# Estate Planning Opportunities:
## Impact of COVID-19 and the SECURE Act

A Guide

Community Foundation
FOR SOUTHEAST MICHIGAN

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The Community Foundation is experienced in accepting gifts of all kinds and we can work with you and your clients to make the gifting process straightforward and efficient, consistent with your clients' business and estate planning goals.

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# Estate Planning Opportunities:
## Impact of COVID-19 and the SECURE Act

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The coronavirus pandemic has caused many individuals who may have delayed estate planning to create or revise their estate plans in light of health concerns. Under equally challenging times for charities, many of whom are suffering from reduced contributions and a higher demand for their services, charitably minded individuals are prioritizing planning for charity in their estates. Individuals with a substantial portion of their wealth in retirement assets are reviewing the beneficiary designations on those assets to confirm that they align with their current goals.

Under the Setting Every Community Up for Retirement Enhancement Act (the "SECURE Act") effective January 1, 2020, beneficiaries of IRA assets are no longer able to stretch payouts over their life expectancy, commonly referred to as the "stretch IRA." Prior to the SECURE Act, a beneficiary who inherited all or a portion of an IRA generally was required to withdraw a minimum amount annually, until he or she reaches the final year of his or her actuarial life expectancy. The new law imposes a 10-year period following the plan holder's death after which the IRA would have to be distributed in full to the designated beneficiary, and (except in the case of a Roth IRA) would be subject to immediate income taxation.

There are exceptions to the accelerated payout under the SECURE Act's 10-year rule. The rule would not apply to a surviving spouse, a disabled or chronically ill beneficiary (if the condition exists on the date of decedent's death), to anyone less than 10 years younger than the IRA owner, or to a child of the owner who has not reached the age of majority. In the case of a minor child, the 10-year payout is deferred until the child reaches the age of majority. This exception only applies to the minor children of the decedent; grandchildren, nieces, and nephews must still take out the full account balance within 10 years of the decedent's death.

Because of the 10-year payout requirement, practitioners may consider the use of trusts as designated beneficiaries of IRA assets to accomplish the "stretch" and protect the accelerated payout from claims of creditors of the beneficiary. There are several factors to consider when determining the appropriate trust to receive inherited IRAs. The following summarizes three trust strategies related to IRA assets for the charitably inclined estate planning client in the wake of the SECURE Act.

### "Conduit" and "Accumulation" Trusts

A common estate planning strategy for clients with retirement assets is to name a discretionary "see-through" trust as the beneficiary of retirement accounts. A "see-through" trust is one under which a trust beneficiary is treated as if he or she was named directly as a beneficiary of an IRA, provided the trust beneficiary is an identifiable individual from the trust instrument, among other requirements, as detailed in the Treasury

Regulations.[1] There are two types of "see-through" trusts: "conduit" trusts and "accumulation" trusts.

"Conduit" trusts have been used to ensure that the bulk of the inherited IRA is preserved for the beneficiary over his or her lifetime with the added benefit of some asset protection. While the SECURE Act does not preclude the use of conduit trusts, it may no longer be a desirable technique as the trust will receive the proceeds of the IRA asset by the 10th year following the plan participant's death, thus eliminating the income tax benefit and exposing the IRA assets to an imprudent beneficiary and his or her creditors or divorcing spouses.

While the trustee in an "accumulation" trust must also withdraw the entire IRA by the end of the 10th year under the SECURE Act, the trustee may accumulate and reinvest the proceeds in the trust, and make distributions to an individual beneficiary only within the trustee's discretion and according to the trust terms. Nevertheless, upon payment of the IRA to the trust, the trust must pay income tax at the highest marginal rate, increasing the tax burden. Furthermore, for a charitably minded client, the accumulation trust may not be a viable option because a charitable remainder beneficiary will render the accumulation trust invalid.

## Charitable Remainder Trust

Given the limitations of "conduit" and "accumulation" trusts in light of the SECURE Act, a Charitable Remainder Trust ("CRT") may be the ideal tool for clients who have charitable inclinations and wish to accomplish the "stretch" payout over the lifetime of an individual beneficiary, defer income taxation, and provide asset protection.

Using a CRT to replace the desired lifetime income from an inherited IRA is not an exact substitute for the "stretch" IRA, but it comes close. The grantor identifies the individual beneficiary and defines a payment schedule of distributions out of the trust for the beneficiary's lifetime or for a set period of years. The CRT isn't subject to income tax (as the "conduit" and "accumulation" trusts are) and the individual beneficiary is only subject to tax on the distributions from the CRT as the payments are received, even distributions made years after the income was received by the trust. At the death of the individual beneficiary or at the end of the term of the trust (which cannot exceed 20 years[2]), the remaining assets which have grown income-tax free over time will pass to the named charity. As a CRT is irrevocable, assets contributed to a CRT may be removed from the client's estate for estate tax purposes.

Your client can create a CRT either by inter vivos agreement or through a testamentary agreement under which the executor creates the CRT upon the date of decedent's death and pursuant to the terms of the decedent's will or trust. The testamentary trust may be funded with property passing to the trust on death of the grantor to the trust's

1 26 C.F.R. § 1.401(a)(9)-4, Q-4,Q-5.
2 26 C.F.R. §§ 1.664-2(a)(5)(i) and 1.664-3(a)(5)(i).



beneficiaries at the end of administration and settlement of the estate. To be a qualified CRT, the trust instrument must satisfy all of the requirements set forth in IRC §664 and the regulations thereunder. The IRS has published revenue procedures with sample instruments for inter vivos and testamentary charitable remainder annuity and unitrusts, as a starting point for drafting a CRT.[3]

There are two basic types of CRTs: charitable remainder annuity trust ("CRAT") and charitable remainder unitrust ("CRUT"). CRTs make fixed "annuity" payments or variable "unitrust" payments to the individual beneficiary which must be paid by the trustee at least annually. Although similar, the annuity trusts and unitrusts function in different ways, and can meet different planning objectives for your client.

A CRAT is required to pay an annuity amount in a sum certain that is equal to at least 5 percent but not more than 50 percent of the net fair market value of the trust assets at funding and creation of the CRT to one or more beneficiaries. For those clients who want their beneficiaries to receive a fixed income stream, regardless of the income generated by the trust, the annuity trust may accomplish their intentions. A CRUT is required to pay a fixed percentage that is equal to at least 5 percent but not more than 50 percent of the net fair market value of the trust assets, revalued annually, to one or more beneficiaries. Although the percentage remains fixed throughout the trust term, the unitrust amount may vary from year to year as the trustee determines the payment based on the annual net fair market value of the trust assets. As the value of the assets increases, so does the unitrust amount.

When your client establishes a CRT, he or she can fund it with cash or with other assets, e.g. real estate, securities, and qualifying closely held business interests. The client-donor must determine the fair market value of the assets as of the date of contribution (in compliance with the substantiation requirements under the IRC) and the actuarial calculation of the charitable remainder interest. On the transfer of appreciated assets to the trust the donor avoids immediate recognition of the capital gains on the donation of the assets to the trust and receives an immediate income tax deduction for the present value of the remainder interest passing to charity. By donating appreciated assets in-kind to the CRT, the donor preserves the full fair market value of the assets rather than reducing it by capital gains taxes, providing more assets for the income and charitable beneficiaries.

A taxpayer who itemizes deductions can claim an income tax deduction for contributions to a CRT. If the CRT is funded with cash, the donor can deduct the cash contribution up to 60% of AGI. If appreciated assets are used to fund the trust, up to 30% of the taxpayer's AGI may be deducted in the current tax year. In addition, if the donor cannot use the whole deduction in the year of the gift, he or she can carry over the deduction for up to five additional years. Note that with the passing of the Coronavirus Aid, Relief and Economic Security Act (CARES Act), enacted on March 27,

3 See https://www.irs.gov/irb/2005-34_IRB.

2020, a taxpayer can supplement the gift to a CRT with cash contributions to qualifying public charities to receive a combined deduction of up to 100% of AGI for contributions made in 2020 only.

## Other Estate Planning Considerations

In reviewing your client's estate plan, you should also consider the powers delegated to your client's agent under his or her general durable power of attorney. If your client is disabled, the power of attorney should grant your client's agent the authority to change the beneficiary designation on IRA assets and to accomplish tax planning and other goals of the client, including the planning suggested in this article as a result of the SECURE Act and the pandemic. The grant of power to make gifts and engage in tax planning is one that must be drafted thoughtfully. The grant to make gifts may be considered a grant of a general power of appointment for estate and gift tax purposes. Also, a grant of authority to make gifts may give rise to conflicts of interest, self-dealing, the risk of abuse, or gifts that interfere with the principal's estate plan.

## Conclusion

The pandemic and the SECURE Act have changed the landscape for estate planning with IRA assets. At this time, when clients are concerned about their health and charities are in need, many clients with a substantial portion of their wealth in IRA assets may consider a charitable remainder trust as the beneficiary of their IRA. Designating a charitable remainder trust as a beneficiary of a traditional IRA is a strategy that substitutes for a stretch IRA payout, defers income taxation, and ensures that the remainder will be paid to charity.

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