on joint returns). Moreover, the extra 3.8% tax on net investment income applies only to humans with over $250,000 of income but hits a trust after only (you guessed it) $12,950 of income.

Fortunately, advisors and affiliated professionals don't have to become tax scholars to help clients and their beneficiaries avoid steep taxes. From the drafting of an IRA trust to post-death administration, working within the following six principles can keep IRA distributions (gross income) from high trust rates.

Principle #1: DNI Deduction

Unlike human taxpayers, trusts get a "distributable net income" (DNI) deduction for money paid to human trust beneficiaries. Then the recipients will pay tax on that income at their (hopefully lower) rate. Rules limit the DNI deduction, though. For example, the distribution from the trust to the beneficiary generally has to occur in the same year the income was received by the trust, or soon thereafter.

If the trustee is required (or given the discretion) to pass taxable income to the human beneficiaries, taxable income can be shifted to lower-bracket taxpayers via the DNI deduction. Income stuck in the trust will get hit with high trust tax rates.

That said, it's a fallacy to think that the trustee can easily erase the higher tax on IRA distributions by paying them out to the beneficiaries. Under the remaining five principles, not every distribution from a trust "carries out" DNI to dodge trust tax rates.

Principle #2: "Trust Accounting Income" Differs from "Federal Gross Income"

Trust taxation may not seem logical. For instance, the language of an IRA trust might say, in essence, "pay income to my spouse and hang onto the principal for my children after my spouse's death."

Does that mean the trustee will automatically pass out all taxable income to the surviving spouse? Not really. Instead, the trustee will pay trust accounting income to the spouse.

The trustee may receive an item that goes into federal gross income but not trust accounting income. The elephant in this room is the IRA.

Example: John dies with a $1 million IRA, which passes to a trust, and the trust cashes out the account. Now the trustee has received $1 million of DNI and the trust has $1 million of gross income.

Under most states' trust accounting laws, only a small portion (or none) of that will count as "trust accounting income" so — *under the terms of the hypothetical trust described earlier* — the trustee cannot pay all the IRA money out to John's surviving spouse. The trust might owe high trust tax rates on the entire IRA distribution!

Planning point: The trustee of an IRA trust should have the discretion (or be required) to pay out all retirement plan distributions regardless of whether they are considered "income" or "principal" for trust accounting purposes.

Principle #3: "Pecuniary" Bequests Can Pose Problems

Example (continued): Suppose John's trust essentially says, "at my death pay $1 million to my spouse Jane and hold the rest of the money in a trust for my children, Brett and Carla, for life." So, the trustee cashes out the $1 million IRA and distributes $1 million to Jane.

Such a distribution won't carry out DNI. There is no DNI deduction for paying a pecuniary (fixed dollar) bequest. (Conversely, pecuniary bequests can merit a DNI deduction if the fixed amount is determined by a formula, such as being based on the size of the taxable estate.) Jane would receive $1 million of cash, income tax-free, and the trust for the children would owe income tax on the IRA distribution.

Planning point: A trust that will be funded by sizable retirement accounts and contains pecuniary bequests may have to cash out (and pay tax on) retirement plan distributions and pay the pecuniary bequests from what's left after tax. It's often better to avoid including substantial pecuniary bequests in this type of trust.

There is no DNI deduction for paying a pecuniary (fixed dollar) bequest.

Principle #4: The "Separate Share" Rules

Another unexpected exception to the "distributions-pass-out-DNI" provision can prevent the deduction of payouts to the trust beneficiaries. The separate share rule applies to a trust that is allocated into separate shares (equivalent to separate trusts).

In this situation, a distribution to one beneficiary reduces that individual's share of the trust assets but does not reduce other beneficiaries' shares. By contrast, with a "pot" or "spray" trust there is just one share, and the trustee makes distributions among the beneficiaries based on factors such as need.

When a trust subject to the separate share rule receives an IRA distribution, the resulting gross income generally must be allocated proportionately among the shares, regardless of who actually receives a payment. Suppose a separate share trust has equal shares for the donor's children A, B, and C.

The trustee cashes out a $1 million IRA and distributes it all to A in a year when this beneficiary has business losses to offset the resulting tax bill. Here, the trustee plans to distribute other assets the following year to B and C, equalizing the amounts received.

Unfortunately, such a plan doesn't work. The trustee could have allocated the IRA distribution equally to all three shares, so for income tax purposes the $1 million of income is allocated proportionately among the shares. Therefore, the trust shares of A, B, and C will each be taxed on $333,333 of income, even though the trust shares of B and C are receiving different (perhaps noncash) assets.

This separate share trap can be sidestepped by requiring the trustee to allocate the IRA proceeds to a particular share. However, it's unlikely that the trust creator would able to foresee which beneficiary will be in the lowest tax bracket at some time in the future.

Another workaround would be for the trustee to pay off the other beneficiaries first. Then the only share that can be funded with the IRA distribution is the one the trustee wishes to report that income.

Planning point: In conceiving, drafting, and administering a trust that will receive substantial retirement benefits, consider tactics that might steer gross income from IRA distributions to lower income beneficiaries.

Principle #5: Charitable Bequests from IRA Trusts Have Their Own Rules!

Surprisingly, even if the trust pays out some "DNI" to a charity, the trust does not get a "DNI deduction" for that distribution. There is no DNI deduction for payments to charity.

The trustee may be able to get a charitable deduction for the check

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that's written — *but that would be under a different code section!* A pecuniary bequest to charity can (if all requirements are met) qualify for a charitable deduction, even though it would never qualify for a DNI deduction.

Planning point: Successfully making charitable bequests via a trust requires the trust drafter and the trustee to master the relevant fiduciary income tax rules. Generally, it's simpler and extremely tax-efficient to fulfill philanthropic intent by leaving retirement benefits directly to charity.

Principle #6: Distributions *of* the IRA Differ from Distributions *from* the IRA

Yes, avoiding high tax rates on IRA trust distributions can require finding a way through a complex maze of rules. But now we come to the secret exit, the hidden path that sometimes enables trustees to emerge successfully.

A distribution from an IRA is gross income. However, the IRA itself is not gross income: The tax code characterizes an IRA as a "right to receive" gross income. Therefore, in some cases the trustee can avoid the snares described above by transferring the *IRA itself* to the beneficiary.

Suppose, for example, there is a separate share trust. If the trustee transfers the IRA itself to one beneficiary and some other assets to a different beneficiary, the transfer of the IRA does not trigger any taxable income at the trust level. The trustee does not need to allocate the gross income proportionately among the shares because there is no gross income to allocate.

Planning point: If a tax-efficient distribution approach for a trust seems to be thwarted by the DNI rules, consider transferring the IRA itself. This won't work with pecuniary bequests, and some IRA providers will not allow it, but the technique has saved many estate plans from a steep income tax hit.

You don't need to be an expert to spot the problems (and these possible solutions) for a client planning to leave an IRA to a trust. To learn full details of all these rules, see Chapters 6 and 7 of *Life and Death Planning for Retirement Benefits* (8th ed., 2019), by Natalie Choate available at ataxplan.com/life-and-death-planning-for-retirement-benefits/order-form. ■

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