Strategies to Mitigate the Impact of the 10-Year Rule

2.13.2024 | FPA DFW

Jeffrey Levine, CPA/PFS, CFP®, ChFC®, RICP®, AIF®, CWS®, BFA™, MSA
Chief Planning Officer, Focus Partners
Professor of Practice in Taxation, The American College
Lead Financial Planning Nerd, Kitces.com
Founder, Fully Vested Advice

Handouts/Additional Materials at: kitces.com/DFW25

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What is the 10-year rule?

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- Created in 2019 by the SECURE Act
- Effective for most deaths 2020 and later
- Eliminated the ‘Stretch IRA’ provision for most non-spouse designated beneficiaries
- Requires funds to be fully distributed by the end of the 10th year following the year of the owner’s death

What is the 10-year rule?

- Split designated beneficiaries into two sub-groups:
- Eligible designated beneficiaries
- Non-eligible designated beneficiaries

IRA Beneficiary (Post SECURE Act)

Designated Beneficiary

Eligible Designated Beneficiary

- Surviving Spouses
- Disabled Persons
- Chronically Ill Persons
- Persons < 10 Years Younger Than Decedent
- Minor Children
- Some See-Through Trusts

Decedent's Death

Prior to RBD	On/After RBD
"Stretch" or 10-Year Rule	"Stretch"

Non-Eligible Designated Beneficiary

- Most Non-Spouse Beneficiaries
- Some See-Through Trusts

Decedent's Death

Prior to RBD	On/After RBD
10-Year Rule Only	10-Year Rule AND "Stretch" RMDs

Non-Designated Beneficiary

- Charities
- Estates
- Non-See-Through Trusts

Decedent's Death

Prior to RBD	On/After RBD
5-Year Rule Only	5-Year Rule AND "Stretch" RMDs?*

Two Client Profiles

Account Owner Clients vs. Beneficiary Clients

Client Profiles to be Covered

Goal

Mitigate the impact of the 10-year rule

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Client Profiles to be Covered

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Strategies for Beneficiary Clients

"Crisis" Planning

01 Leave the account alone for as long as possible

02 Turn the 10-year rule into an 11-year rule

03 Strategically time distributions from the inherited account

01 Leave the Account Alone for as Long as Possible

Drawbacks

- Income compression
  - Taxable distribution condensed to single year
  - Risk of higher tax bracket

If this risk exists, the "leave it alone" strategy may not make sense

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01 Leave the Account Alone for as Long as Possible

Example

- Non-eligible designated beneficiary inherits a $250,000 IRA
- Assume it will grow to $500,000 in 10 years at 7% return
- Leaving it to the 10th year would create a $500,000 income increase
- Payments are $35,000, if amortized over 10 years at 7% return

For illustrative purposes only.

01 Leave the Account Alone for as Long as Possible

When it might make sense

- It is a **Roth account**
- The beneficiary is already in the **highest tax bracket**, and…
    - Will remain at the same high rate in the future
    - Utilizes and investment or investment strategy that generates ongoing income
- When inheriting **small balance** with negligible tax impact

02 Turn the 10-Year Rule into an 11-Year Rule

- Distributions can be spread out over as many as 11 tax years
- “Year 1” is the year following death
- Beneficiary may take a distribution in the year of death
  - Effectively a “Year 0” distribution
  - Death must occur early enough in the year

03 Strategically Time Distributions from the Inherited Account

- Strategy for beneficiaries with large variability in annual income
- Distributions should be taken during low-income years

When it Might Make Sense

- Retirement or reduced employment
- Starting Medicare
- Child applying for student aid
- Moving to lower/higher income state
- Planning large charitable gift
- Disposition of passive investment with suspended losses

- New spouse with modest income
  - Filing jointly in lower bracket
- Beneficiary or spouse expected to pass away within 10 years
- Beneficiary is a child aging out of “The Kiddie Tax”
  - Will have lower rate than parents

Strategies for Account Owner Clients

Proactive Planning

01 Increase the number of beneficiaries to spread out income subject to the 10-year rule

02 Consider giving more weight to beneficiaries' tax situations (and leaving them unequal assets)

03 Bypass the spouse at the first death to create two separate 10-year distribution windows

Strategies for Account Owner Clients

Proactive Planning

04 Use (partial) Roth conversion to reduce the tax bite for future beneficiaries

05 ‘Trade In’ The Pre-Tax Retirement Account For Life Insurance

06 Use charitable remainder trusts to replicate many of the benefits of the ‘Stretch IRA’

01 Increase the Number of Beneficiaries to Spread Out Income Subject to the 10-Year Rule

- Spreads income (and tax burden) among more people
- When leaving pre-tax funds to younger beneficiaries:
  - Taxable retirement account distributions considered unearned income
  - May be subject to Kiddie Tax
  - May eliminate the tax benefit of increasing beneficiaries

02

Consider Giving More Weight to Beneficiaries' Tax Situations (and Leaving Them Unequal Assets)

- Beneficiaries with different tax brackets
  - Receive equal benefit for Roth accounts
  - Do not receive the same benefit for traditional accounts

03 Bypass the Spouse at the First Death to Create Two Separate 10-Year Distribution Windows

- Bypass spouse beneficiary
- Leave some or all of the first-to-die spouse's assets to the ultimate beneficiary
- Death of first spouse creates a 10-year window (for first spouse's retirement accounts)

03 Bypass the Spouse at the First Death to Create Two Separate 10-Year Distribution Windows

- Second 10-year window is created with the second-to-die spouse (for second spouse's retirement accounts):
  - Beneficial if second spouse is expected to have longer life span
  - Creates long distribution period through two 10-year windows
- May make sense when the beneficiary has a lower tax rate than the current asset owners
- Typically accomplished via disclaimer
  - Makes beneficiary form planning more important

03 Bypass the Spouse at the First Death to Create Two Separate 10-Year Distribution Windows

Example

- Oswald and Vicki are each age 85
- Have the following investable assets:
  - Oswald Traditional IRA: $1 million
  - Vicki's Traditional IRA: $1 million
  - Joint Taxable Brokerage Account: $2 million

Could the survivor live comfortably on "just" their $1 million IRA and the $2 million brokerage account?

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04 Use (Partial) Roth Conversion to Reduce the Tax Bite for Future Beneficiaries

- Straightforward and simple strategy
- Minimizes complexity for beneficiary
  - Removes tax burden

When it makes sense

- Tax rate on converted amount is less than the beneficiary's tax rate
  - Should consider the impact of taxable distributions on the beneficiary over a 1 to 11-year withdrawal period
  - Could make sense for beneficiaries to gift funds to account owners to help pay tax on conversions

05 ‘Trade In’ The Pre-Tax Retirement Account for Life Insurance

- Take distribution
- Use after-tax funds to purchase life insurance (or another asset)
  - Beneficiaries receive tax-free payout upon policy owner’s death

Considerations

- Age
- Health
- Projected rate of return
- Whether the account owner needs funds to live
- Tax rate of owner vs. tax rate of beneficiary

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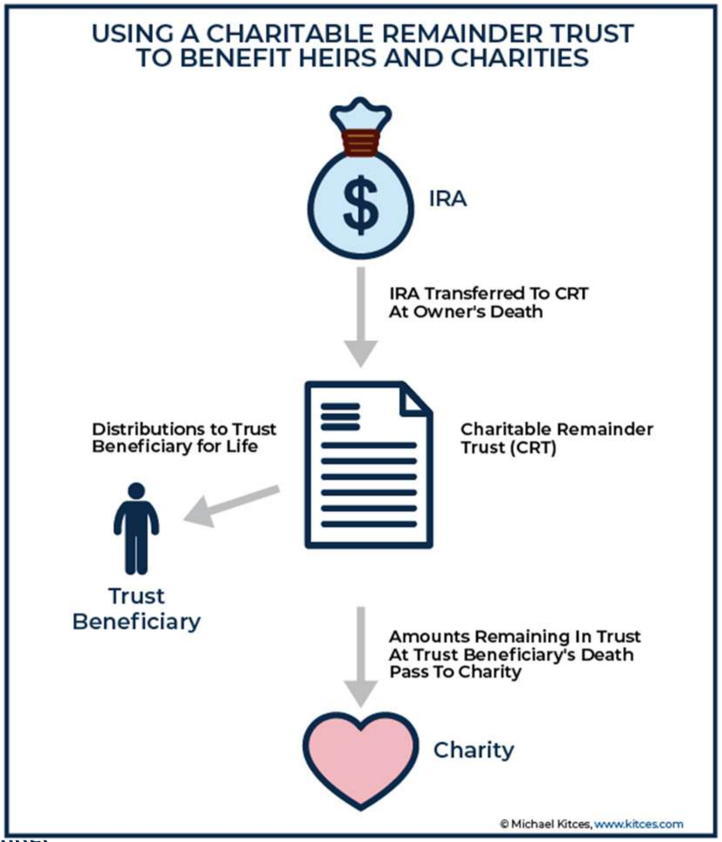
06 Use Charitable Remainder Trusts to Replicate Many of the Benefits of the 'Stretch IRA'

- Charitable remainder trust (CRT) named as beneficiary
- Assets distributed to trust at death without any current tax liability



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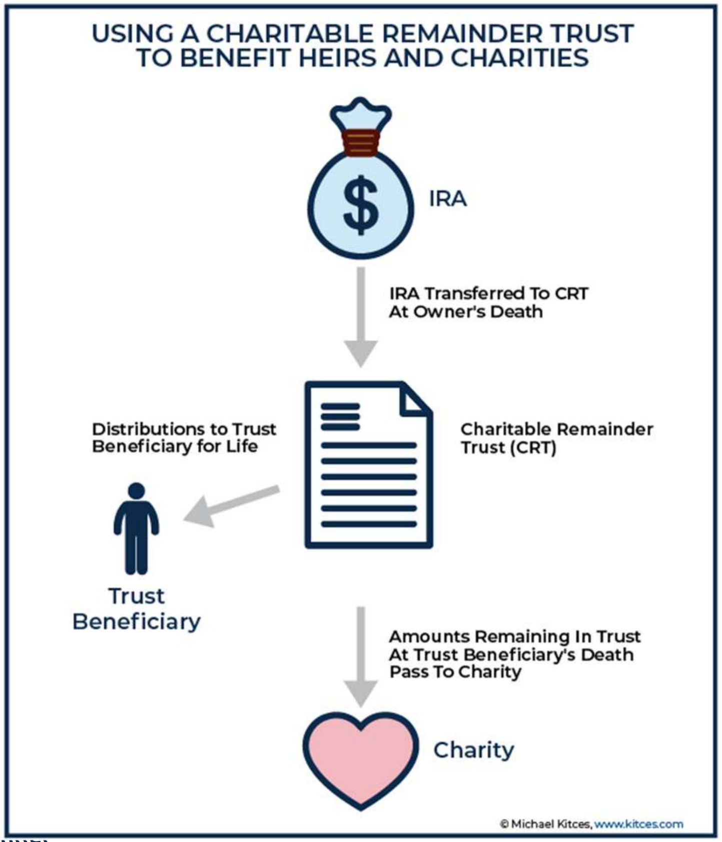
Use Charitable Remainder Trusts to Replicate Many of the Benefits of the 'Stretch IRA'

- Trust distributes assets to beneficiaries
  - Life of beneficiary
  - Term certain: Up to 20 years
  - Combination of the above
- Remaining trust assets pass to charity upon trust termination



06 Use Charitable Remainder Trusts to Replicate Many of the Benefits of the 'Stretch IRA'

Break-Even Point

- CRUTs don't eliminate taxes; they just defer them.
- Main point: If wealth transfer is the primary concern:
  - The projected wealth made possible by the CRUT's extended tax deferral (compared to the 10-year rule) MUST outweigh the projected loss of the 10% remainder assets to the charity.

CRTs typically do NOT make sense from a purely financial perspective.

06 Use Charitable Remainder Trusts to Replicate Many of the Benefits of the 'Stretch IRA'

Break-Even Point

- The break-even point varies based on a variety of factors, including:
  - CRUT beneficiary's ordinary income tax rate
  - CRUT beneficiary's ordinary income tax rate
  - CRUT beneficiary's LTCG rate
  - Percentage of growth in the CRUT comprised of ordinary income versus capital gain income
  - Turnover of CRUT investments
  - CRUT payout percentage

⚠ The break-even point will vary but often takes three or more decades to 'break-even'

06

Use Charitable Remainder Trusts to Replicate Many of the Benefits of the 'Stretch IRA'

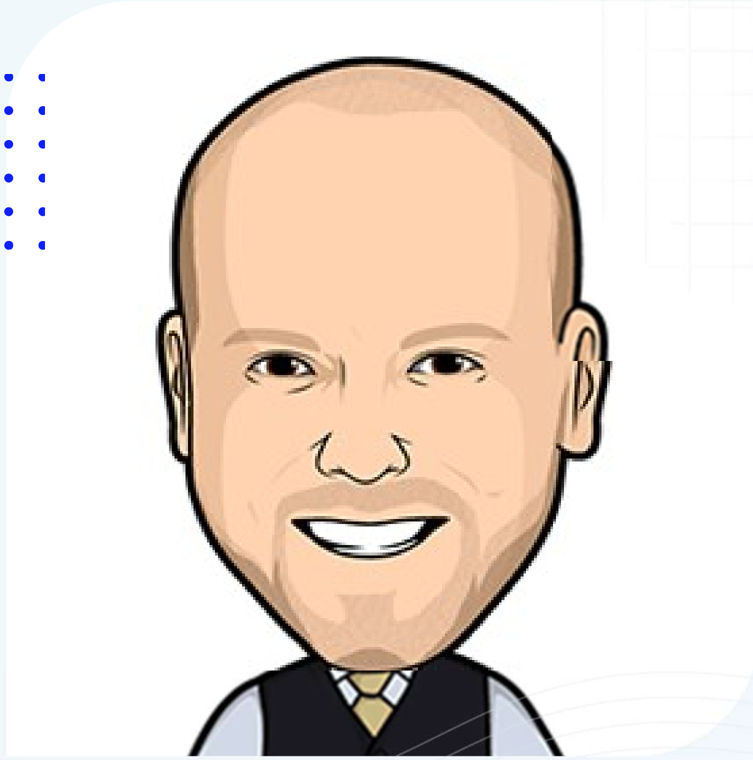
When it May Make Sense

- The perfect storm is when the beneficiary:
  - Is not too young
  - Is not too old
  - Will remain in a high tax bracket
  - Will have fairly strong investment returns

06 Use Charitable Remainder Trusts to Replicate Many of the Benefits of the 'Stretch IRA'

When it May Not Make Sense

- Complex
- Loss of optionality
- Organizational expenses
- Operational expenses



Want to connect with this month's presenter?

Jeffrey Levine, CPA/PFS, CFP®, AIF®, CWS, BFA

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Questions?

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