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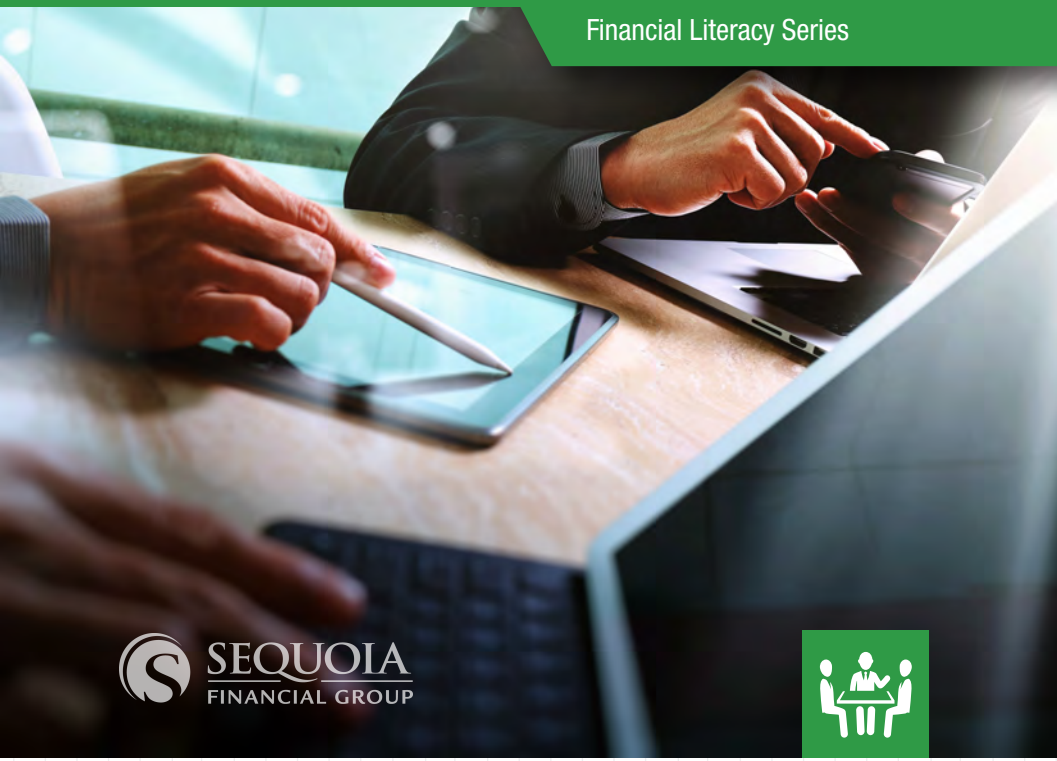

50 Good IRA Ideas

Making the Best Use of IRAs

Tax, Investment, Estate Planning and Roth Ideas

Leon LaBrecque, JD, CPA, CFP®, CFA

2020 UPDATES

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5th Edition

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Table of Contents

BONUS CARES ACT IDEAS FOR 2020 ONLY

TAXES

ROTH

BENEFICIARY

GIFTING

LEGAL

INVESTING

IDEA 1

Rule On 60-Day Rollovers

There is a relatively new rule from the Tax Court resulting from the case of Bobrow v. Commissioner of Internal Revenue which now allows only a single 60-day rollover per year[1]. Prior to this case, you could take a distribution from an IRA in your name (without withholdings), use the money for personal purposes, and roll it back into the IRA within 60 days without incurring taxes for using the funds. Before this ruling, a person could do this with more than one IRA, effectively allowing a series of tax-free loans from all of your IRAs. The IRS even indicated, in Publication 590, that you could do a 60-day rollover from each IRA separately. The Tax Court has since reversed this position and ruled that you may now take only a single 60-day rollover from a single IRA in any 12-month period. If you do decide to take a rollover (where you use the money), you may do so only once from only one of your IRAs within the 12 months.

There is an exception to this rule: if you provided your financial institution with the rollover check before the 60 days ended, and it was not deposited into your account on time purely because of administrative error by the financial institution[2], you can be granted a waiver to avoid taxes and penalties.

Part of the Coronavirus Aid, Relief and Economic Security Act (CARES) allows individuals to suspend their RMD for 2020. If you have already taken an RMD in 2020 you may be able to use the 60-day rollover rule to get those funds back into your account. If you have taken your RMD for 2020 (lump sum or period payments) you will have until August 31st 2020[3] to return the distribution to your account.

[1] Alvan L. Bobrow et ux., 107 T.C.M. 1110 (2014)

[2] 60 Day Rollover Waiver

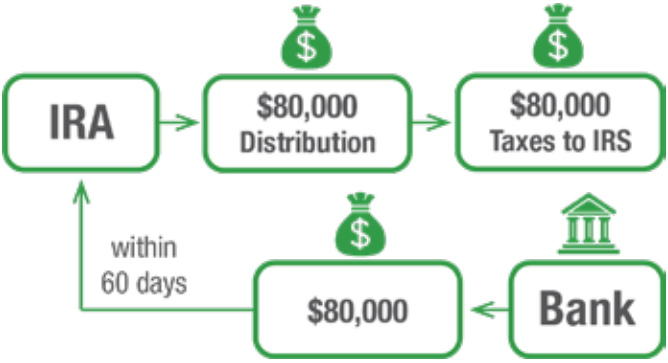
[3] Notice 2020-51

IDEA 2

Making Good Use Of The IRA Rollover Rule

Despite the restriction on multiple rollovers from multiple IRAs, there are good opportunities that fall within the parameters of the rule. IRA distributions allow the owner to withhold taxes on the distribution. If taxes are withheld from an IRA distribution, they are deemed to be equally withheld throughout the year. This can be of great benefit if estimates are underpaid.

Here's an example: Suppose Mr. Smith owes $80,000 more in taxes than he has paid estimates on. He has the money in the bank but missed two estimated tax payments. He will be penalized for underpayment if he catches up on the third estimate by writing a check. Instead, he takes an $80,000 distribution from his IRA and withholds 100%. Within 60 days, he rolls $80,000 from his bank account back into the IRA. The 60-day rule does take into account tax withholding, so the only rule is that if $80,000 comes out, $80,000 has to go back in. What is the end result? $80,000 of withholding will be deemed to have been made on a timely basis, thus no tax penalty would be assessed for missing a quarterly estimate.



IDEA 3

Rule On Inherited IRAs

In 2014, the Supreme Court made a landmark decision in the case of *Clark v. Rameker*[4]. The Court held that inherited IRAs were not subject to the asset protection of a regular IRA or spousal IRA. In this case, the daughter of an IRA owner inherited her mom's IRA. The daughter ran into business trouble with her husband and they declared bankruptcy. The creditors went after the IRA. The Supreme Court ruled that the IRA was subject to the claims of creditors. Now, we not only have to worry about the kids and possibly the spouse of the kids squandering our IRA, but the creditors of the kids getting the IRA. Fortunately, there's a solution, employ a conduit trust as the beneficiary. (For more information on setting up a conduit trust, and protecting your IRA assets for your beneficiaries, see Idea 4).

[4] Clark v. Rameker, 134 S. Ct. 2242 (2014)

IDEA 4

Protect The Kids From The Money And The Money From The Kids

In December of 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act[5] was signed into law. This act rescinded one of the most significant benefits of an inherited IRA, the stretch provision. Prior to SECURE, beneficiaries of inherited IRAs could stretch RMDs over their life expectancy, allowing continued tax deferral on the growth of the funds remaining inside the account. With the passage of SECURE all monies from the inherited IRA must be distributed by the end of the 10th year following the original owner's death. The only required distribution is in the final year. There are still exceptions to the SECURE Act's 10-year deadline, provided you are an eligible beneficiary. An eligible beneficiary is defined as:

- The surviving spouse of the IRA owner
- A disabled individual
- A chronically ill individual
- An individual who is not more than 10 years younger than the IRA owner, or
- A child of the IRA owner who has not reached the age of majority. When said child reaches the age of majority, the 10-year rule shall apply the year after the child reaches the age of majority

With the accelerated distribution requirements and the far-reaching implications of the Supreme Court case, *Clark v. Rameker*, the use of an IRA Conduit Trust may be beneficial.

This type of trust takes the RMD and distributes it to the beneficiary. Since inherited IRAs only have one mandatory distribution (in the final year), the trust needs to be written to accommodate this. Trust language should allow trustee discretion to take a discernable amount each year depending on individual circumstances with the provision that any mandatory distribution be taken.

The Conduit Trust protects the IRA from the beneficiaries taking out too much too soon or too much at the end, but what about creditors? Inherited IRA assets are not protected from creditors unless expressly authorized by your state law. A well-constructed IRA trust will have a spendthrift clause to protect the assets of the IRA. This clause will keep creditors away from the IRA balance. If the trust provides that the distribution is made to the beneficiary, the beneficiary can obviously collect on the distribution, but the spendthrift clause keeps the creditors at bay.

IRA trusts should be done on a per-account basis. Each kid should have either their own trust or a sub-trust which is part of the main IRA trust. I use a sub-trust for my kids.

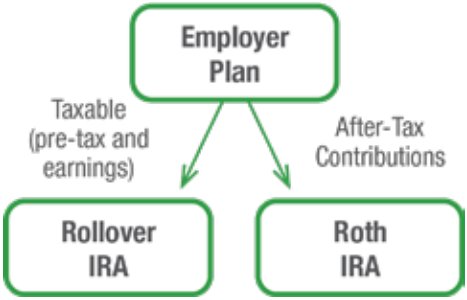
There is another kind of IRA trust, called a 'Toggle' Trust. Here, the trustee can take the distribution into the trust and either give it to the beneficiary or retain it in the IRA trust. This might be used when the child or grandchild has credit or personal problems. (Lots of complexity and tax issues here.) In all cases, use a separate IRA trust rather than a revocable living trust, and in the case of a 'toggle' trust, use an expert to draft the trust language.

[5] Inherited IRAs created before the start of 2020 are not subject to the new SECURE rules and can continue to be stretched over the beneficiary's life expectancy.

IDEA 5

Double Your IRA Firepower If You Have After-Tax Money In A Qualified Plan

There's a rule, IRS Notice 2014-54[6], that addresses how to handle after-tax contributions in a qualified plan. Who has after-tax contributions? Some notable organizations, Ford (SSIP) and GM (SSPP), for example, have allowed their salaried employees to make after-tax contributions to their 401(k) plans for years. Many municipalities have after-tax contributions to their pensions for police and firefighter annuity withdrawal. This new rule says you can roll over the taxable portion to a regular IRA and rollover the after-tax portion directly to a Roth IRA. This is a fabulous planning opportunity, since it takes the taxable monies and defers the tax on the earnings and contributions *and* allows the after-tax monies to grow tax-free while being held within a Roth. This means that you need to direct the plan to conduct two rollovers, one to the conventional Rollover IRA and one to your Roth.



[6] Notice 2014-54, 2014 I.R.B. 670

IDEA 6

Watch Out For Hard-To-Value Assets

The forms used by the IRS to indicate IRA assets and distributions (Form 5498 and Form 1099-R) now contain a new box for certain assets like real estate (see Idea 32) or under-traded securities, and limited partnerships. Be careful when using those assets in an IRA and consider whether holding them is worth the possible IRS scrutiny. The problem lies in valuation. Suppose I have a non-traded Real Estate Investment Trust (REIT) in my IRA. I bought it for $50,000 and my broker shows it as being worth that amount. In reality, it is only worth $28,000[7]. Under these circumstances, when I attain age 72 and need to take a $50,000 Required Minimum Distribution (RMD). I take the REIT as my distribution (you can take RMDs in-kind, see Idea 21). The IRS audits me (because the new Form 1099-R requires the custodian to tell the IRS that I took a hard-to-value asset distribution) and determines that my distribution was too small. I get fined 50% on the portion I failed to take as an RMD (50% of the $22,000). A solid suggestion is to consider selling those assets, unless they are a critical part of your IRA and you intend to potentially take it to the mat.

[7] Frequently, non-traded assets are valued significantly different than their purchase price. Broker-dealers will typically report them at original cost.

IDEA 7

An Oldie And Goodie, The Qualified Charitable Distribution

This particular idea has been granted and rescinded a number of times by the year-end whims of Congress but has now been made permanent. If you are age 70½ or older, you can give an IRA distribution directly to a qualified charity. This scenario is valuable from a tax standpoint because you don't include any portion of the Qualified Charitable Distribution (QCD) in your income. Maintaining lower Modified Adjusted Gross Income (MAGI) and Adjusted Gross Income (AGI) by employing QCDs could prevent increases in the taxability of Social Security benefits and increased Medicare premiums (The QCD is not included in either MAGI or AGI). You can contribute up to $100,000 per year via a QCD. It reduces gross income for federal and almost every state income tax. Charitable contributions after attaining 70½ made from a qualified account, must be payable directly to the charity[9]. You may not donate to a Donor Advised Fund, Private Foundation or charitable trust.

The SECURE Act allows individuals with earned income to contribute to their IRA past age 70½. If you are planning to make a QCD and decided to contribute a tax-deductible amount to your IRA, there are some issues. Any tax-deductible contributions made after 70½ will disqualify the standard QCD rules, and any charitable distribution up to the post 70½ contributions would be included in income with a below the line charitable deduction. While you may arrive at the same deduction (depending on whether you itemize deductions), the distribution would not be as advantageous as the standard QCD as this could increase income levels, potentially resulting in increased Social Security taxability and Medicare premiums.

Here's an example: Tom is 70½, has earned income and would like to make a $7,000 tax-deductible IRA contribution for the next two years. At 72 his first RMD is going to be $8,000, and he would like to make a QCD to his favorite charity for the entire RMD amount. Since Tom has made $14,000 in tax-deductible contributions after 70½, his QCD is completely "rejected" and will be included in income and can be used as a below the line charitable deduction. At age 73 Tom's RMD will be $9,000, and he still would like to use a QCD to donate to charity. Since he only has $6,000 left in post 70½ tax-deductible contributions ($14,000 - $8,000 = $6,000), only part of his QCD will be "rejected." He will have $6,000 treated as a taxable distribution and included in income (with an above the line deduction of $300[10] and a below the line charitable deduction of $5,700), and the remaining $3,000 will be treated under the normal QCD rules and not included in income. Going forward if he does not make any further post 70½ tax-deductible contributions, all of his QCDs (provided he follows the rules) will be qualified and not included as a part of income.

[8] I.R.C. §86(a)(2)

[9] I.R.C. §408(d)(8), §408(d)(8)(B)(i)

[10] CARES Act includes a provision to allow an annual $300 above the line charitable deduction

IDEA 8

The Kid Roth

Roth IRAs grow tax-free. The power of compounding interest is amazing, and the power of tax-free compounding is even more amazing. The longer you have a Roth, the better it gets. Suppose a 16-year-old child has a summer or part-time job and earns over $6,000 for the year. Suppose the child does this through college until age 22. During that time, Mom or Dad (or maybe Grandma or Grandpa) deposit $6,000 in a Roth for said youngster, putting it in an index fund. For purposes of my example, let's say they put it in at the beginning of the year. Suppose the investment makes 7.5% annually. By the time the kid reaches 22, the Roth would contain about $57,000. If we left that alone until the kid was 65, the Roth would be worth over $1,270,000, all from seven $6,000 contributions. Did I mention that's $1,270,000 tax-free? What would happen if we could instill in said child the notion of saving for retirement and encourage the kid to keep making their own Roth contributions until age 65? Even if the limits on contributions never changed, the kid would have $3,112,000 at 65. If (s)he took out 4%, that's over $124,400 a year tax-free during his/her retirement years.

IDEA 9

The Mom Roth

Roth IRAs work best when the deposits are from a low tax bracket and withdrawals are from a high bracket. So, here's a use for a Roth conversion where an IRA holder (like a parent) is in a low bracket and the beneficiary is in a high one. For example, a client's mother was in her 80s and in a nursing home, with significant long-term care expenses (which can be deducted as an itemized deduction). She had a conventional IRA and was taking Required Minimum Distributions (RMDs). Her tax bracket was effectively zero. All her children were paying taxes. We converted her conventional IRA into a Roth in two steps, both gearing to get her into the 10% bracket. The end result was essentially a tax-free Roth and no more RMDs. In this case there was enough money outside the Roth to pay for the mother's care. Otherwise, Mom could have been penalized if she withdrew from the Roth within 5 years of the conversion. This is a good example of a low-bracket taxpayer (mom) converting for the benefit of a higher-bracket beneficiary.

IDEA 10

Top Your Bracket

Roth conversions are best when the conversion is made in a lower tax bracket. A lot of folks don't understand that if they have an IRA, they will probably be in a higher tax bracket at some point. The reasons include:

1. The simple mechanics of Required Minimum Distribution (RMD) calculations. The RMD calculation is a fraction where the numerator is the IRA balance at the end of the previous year and the denominator is the life expectancy from an IRS table. It should be obvious that your life expectancy gets shorter as we age (Note: My favorite IRS quote out of Publication 590[11] is 'when you die, your life expectancy is zero'). Quite simply, this means an IRA distribution will get bigger and can get considerably larger, if the IRA investment earns a return greater than the distribution. Simply put, IRA distributions will generally increase in size, and you must begin taking them at age 72.

2. The simple mechanics of spousal mortality. Many IRA owners are married, and the IRA constitutes a portion of the couple's retirement wealth. Barring some mutual tragedy, one spouse will die first, leaving the IRA to the other. The survivor will likely file as a single person, and most likely be paying taxes in a higher marginal tax bracket.

Knowing this, we can project your RMDs and your tax bracket. For people below age 72 and over age 59½ who don't need the money, each year we like to convert an amount high enough to 'top off' the tax bracket.

Here's an example: Suppose Helen and Joel are below age 72, have a significant IRA ($1M), collect a couple of pensions and two Social Security benefits. Their adjusted gross income, without any IRA withdrawals, is $70,000. This includes the taxable portion of their Social Security benefits. They are squarely in the 12% tax bracket. We'd point out to them that their RMD will probably be over $40,000, which will take them into the 22% bracket. We'd suggest moving some of the

IRA into a Roth at the lower 12% rate. How much? Well, it depends on everyone's individual circumstances. In this case they could convert about $35,050 if they used the standard deduction (Starting at the top of the Married Filing Jointly 12% bracket, $80,250 for 2020, add the standard deduction for a married couple, $24,800 for 2020, for a total of $105,050, and subtract the current assumed AGI in this example of $70,000). This would cost them about $4,206 in federal taxes (they may pay state taxes too, depending on their state). They clearly should pay the taxes on the Roth conversion from non-IRA sources.

The ideal "bracket top" is a younger retiree who doesn't need the money, possibly before collecting Social Security. We like to analyze Social Security strategies (meaning deciding when to begin taking the benefit) and find that delaying collecting benefits (e.g., to age 70) can be a lucrative strategy. For someone temporarily in a lower bracket, or for someone who can control their income, the bracket topping can be very valuable.

Here's an example: Crassius and Evita are 62. They sold their business and have ample assets to live on, which are primarily invested in municipal bonds and dividend paying stocks. They have analyzed their Social Security strategy and have determined that the best approach is to each delay their benefits until age 70. Their current adjusted gross income is about $40,000, of which all are qualified dividends (they also receive $50,000 of municipal bond interest which is tax-free). Right now, their tax rate is effectively zero, since the dividend tax rate for taxpayers in the 12% bracket is zero and municipal bonds are exempt from income taxes. They can likely convert about $64,800 into a Roth. This will cost them about $7,776 in federal taxes and will still keep their dividends tax-free. They can do this each year until age 70, for a total of 8 years. When Crassius and Evita claim Social Security at age 70 they would have combined Roth IRAs worth (at 6% growth) about $680,000 and would have only paid about $62,208 in federal taxes.

[11] Distributions from Individual Retirement Arrangements (IRAs), Pub. 590-B

IDEA 11

Create A Roth Placeholder

If you are currently contributing (or have previously contributed) to a Designated Roth Account (DRAC), you may be in for surprise at retirement when you try and roll your funds out of the account and into a Roth IRA. Roth IRAs and DRACs have a required 5 year holding period that starts on January 1st of the year the first contribution is made. Even if that contribution were to hit in December, they would still get credit for the entire year. This 5-year rule starts the clock running for when the account owner can make tax free withdrawals of earnings from their Roth IRA. Keep in mind that contributions will always come out tax-free.

In order to avoid any issues, open and fund a Roth IRA with any amount up to the annual maximum of $6,000 ($7,000 for 50 and older). If you are unable to contribute to a Roth IRA due to phaseouts (see limits in Idea 12), another way to start the clock could be a Roth conversion from a traditional IRA; you could convert a very small amount just to get the account open and funded!

IDEA 12

How To Have A Roth If You Make Too Much

Here is one idea I use for myself. Contributory Roth IRAs have an income limit (for a married couple filing jointly, $196,000 - $206,000; single, $124,000 - $139,000, etc.[12]); nondeductible IRAs do not. Roth conversions have no income limit. I simply make a contribution to my nondeductible IRA and convert it to a Roth later with no tax effect. Voila! I have a Roth.

Some important points: First, note that this is a conversion, not a contribution. Conversion rules apply. Make sure you file a Form 8606[13] and a Form 5329[14] correctly on your tax return. Second, and this is important; to make this conversion tax-free, you should not have any other IRAs. When you convert an IRA to a Roth, all IRAs are aggregated. So, if you only have a nondeductible IRA with $6,000 of after-tax contributions in it and no other IRA assets, that conversion is wholly tax-free. However, if you have $6,000 of nondeductible after-tax contributions in your nondeductible IRA and $54,000 of taxable funds in a Rollover IRA, you will have a taxable conversion for 90% of the nondeductible IRA, even though you only converted the nondeductible IRA. Ed Slott calls this the 'cream in the coffee' rule. You can't get the cream (the taxable part) out of the coffee. You can make this work if you participate in a 401(k) or 403(b) by rolling your Rollover IRA into your 401(k), which will leave you with only nondeductible IRAs, then you can have an unconventional Roth IRA.

[12] IRS Publication 590-A (2019)

[13] Form 8606, Nondeductible IRAs

[14] Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts

IDEA 13

New Tax-Advantaged Way To Pay Alimony

The new tax law makes alimony in divorces after 2018 (or arrangements modified after 2018) nondeductible. Prior to the new rules, alimony was deductible by the person who paid it and taxable to the person who received it. Under the new law, it is non-deductible and nontaxable. This new rule makes it possibly more attractive to use an IRA to pay the equivalent of alimony. To take advantage of this opportunity, the payer would give the payee an IRA as the equivalent of a lump sum of alimony. Would it work? Yes, if the payee is in a lower bracket. A problem could exist if the payee is under 59½ and needs the money immediately. On the other hand, it could be a big benefit if the payee spouse is over 59½ or doesn't need the money for a while. The transfer of IRAs between spouses in a divorce is tax-free, and the IRA to the payee could keep growing.

IDEA 14

Fund Your HSA With Your IRA

Health Savings Accounts (HSAs) are a widely misunderstood planning tool. An HSA is available to individuals enrolled in a high-deductible health plan. You contribute pre-tax dollars to an HSA and withdraw the monies tax-free, as long as they are used for qualified medical expenses. There is no time limit on an HSA, so you can invest the funds tax-free, as long as the funds are eventually withdrawn for medical purposes. Medical receipts may be retained and used later, and HSA withdrawals can be used to pay Medicare B and D premiums. Some investors keep a file (with an on-line backup) of medical receipts for future use.

What a lot of folks don't know is that you can use an IRA to fund an HSA tax-free and penalty free. You can transfer no more than what the investor could have contributed to the HSA for the year. For 2020, that amount is $7,100, with an HSA catch-up of $1,000 for investors age 55 or older.

Worth it? If you moved $8,100 from your IRA into your HSA at age 55 (and didn't use it, but invested it at 6%), and retired at age 65, you'd accumulate about $14,500 tax-free. If you left that same amount in your IRA and withdrew it at a 22% bracket, you would have only about $11,315.

This is a one-time-only deal, but it's worth considering.

IDEA 15

In-Service Rollover

If you are working and at least 59½, and have money in a 401(k), you may be able to do what's called an in-service distribution from your 401(k). Your 401(k) plan can include provisions to allow you to roll out of the 401(k) and into an IRA, but new rules allow you to access profit sharing and employer contributions if:

1. The money has been in there for at least 2 years, and

2. You have been a participant for at least five years (or the plan documents allow earlier)

The further good news is that you can roll any after-tax contributions to a Roth IRA and roll your pre-tax contributions to a conventional IRA. Many people choose an in-service rollover to access a wider range of investment options than are available in their employee plan. IRAs traditionally allow a very broad range of investments.

IDEA 16

The Roth Estate Tax Reducer

If you have a taxable estate (for 2020, figure approximately 40% of everything above $11.58M for single tax filers, or $23.16M for joint tax filers), converting a conventional IRA (Traditional, Rollover, SEP) could reduce the overall estate tax. Keep in mind that these current levels are set to sunset starting in 2026 and will be reduced to the prior exemption levels adjusted for inflation which is expected to be around $6.8M for an individual and $13.6M for joint tax filers. It may seem counter-intuitive, but pre-tax IRAs would be double taxed to filers that are exposed to estate tax; once at the estate tax level, and again when the beneficiaries of the retirement account take distributions after inheriting the account. By converting to a Roth IRA, the owner will pay income taxes on the conversion which will reduce the amount of the estate that would be subject to estate tax upon the owner's death.

Here's an example: Janet has a taxable estate and is single. She is 76 years-old and will probably live to age 90. She has $14M in assets, $2M of which are held in a Traditional (Rollover) IRA. Let's assume her IRA will grow at 6%, less the RMDs, which will go away if she converts the entire IRA to a Roth IRA. Let's also assume her non-IRA assets grow at a rate of 3%. She is taking RMDs on her IRA of about $95,000 a year, these distributions are getting larger because of the RMD rules. For Janet, doing a conversion will reduce the estate taxes by the income taxes paid on the Roth conversion, and the family will enjoy tax-free growth and distributions from the Roth upon inheriting the account.

To make it work, Janet will pay the taxes on the conversion from non-IRA funds.

Here's the math:

	No Roth Conversion		
Age 76	**IRA**	**Other**	**Total**
(Pre-Conversion)	$2,000,000	$12,000,000	$14,000,000
Age 90			
(Reinvest RMD)	$1,872,627	$20,264,842	$22,137,469
Estate Tax			$5,794,988
Income Tax on IRD	($393,252)		($393,252)
Net			**$15,949,229**

	Roth Conversion		
Age 76	**Roth IRA**	**Other**	**Total**
(Post-Conversion)	$2,000,000	$11,300,200	$13,300,200
Age 90			
(Reinvest RMD)	$4,655,487	$17,870,260	$22,525,747
Estate Tax			$5,950,299
Income Tax on IRD	0		
Net			**$16,575,448**

*This does not include state income or estate taxes

Bottom line for Janet's family is a net savings of at least $626,000 in total taxes, not counting the advantage of tax-free income to the kids or other beneficiaries.

IDEA 17

Use Your Required Minimum Distribution To Pay The Taxes On A Roth Conversion

This is a simple idea for people who have unwanted Required Minimum Distributions (RMDs) (unwanted meaning they don't need the money). Simply put, the idea would be to take the amount of the RMD and fully withhold on it, converting the appropriate amount to a Roth to use up all of the tax or the RMD.

Here's an example: let's say I am in the 22% bracket, and my RMD is $18,000, I would withhold $18,000 in tax and convert $63,818. My IRA would be reduced by the RMD of $18,000 and the $63,818 Roth conversion, total $81,818. 22% tax is $18,000, or the RMD.

This idea is incredibly relevant for 2020 due to the passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act[15] as one of the main provisions of this Act suspends the 2020 RMD. This is a great time to take what would have been a required distribution and complete a Roth conversion.

[15] 2020 CARES Act

IDEA 18

Almost Always Pay Taxes On Conversions Out Of Other Non-IRA Funds

This idea is simple. When you make a Roth conversion, or convert traditional taxable IRA funds into a tax-free Roth, you will have to pay taxes on the conversion. To maximize the conversion, you should pay the taxes out of non-IRA funds. Otherwise, the Roth becomes very similar to the IRA you transferred from, because you effectively made a distribution and Roth contribution of the after-tax distribution. Pay the taxes from somewhere else, but not the IRA.

There are certain instances when paying the taxes with outside assets may not make sense but consult with an advisor for your specific situation.

IDEA 19

When To Take A Spousal Rollover And When Not To

When you die, if your spouse is named as your primary beneficiary, your spouse can roll your IRA into their IRA as a spousal rollover[16]. The spousal rollover is a good idea in many cases. The spouse treats the IRA as their own, so they can start taking their Required Minimum Distribution (RMD) when they reach age 72. For a younger surviving spouse, this can be a big advantage, since they don't have to take the distribution until they reach 72. Suppose Julie, age 60, survives Henry, age 72. Julie can roll Henry's IRA to hers and is not required to take distributions until she reaches age 72. When she does take her RMDs, she uses a more favorable life expectancy table to compute the distributions. If the IRA were worth $500,000 and she earned 6%, the IRA would be worth about $1M when she reaches age 72. She would then withdraw it using the RMD table, resulting in an RMD of about $39,000. If Henry left his IRA to a 60-year-old non-spouse, that person would have to begin to take distributions so that the entire account balance is distributed by the tenth year following Henry's death. Higher accumulations are available with a spousal rollover.

However, a spouse may not want to use the spousal rollover when the surviving spouse is under 59½. If the surviving spouse is under 59½ and needs the money, the exemption to the 10% penalty (for withdrawal before age 59½) for distribution upon death is better than the distribution options available under a spousal rollover. However, the surviving spouse may have to take RMDs of their own, and their options upon the spouse's death are limited.

Another situation might arise when the surviving spouse is much older than the decedent: Suppose in my example above, Julie had died before Henry. Henry may be better off leaving Julie's plan alone and taking her RMD when she would have attained the age of 72. This is because a surviving spouse can take distribution on the required beginning date of the deceased person[17], which is typically September 30 of the year after the year the deceased died.

Roth IRAs are not subject to RMD rules and as such, allow additional tax-free growth by using the spousal rollover. Another consideration is that inherited IRAs[18] may be subject to the claims of creditors, but spousal Rollover IRAs are not. If there is an asset protection issue, the spousal IRA affords more protection.

[16] I.R.C. §408(d) (3); Treas. Reg. 1.408-8. Q&A 5(a)

[17] I.R.C. §401(a)(9)(B)(iv)(I); Treas. Reg. 1.401(a)(9)-3, Q&A 3(b)

[18] State Inherited IRA Chart - American College of Trust and Estate Counsel (ACTEC)


IDEA 20

Age 72 And The First Required Minimum Distribution

RMDs have seen a lot of changes in 2020 due to the passage of the SECURE Act and language in the CARES Act. The SECURE Act increased the RMD age from 70½ to age 72[19] (with the first still required by April 1st following that birthday) and due to a provision in the CARES Act all 2020 RMDs have been suspended. Thus, if Maurice turns 72 on June 12, 2021, he could take his first RMD during 2021, or wait until April 1, 2022. But if he does that, he will have to take an RMD for both 2021 and 2022 in the 2022 tax year. Normally, taking two distributions in a tax year would have double the tax liability. However, in certain circumstances, it might make sense. For instance, taking the RMD in the first possible year (2021 in the example above) might cause Social Security benefits to be taxable. The timing of the first year RMD provides an opportunity for tax planning.

If you turned 70½ by the end of 2019, your RMD will fall under the pre-SECURE rules and you will be required to take an RMD for the 2020 year – though the CARES Act suspended RMDs for 2020.

[19] I.R.C. §401(a)(9)(C)

IDEA 21

Required Minimum Distributions In-Kind After Age 72

If you are taking Required Minimum Distributions (RMDs), you can take distributions in-kind. The distribution comes out at fair market value and that is the basis of the distributed asset. If you had XYZ fund or stock in your IRA and you wanted to keep it, you could take it as a distribution. You'd save the commission or costs, plus you may want XYZ because you think it has appreciation potential. It also stops you from selecting investments you may not want to sell and allows you to take the subsequent appreciation as capital gains.

Reminder, due to the CARES Act, there are no RMDs for 2020.

IDEA 22

Take Your Required Minimum Distribution At The End Of The Year

Once you are subject to a Required Minimum Distribution (RMD), you can take it any time during the year. You must take it, or you will be subject to a 50% penalty. The question then arises, when is the best time to take the RMD? The market has traditionally experienced an upward bias, so we ran a hypothetical case with real numbers. We took an IRA with 60% in the Vanguard S&P 500 index fund and 40% in the Vanguard Total Bond Index. We used the current Table III[20] chart (note that in our example, this chart was only used for distributions in 2003 or after) and the real returns from 2000-2019, presuming that the IRA holder was 72 at the beginning. There are studies that show the timing of deposits or withdrawals diminishes over time, so we weren't sure what to expect. Here are the results, assuming you started 20 years ago in a 60% equity/40% bond portfolio:

	Beginning of year Withdrawal	End of year Withdrawal	Monthly Withdrawal
Total RMDs	$1,121,288	$1,154,936	$1,140,130
Ending Balance 20 yr	$1,035,622	$1,127,234	$1,086,150
Total	**$2,156,910**	**$2,282,170**	**$2,226,280**

Conclusion? The end of year RMD withdrawal left a higher balance than the other two options. In total, using the same investments and calculations, the end of year withdrawal produced a total wealth increased by $55,890 and a balance that was $41,084 larger.

Would we always recommend taking the RMD at the end of the year? Of course not. If you need the RMD, you'd be better taking it monthly. If you had a designated use for the RMD, like an annual family vacation, or gifts to grandchildren, take it and the associated cash flow. If you had a terminal illness and death looked probable, the RMD would be better taken before death to help the beneficiaries. Similarly, if the IRA owner were in a low tax bracket and the beneficiaries were in a higher bracket, taking the RMD and possibly bracket topping with a Roth (see Idea 10) would be something to consider.

[20] IRS Uniform Lifetime Table

IDEA 23

If You Want It To Last, Only Take The Required Minimum Distribution

The Required Minimum Distribution (RMD) calculation is based on a joint life expectancy table of an owner and someone ten years older. This is how the calculation works: the previous year-end IRA balance divided by your life expectancy from the IRS table (Table III) based on your age at year-end. The IRS table indicates the life expectancy at age 72 is 25.6 years. If your 72 birthday was 1/1/20 and you had an IRA balance on 12/31/19 of $500,000, your RMD would be about $19,531 ($500,000/25.6).

Note that if your beneficiary was younger by more than 10 years, you would use a different table that would establish a smaller RMD (Table II). The RMD table is aimed at making it so the IRA cannot run out of money (theoretically it could if the IRA investments went to zero in a year). Taking only the RMD assures that you should always have some distributions from the IRA and the tax bite from the IRA is as small as it can be. This is in keeping with the goal of keeping the IRAs (and Roth IRAs for that matter) alive as long as possible.

IDEA 24

Watch State Tax Laws On Distributions And Conversions

Here's an idea based on something a lot of folks tend to forget, especially on Roth conversions: you pay federal tax on distributions, including conversions to Roth IRAs. You also will probably pay state tax on a conversion. State income tax rates vary from the wonderful rate of zero (Alaska, Florida, Nevada, South Dakota, Washington State, Wyoming and Texas) to some pretty high rates, like 8.82% in New York, or 12.3% in California (or 15.8% if you make an early withdrawal, and 1% higher if you make over $1M), in 2020.

In addition, many states have exclusions for certain parts of distributions. For people who may have residency in multiple states, like Florida and New York, changing residency before significant withdrawals or conversions can make a big difference. This is particularly true in cases where a large conversion is anticipated, like for estate tax purposes. If you work in California and plan to retire in Nevada, the taxes on your retirement income would look quite a bit different.

IDEA 25

Use The Substantially Equal Periodic Payments (SEPP) Exemption To Avoid The 10% Early Withdrawal Penalty

IRAs are subject to the rule that funds must remain in the IRA until age 59½. There are a variety of exceptions to this rule, including some exceptions only appropriate for IRAs (See Idea 46 for example). One significant exception is the Substantially Equal Periodic Payment (SEPP), or §72(t) exemption. This provides that you may withdraw from an IRA at any age provided you take a series of substantially equal payments over a period associated with your life expectancy. The series of payments cannot be modified for a period of the longer of the time period in which you attain age 59½ or 5 years. If you begin a SEPP at age 52, you must continue it to age 59½. If you begin a SEPP at age 57, you must continue it until age 62 (5 years).

There are three methods of taking the SEPP:

1. You may use your life expectancy under the IRS Single Life Expectancy Table. You take the distribution in a manner similar to the calculation of an RMD: You divide the balance in the IRA by your life expectancy. Each subsequent year, subtract one year from the life expectancy. For example, if you were 53, you would take the IRA balance and divide it by 31.4. If the IRA were worth $500,000, your SEPP would be $15,924.

2. You may use the life expectancy table and the §7520 rate[21] to determine an amortized distribution. If the interest rate for calculation was 2.04%, the amortization method would produce a SEPP for a $500,000 IRA on a 53-year-old owner of $21,721.

3. You may also use the fixed annuitization method. For the above example, this method would produce a SEPP distribution of $21,617.

Do not modify the SEPP stream once it is calculated. Modification means increasing, decreasing, stopping or transferring into or out of the SEPP IRA. You must leave the IRA alone for a time period equal to the longer of 5 years or number of years to attain age 59½.

You can get a one-time Mulligan for a SEPP calculation. Rev. Rul. 2002-62 permits a one-time change in the calculation method used[22]. Thus, if the market made a significant change in the IRA value, or your facts and circumstances changed, you could make a one-time change from whatever method you used to the life expectancy under the IRS Single Life Expectancy Table (similar to a RMD calculation).

You also should know with SEPP that the calculation is done on a per-IRA basis. If you were 53 and had a $1,000,000 IRA, but only needed about $21,721, you could split the IRA and take a SEPP on a $500,000 IRA and leave the other to grow. You can have as many SEPP calculations of separate IRAs as you want. If you start a new SEPP calculation, the rule of 5 years or age 59½ testing applies to each calculation. All in all, the SEPP exception is a good way to access IRA money early if you need it, but it's like the mercury lights we used to have in the school gym way back in the 60s, once you turn it on, you have to leave it on, for the longer of 5 years or age 59½.

[21] I.R.C. §7520(a)(2)

[22] Rev. Rul. 2002-62, 2002-2 C.B. 710

IDEA 26

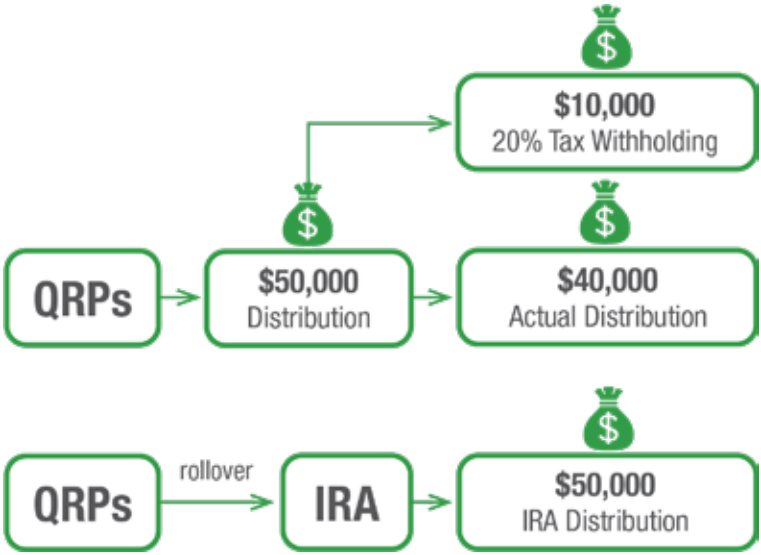
Use A Qualified Plan (401(k), §457(b) Or 403(b)) To Dodge Required Minimum Distributions

Traditional IRAs mandate Required Minimum Distributions (RMDs) to begin at age 72. If you are over 72 and still working at a company that you (or a spouse or child) don't own 5% or more of, you can roll your Traditional IRA into a 401(k), §457(b), or 403(b). You're not required to withdraw from those plans until after you retire. Remarkably, the IRS does not define 'retirement' anywhere. Probably getting a W-2 indicates you are not retired. This tip allows us to defer RMDs.

IDEA 27

Use An IRA Rollover To Avoid 20% Withholding On A Qualified Plan Distribution

Qualified Retirement Plans (QRPs), like 401(k), §457(b), or 403(b) plans, must withhold 20% on any distributions. So, if you had $50,000 in the plan and wanted to take it all out, the plan is required to withhold $10,000 ($50,000 x 20%). Suppose you had significant losses, like a Net Operating Loss on a business, or very large itemized deductions, you could avoid the withholding by rolling or transferring the QRP to an IRA, then making an IRA distribution. You can elect to have no withholding on an IRA distribution.



IDEA 28

Make IRA (Traditional Or Roth) Contributions After Age 72

Thanks to the passage of the SECURE Act, individuals with earned income (or who are married to someone with earned income) can make IRA contributions (both Traditional and Roth) after their RMD age of 72. If Tom is 73 and retired, married to Laurie, who's 60 and working, they can both contribute to an IRA, subject to the income limits. However, if you plan on making QCDs be careful of the anti-abuse rules for traditional IRAs (see Idea 7).

IDEA 29

You Can Finance A New Business With Your IRA, But You Probably Shouldn't

Many 9-to-5 workers dream of being able to stop working for someone else and start their own business. It has become harder to obtain credit these days, especially for a new small business, so people look for alternative ways to access the monies needed to fund their start-up. Generally, if you use IRA assets to purchase assets in a business you control, or use the funds as a guarantee on a loan on your business, it will be considered a prohibited transaction and will cause the funds used to purchase the asset to be considered a distribution and be taxable (as well as subject to a penalty if before age 59½). There are plans that have been promoted as ways to use an IRA that will ultimately own the business. This transaction is called a Rollover as Business Start-Up or ROBS transaction. A ROBS transaction is fairly complex and can lead to significant tax penalties if completed incorrectly.

Let's say you have an IRA you rolled over from an old 401(k) that you have never added new contributions to. If you didn't comingle funds from any contributory IRAs, you'll be able to roll this into a new 401(k) plan. In order to do this, you would set up a C Corporation to own the new business venture and have that C corp. create a retirement plan such as a 401(k). As the owner of the company you certainly can participate in the 401(k) plan, so you roll your IRA into the new 401(k). With the funds you rolled over, you now buy the company stock in the closely held corporation you just created. The C corp. that owns your start-up business now has cash from the sale of its stock to your 401(k) and you can now use it to fund the business.

While this may seem like a good way to access the funds in an IRA or other qualified plan to use as start-up capital, there are a number of issues connected to a ROBS transaction. The first is cost. Due to the complexity of the transaction, a number of experts will have to be engaged to facilitate the transaction like CPAs, lawyers and advisors that specialize in ROBS funding, and administrators for the new 401(k). Each of these professionals will charge fees. In addition, a Form 5500 will have to be filed every year on the plan even if the value is less than $250,000.00[23]. The IRS is looking at ROBS transactions very carefully. While they have not yet ruled them prohibited transactions, there has been growing scrutiny, which can lead to costly professional fees and even the potential of significant fines and tax liability. Lastly, even if all of that were not the case, a large number of new business ventures fail in the first few years. Is this really the most prudent investment for your retirement funds? With that conclusion, it seems like this is not a good IRA idea.

[23] This is because the exemption only applies for a plan in which the participants are the owner and/or the owner's spouse. Since a C Corporation has to be the owner of the company not an individual, the exemption for plans under $250,000.00 does not apply.

IDEA 30

Tracking Your Own Basis

Most of the time you do not really need to pay attention to the cost basis in an IRA. Generally, you pay attention to your contributions, if you are able to deduct them, and then to the withdrawals you make which will become part of ordinary income. However, there are some very specific situations in which the basis needs to be tracked, and it will most likely fall on you to do the tracking.

When you make a non-deductible contribution to an IRA, or rollover after-tax funds, the basis will come out tax-free when you withdraw those funds, otherwise you would be taxed twice on the same money. An IRS form 8606, Nondeductible IRA is used to track the basis and must be filed or you may incur penalties. With a normal nondeductible IRA contribution this is usually completed automatically in the year the contribution is made. The issue comes into play if you have made after-tax contributions to a company-sponsored plan and then roll it over into an IRA when you separate service. Generally, most people won't track this and once the funds are commingled in the rollover IRA it will be difficult to tell what the basis was. If you have a nondeductible IRA or after-tax money in a plan, make sure you do your homework.

IDEA 31

Pay Management Fees On A Roth IRA From Outside Sources

For Roth IRAs, it may make sense to pay management fees with outside funds, just like it makes sense to pay the taxes on a Roth conversion from outside funds. Roth IRAs are tax-free, and growth is the goal. Thus, paying fees with outside funds keeps more money in the Roth and allows the balance to continue its tax-free growth. On the other hand, regular IRAs are taxable. As such, taking the management fee from the taxable money effectively makes the fee fully tax deductible. You can pay investment expenses out of your own pocket and build the IRA, but on a Traditional IRA this is no longer deductible under the Tax Cuts and Jobs Act. You are now using taxable funds to build tax deferred funds.

Be careful with taking this tip too far, don't use your regular IRA to pay fees for other accounts, like taxable accounts or Roth IRAs. By doing that, you run into the risk of a prohibited transaction. Pay those fees from their respective taxable IRA accounts.

IDEA 32

Buy Actual Real Estate In Your IRA

You can buy property such as a home, building, or raw land in a self-directed IRA through IRA custodians that specialize in this market. On the surface, it makes sense that buying and selling real estate free of tax would be a good idea, but the following must be considered before going forward:

1. You lose many of the tax advantages of owning property. You cannot depreciate property in an IRA. If the real estate has a building or other depreciable asset on it, you lose a tax deduction.
2. Holding property long-term in an IRA does not necessarily make sense. Any gains on property held for more than one year in an IRA are still generally treated as ordinary income when taken from the regular IRA as opposed to long-term gain treatment. If you put real estate in a Roth IRA, the gain is tax-free, but long-term capital gains are still a tax advantage, being as low as 0% and as high as 20% or 23.8% if you add in potential net investment income tax.
3. You and your relatives are barred from working on the property. No "sweat equity," or you risk getting hit with tax evasion and/or prohibited transaction violations.
4. All improvements must be hired out to an unrelated party.
5. All expenses, renovations or upkeep must be paid for out of the IRA.
6. If you plan to rent the property, you generally must hire a manager to find tenants.
7. You should expect to pay cash for the home. Getting a mortgage with an IRA is very difficult and can trigger a tax on that portion of the income attributable to the financed part of the transaction, called Unrelated Debt-Financed Income[24].

8. If you have a loss, you cannot write that off. If you kept the property out of the IRA, you could.
9. There are not many companies that handle these types of IRAs. The cost to start-up and to maintain the IRA can be very high.
10. You and your family members are prohibited from using the property for any personal benefits. You, your spouse, or family members cannot buy the property from the IRA or sell property to the IRA. You must know and follow the Disqualified Persons Rules[25]. No family cottages in the IRAs.
11. The IRA custodian must keep track of, and report on, deposits, withdrawals and year-end balances.

With all the rules and tax disadvantages, who should consider buying real estate in an IRA? A very experienced real estate investor who flips houses or raw land (and the income earned is normally taxed as ordinary income, think parking lots or farmland) might consider this strategy. The investor would need a large IRA (ideally a large Roth IRA) in order to pay for, and possibly upgrade and maintain, the property. If using a contributory IRA, it would also make sense that the investor is currently in a high tax bracket and expects to be in the same, or a lower tax bracket, later. Finally, you must be very diligent in following the rules or you will lose IRA status and there will be severe tax consequences, including the investment being treated as a distribution (if under 59½, an added 10% penalty) and the participant being subject to a 15% excise tax on the amount involved for each year, plus additional penalties accruing for each year before the IRS catches the violation.

[24] I.R.C. §514(a)

[25] I.R.C. §4975(c)(1)

IDEA 33

Retirement Saver's Credit

The first year your child is over 18, no longer a dependent on someone else's return, or a full-time student is the year they are eligible for the "Retirement Savings Contributions Credit (Saver's Credit)." In 2020, the credit is either 50%, 20%, or 10% of your retirement plan contributions (up to $2,000 per individual) depending on your adjusted gross income (reported on your Form 1040 series return). If you gift your child $2,000 and they contribute it to a Roth IRA, then they can get up to $1,000 back when they file their tax return. That's an automatic 50% return! This isn't just for children either, although the AGI limits are easier to meet earlier in a career. Pay yourself and get paid from the government for doing so. Sounds like a good IRA idea to me.

Credit Rate	Married Filing Jointly	Head of Household	All Other Filers*
50% of your contribution	AGI not more than $39,000	AGI not more than $29,250	AGI not more than $19,500
20% of your contribution	$39,001 - $42,500	$29,251 - $31,875	$19,501 - $21,250
10% of your contribution	$42,501 - $65,000	$31,876 - $48,750	$21,251 - $32,500
0% of your contribution	more than $65,000	more than $48,750	more than $32,500

* Single, married filing separately, or qualifying widow(er)

Source: https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-savings-contributions-savers-credit

IDEA 34

Worried About Outliving Your IRA? Enter The Qualified Longevity Annuity Contract

The Qualified Longevity Annuity Contract (QLAC) isn't really a new type of annuity. It is simply a new tax treatment approved on July 1, 2014, by the Internal Revenue Service, for types of annuities that are purchased in Traditional IRAs, 401(k)s, and other approved retirement plans[26]. You designate and contribute a lump-sum up to 25% of your IRA or $125,000, whichever is less, to fund the QLAC. The insurance company tells you today exactly how much fixed annuity income you will begin receiving in the future, regardless of how long you live. The QLAC is excluded from your Required Minimum Distribution (RMD) calculations, which could potentially lower your taxes.

Here's an example: if you have a $600,000 Traditional IRA, you could fund a $125,000 QLAC (not $150,000) under the current rule. Your RMD would then be calculated on $475,000. There is no stock market or interest rate risk, therefore the principal is protected. QLACs allow you to defer as long as 15 years or to age 85. A QLAC has no annual fees. The commissions to the agent are built into the product, which can be very low when compared with fully-loaded variable or indexed annuities. Cost-of-living adjustment (COLA) can be attached to increase the annuity, if the insurance carrier allows it.

[26] Treas. Reg. 1.401(a)(9)-6

IDEA 35

Filing A 5329 To Set The Statute Of Limitations

IRAs are tax-favored accounts that are subject to many restrictions, which can translate to added risks in the form of tax penalties.

Here are a few examples: 6% penalty for excess contributions, 10% penalty for distributions prior to age 59½ (unless an exemption is applied), and a daunting 50% penalty if you fail to take a Required Minimum Distribution (RMD).

The federal income tax statute of limitations runs three years starting from the return due date or filing date, whichever is earlier. Here is the terrifying truth: If you did not file Form 5329, (Additional Taxes on Qualified Plans and Other Tax-Favored Accounts) by attaching it to Form 1040 or separately, the clock of the three-year statute of limitation in regards to an IRA penalty will not be set to start until the time the error is detected. In the 2011 case of *Robert K. and Joan L. Paschall v. Commissioner*[27], the Tax Court decided the Roth conversion the Paschall's did in 2000 was improper. The transaction was deemed as an IRA taxable distribution. The three-year statute of limitations for this unreported income had expired. However, the IRS treated the conversion as an excess contribution to the Roth IRA. Since form 5329 was not filed, the statute of limitations clock wasn't set. The IRS was able to impose a 6% penalty annually on this excess contribution. Doing a conversion? File Form 5329 with your 1040.

[27] Robert K. Paschall, 137 T.C. 8 (2011)

IDEA 36

Mind Your Beneficiaries

You should pay attention to the financial situation of your beneficiaries. For beneficiaries in a high tax bracket, leave them your Roth IRA, since the taxes have already been paid. For beneficiaries in a low tax bracket, leave them the Traditional IRA. If you want to leave an IRA to a charity, leave the charity a Traditional IRA. You should also pay attention when leaving an IRA to a 'special needs' beneficiary. Naming the special needs individual as a beneficiary could cause them to lose government benefits. It is better to name the individual's Special Needs Trust as the beneficiary and not the individual directly. Finally, think about the individual you want to name as a beneficiary: Are they a credit risk? Is there potential for a divorce? Are they physically or intellectually capable of managing the IRA? If any of these might apply, you may want to consider an IRA Trust (see Ideas 3 and 4).

IDEA 37

How To Write A Good Beneficiary Designation

A good beneficiary designation clearly states where your IRA will go after your death. You should name both primary and secondary beneficiaries. For married couples, the spouse is usually named as the primary beneficiary and the children as secondary or contingent beneficiaries. To name individual beneficiaries, give the complete legal name of each beneficiary. For multiple beneficiaries, you must also state the percentage of the IRA each will receive.

Here's an example: 50% to Jack Doe and 50% to Jill Doe. You can add 'per stirpes' after the name of an individual beneficiary if you want that beneficiary's children to receive the share if the beneficiary you named predeceases you. If you name a revocable trust as a beneficiary, you will need to give the name of the trust and the date the trust was created. Make sure your Revocable Trust has the correct language (see Idea 48). If you name an IRA trust as a beneficiary, you would use the following designation: "name of trust, date trust created, FBO name of beneficiary." Typically, the custodian of the IRA has a beneficiary designation form. If the custodian does not have a beneficiary designation form, you should give the custodian a written statement listing your beneficiaries.

IDEA 38

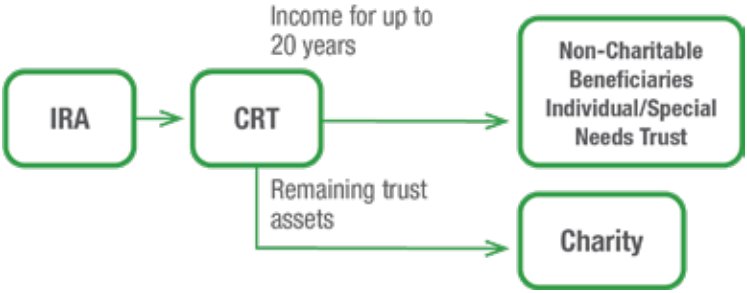
Leave Your Traditional IRA To Charity

For a taxable estate (e.g., above $23.16M per married couple or $11.58M per individual in 2020), the naming of a charity as a beneficiary has a double benefit. There are no income taxes to the charity and there are no estate taxes on the gift to the charity. If you have a taxable estate (I hope you do), and you have charitable intent, then leaving the IRA to the charity makes the most sense. You save income taxes on the IRA and estate taxes. Obviously, a charitably-minded donor would be best leaving the IRA to charity and other assets to a non-charity beneficiary. From a planning standpoint, it makes sense to segregate the portion you want to leave to a charity into a separate IRA, to not confuse the IRA beneficiaries. In other words, if you want to leave $50,000 to charity, then segregate a $50,000 IRA and name the charity the beneficiary.

IDEA 39

Leave Your IRA To A Charitable Remainder Trust

You can leave an IRA to a Charitable Remainder Trust (CRT). A CRT provides income to a beneficiary and a remainder interest to a charity. The income for the charity can be a fixed amount, in which case it's called a Charitable Remainder Annuity Trust (CRAT)[28], or a percentage of the Trust's income, where it is called a Charitable Remainder Unitrust (CRUT)[29]. With the passage of SECURE, a CRT as an IRA beneficiary will allow the IRA to be paid for a much longer period, as long as 20 years. A CRT can be a good choice for an IRA holder who wants a longer payout and is charitably inclined.



If the CRT meets the strict requirements of the tax code, which includes a requirement that the charitable portion be at least 10% of the value, it will provide an income to the beneficiary, plus an estate tax deduction to the estate for the charitable gift. This is ideal when an IRA owner wants to provide for their favorite charity and have some income for heirs, for a period of up to 20 years. This can be beneficial in a variety of circumstances, such as where there is an older beneficiary or a special needs beneficiary. In this case, the IRA is left to the CRT with the income beneficiary as a Special Needs Trust. The Special Needs Trust allows the disabled beneficiary to receive additional benefits above any governmental benefits, which otherwise might have been reduced or lost. The CRT also works well if you have a desire to leave a specific periodic amount to a group of beneficiaries.

The difference between the two types of trust is that a Charitable Remainder Annuity Trust (CRAT) pays a fixed amount and gives the remainder to charity, while a Charitable Remainder Unitrust (CRUT) gives a specific percentage to the beneficiary with the remainder going to charity at the end of the term. In a $1M CRAT with 5% payout for 20 years, it would pay $50,000 a year for 20 years. In a $1M 5% CRUT, the beneficiary would receive $50,000 in the first year and 5% of the trust balance each year for 20 years. It's important to note that CRT's are valued using the IRS §7520 rate and must meet the 10% test. Since the rate changes monthly, the calculation needs to be addressed at the start of the CRT. You'll need a smart advisor for this one.

[28] I.R.C. §664(d)(1)

[29] I.R.C. §664(d)(2)

IDEA 40

Leave Your IRA To A Charitable Gift Annuity

A Charitable Gift Annuity provides a lifetime income to a beneficiary and the remainder to charity. The gift to the charity is deducted from the decedent's estate (based on its present value at date of death or 6 months later if using alternative date). The benefit to the charity is not subject to income taxes. This would work well in a situation where there is a taxable estate, older beneficiaries and a charitable intent.

IDEA 41

Don’t Leave Your Roth To Charity

Leaving a Traditional IRA to charity is a good idea, leaving your Roth IRA to charity is not. Roth IRAs are tax-free and so are charities. You paid the tax on funds that went into the Roth, whether via conversions or contributions. Use taxable IRAs or assets with an unrealized capital gain to fund charitable gifts. Leave the Roth to humans.

IDEA 42

Don't Try To Convert An Inherited IRA To A Roth

This question is commonly asked, and here's an easy answer: You can't convert an inherited IRA to a Roth because the law doesn't allow it[30]. Don't do it.

One exception would be if a spouse passed away and an individual left the IRA as an inherited IRA but later retitled the IRA as a personal IRA and then converted those monies to Roth.

[30] I.R.C. §408(d)(3)(C)

IDEA 43

Title Your Inherited IRA Correctly

Inherited IRAs (as opposed to your personal IRA or a spousal IRA) must be titled correctly to show the IRA as being received from a decedent. Ed Slott suggests the following designation, which I agree with: “John Smith, IRA (deceased December 16th, 2018) F/B/O John Smith Jr., beneficiary”. Remember that you cannot roll over an Inherited IRA to a Traditional IRA in your own name, nor can you convert it to a Roth (See Idea 42).

IDEA 44

Stretch The Benefit Of The Inherited IRA[31]

IRA beneficiary rules are complex. For non-spouse beneficiaries, a preferred method, tax-wise, is to 'stretch' the payout over the life expectancy of the beneficiary. This is done through separate accounts for each beneficiary, created by September 30th of the year following the IRA owner's death. It's important that an IRA bequest by that date be represented as percentages, not as dollars, and all to individuals. It would be fine to leave an IRA to Huey, Dewey and Louie in equal shares (33 1/3%). It would not be fine to leave Huey $50,000 and Dewey and Louie 50% of the remainder. In that case, paying Huey before the September 30th beginning date would be preferable. Likewise, if a charity was a partial beneficiary of an IRA (See Ideas 38-40), paying the charity earlier or using a separate IRA for the charity makes sense. In a 'stretch', we also want to name an alternate beneficiary to receive the Required Minimum Distributions (RMDs) the beneficiary would have taken.

Our basic 'stretch' rules for multiple beneficiaries:

1. Name individuals as beneficiaries of the particular IRA you want to stretch.

2. Establish a separate Inherited IRA account for each of the separate beneficiaries by September 30th and begin taking RMDs by December 31st of the year following the owner's death.

3. Name a contingent beneficiary on the Inherited IRA.

[31] With the passage of the SECURE Act, this provision only applies to individuals who received their inherited IRA from someone who passed away before 12/31/2019.

IDEA 45

Asset Protection Tip: Don't Commingle Rollovers And Traditional IRAs

According to federal bankruptcy law, Rollover IRAs have unlimited protections, while Contributory IRAs are only protected to $1,362,800 (last updated in 2019)[32]. If you have both, it's probably not a good idea to commingle them.

[32] The Bankruptcy Code, 11 U.S.C. §522

IDEA 46

Use An IRA To Get Special Withdrawal Treatments If Under 59½

There are some special exemptions to the early withdrawal penalty that are only applicable to IRAs. These include:

- Health insurance premiums for the unemployed[33]
- Qualified higher education expenses[34]
- Qualified first-time homebuyer expenses[35]

You can use the early withdrawal exemptions to assist a younger person in buying a house (I did this with my daughter's IRA). You could also roll some money out of a qualified plan into an IRA and use the exceptions. A younger person might roll over from their Qualified Plan to take advantage of the first-time homebuyer exception. If the person is currently employed, the plan will have to allow for in-service withdrawals. If the person has separated service from the company but the money is still in the plan, he/she could directly transfer the money to an IRA to take advantage of the above exceptions.

[33] I.R.C.§72(t)(2)(D)

[34] I.R.C.§72(t)(2)(E)

[35] I.R.C.§72(t)(2)(F)

IDEA 47

Roll Over A Designated Roth Account To A Roth IRA

401(k), §457(b), and 403(b) plans can offer Designated Roth Accounts (DRACs). These accounts can allow a significant building of tax-free money, much larger than a Contributory Roth, since the DRAC has the same limits as a conventional 401(k), §457(b), or 403(b) plan. However, DRACs are subject to the Required Minimum Distribution (RMD) rules, whereas Roth IRAs are not. Accordingly, when you retire from a 401(k), §457(b), or 403(b) plan with a DRAC, roll the DRAC into a Roth IRA so you have no RMD. Be careful if you intend to take the money out of the Roth soon after the rollover, because both DRACs and Roth IRAs have a 5-year holding period for a qualified distribution. If you are close to the 5-year period but not over it, it may be better to wait.

One good way to avoid running into a 5-year holding period issue would be to open a Roth IRA when you first start making DRAC contributions so that the 5-year timeline starts counting down before you are close to retirement (see Idea 11).

IDEA 48

If You Name A Trust As A Beneficiary, Make Sure It Has A Pass-Through Provision

Naming your Revocable Living Trust as an IRA beneficiary will allow tax-deferred growth (for traditional IRAs), or tax-free growth (for Roth IRAs), for your individual beneficiaries for up to ten years beyond your death, provided the trust has the correct pass-through language.

In order for a trust to be a designated beneficiary, there are four mandates:

1. The trust must be considered valid and legal under state law, which typically means the creation of the trust document must be witnessed and notarized.

2. The trust must be irrevocable upon the plan owner's death, meaning that the listed beneficiaries can be changed up to the point where the IRA owner passes away, but not after.

3. All beneficiaries must be easily identifiable, eligible, and legally named.

4. Documentation of the pass-through trust must be provided to the custodian of the IRA by October 31 of the year following the IRA owner's death. The regulations governing the trust and how it relates to the distribution of the IRA are part of 26 Code of Federal Regulations Section 1.401(a)(9).

If your trust has the correct language, the IRA will flow through the trust and will then be divided into separate Inherited IRAs, one for each individual beneficiary you named in your trust. For larger IRAs, many attorneys are advising adding language to allow the trustee to distribute funds according to the best tax benefits to the beneficiaries. Under SECURE, all assets in an inherited IRA must be distributed within a 10-year period beginning the year after the death of the owner of the IRA unless an exception applies (see Idea 4). For beneficiaries of a

traditional taxable IRA, it may be advantageous to tax funds relatively equally, or distribute to match a beneficiary's tax situation. For inherited Roth IRAs, it will likely be advantageous to hold the funds for the full period and then make a tax-free distribution.

Another issue presented by SECURE is what happens at the end of the 10-year period.

Here's an example: if a grandparent leaves their sole 18-year old grandchild a $1M Roth IRA, and the trust holds it for 10 years, the IRA, if it makes 6%, would be worth about $1.8M. The grandparent would not likely have wanted a 28-year old to have $1.8M in tax-free dollars. They may modify their trust language to hold the proceeds and distribute income and 'sprinkle' principal over a period of time. For example, the trustee might be instructed to hold the proceeds, and distribute the income to the beneficiary and then give the beneficiary 1/3 in 5 years, ½ the remainder in 10 years and the balance in 15 years. A 'spendthrift' clause in the trust would protect those retained trust assets from the claims of creditors of the beneficiary.

If you have already named your revocable trust as the beneficiary, you should check with either the attorney who drafted the trust or another estate planning attorney to make sure that the trust has been properly drafted to be named as the beneficiary of your IRA.

IDEA 49

Use Your Roth IRA As A College Education Savings Tool

Many people do not have the financial resources to save enough for retirement and college for their children. Often, people will add to college accounts and neglect their retirement savings. While it is noble to think of your children before yourself, you can actually do both at the same time. You can add $6,000 per year (or $7,000 if 50 years old or more) to a Roth and another $6,000 per year (or $7,000) for your spouse, assuming you qualify under the income rules. Let's say you save the max for you and your spouse for 18 years, while under 50 years old, you would have $216,000 just in principal! That does not take into account that the amount you can contribute increases depending on the rate of inflation.

While a Roth IRA was meant for retirement by law, it has rules that make it a useful tool for college savings. First, with a Roth IRA you are able to take the principal out at any time with no penalty or tax! For qualified education expenses, you can take the principal out penalty and tax free, but the earnings are taxed as ordinary income. If your child does not go to college, gets a scholarship, joins the military or you are having financial hard times, you can access those funds for other reasons and possibly get financial aid for your children. There is a lot of flexibility. When you have limited resources, flexibility is important and provides a safety net for the family.

Another benefit of contributing to a Roth as opposed to a §529 plan is the rule to decide eligibility for financial aid. Assets in an IRA or Roth IRA do not count towards calculating financial aid. Only when money is withdrawn from an IRA is it counted as the parents' income in financial aid determinations. Money in a §529 plan is counted against the financial aid calculation, although at a favorable rate, depending on whether the parent or grandparent owns the account. Money in an UGMA/UTMA counts as the student's asset. How these assets are counted has changed many times and probably will change again, but I would bet that retirement assets in the future will still count more favorably than education savings.

The moral of the story is that a Roth IRA gives you flexibility.

Here's an example: Let's say your children are just about to start college and you have paid off all your debts and you now have ample income to pay for college! Why even touch the Roth? Now instead of having a bunch of money in a §529 plan that will have to be taken out, you have a huge IRA that you can use for retirement while keeping the favorable tax status.

IDEA 50

Use The Roth IRA As An Emergency Fund Account

Most young people just starting out in their career have little savings and are not thinking of retirement. The idea of putting money into an account and not seeing it for 30-40 years is unthinkable. One of the first priorities in financial planning is having an emergency fund that you can access quickly. Most people think a bank account is the only option, but banks are not paying much interest right now. A Roth IRA is viewed as an account that cannot be accessed quickly, but that has changed. You can set up an electronic link from your Roth directly to your bank account and have those funds available in 1-2 business days (potentially 4 business days if you have to sell individual equities or ETFs which have a 2-day settle). The principal is always available tax and penalty free, up to your contributions.

The reason a Roth IRA makes sense is that an emergency fund is not always used. If you add to the Roth over several years and find your income has grown, then you can add to an emergency fund at the bank with any extra income. Now you have several years of Roth IRA contributions AND an emergency fund. You have also gained a lot of flexibility in the process.

IDEA 51

$100K Penalty-Free Withdrawal With 3-Year Payback

A special feature of the CARES Act in 2020 was to allow a penalty-free withdrawal to a 'qualified individual' from an eligible retirement plan or IRA until the end of 2020, up to an aggregate limit of $100,000 from all plans and IRAs.

For purposes of the rules, you are a 'qualified individual' if:

- You are diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention. Your spouse or dependent is diagnosed with SARS-CoV-2 or with COVID-19 by a test approved by the Centers for Disease Control and Prevention. You experience adverse financial consequences as a result of you, your spouse, or a member of your household:
    - Being quarantined, being furloughed or laid off, or having work hours reduced due to SARS-CoV-2 or COVID-19
    - Being unable to work due to lack of childcare due to SARS-CoV-2 or COVID-19
    - Having a reduction in pay (or self-employment income) due to COVID-19 or having a job offer rescinded or start date for a job delayed due to COVID-19
    - Closing or reducing hours of a business that you own or operate due to SARS-CoV-2 or COVID-19

A 10% penalty tax generally applies to distributions from an employer retirement plan or IRA before age 59½ unless an exception applies. Due to the 2020 coronavirus pandemic, the penalty tax will not apply to up to $100,000 of coronavirus-related distributions for 2020. Additionally, income resulting from a coronavirus-related distribution is spread over a three-year period for tax purposes unless you elect otherwise.

Here's an example: if you took a $9,000 coronavirus-related distribution in 2020, you would report $3,000 in income on your federal income tax return for each of 2020, 2021, and 2022. However, you have the option of including the entire distribution in your income for the year of the distribution. Coronavirus-related distributions can also be paid back to an eligible retirement plan within three years of the day after the distribution was received. If you repay a coronavirus-related distribution, the distribution will be treated as though it were repaid in a direct trustee-to-trustee transfer and you will not owe federal income tax on the distribution.

Only distributions otherwise eligible for tax-free rollover treatment may be recontributed, meaning that any coronavirus-related distributions by beneficiaries of inherited retirement plans cannot be recontributed. If, for example, you receive a coronavirus-related distribution in 2020, you choose to include the distribution amount in income over a 3-year period (2020, 2021, and 2022), and you choose to repay the full amount to an eligible retirement plan in 2022, you may file amended federal income tax returns for 2020 and 2021 to claim a refund of the tax attributable to the amount of the distribution that you included in income for those years, and you will not be required to include any amount in income in 2022.

For an individual who is a qualified individual as a result of experiencing adverse financial consequences as described above, coronavirus-related distributions are permitted without regard to the need for funds, and the amount of the distribution is not required to correspond to the extent of the adverse financial consequences experienced by the qualified individual.

IDEA 52

Pass-Through Business Roth Conversion Offset

The CARES Act suspends the Excess Loss Limitation (ELL) rules for pass-through businesses. A pass-through business is generally anything other than a C-Corporation, and includes Sub-S corporations, LLCs taxed as a partnership or a Sub-S, partnerships, and estates and trusts. In a pass-through, gains and losses go directly to the business owner's tax return. If a pass-through owner has $100,000 of income, it flows to their individual tax return (1040). Likewise, a loss also flows through to the owner's 1040. With a loss year, like 2020 might potentially be, there is an opportunity for pass-through business owners with losses to offset those losses with a Roth conversion. The Roth conversion can be done at a very low tax cost.

Here's an example: Tim and Elaine have an upscale farm-to-table restaurant that is a pass-through business (an LLC). They suffered dramatically during the Covid shutdowns, and additionally, had made substantial improvements to the restaurant at the beginning of 2020. As a result, it appears the business will generate a loss of $150,000 for 2020. Fortunately, Tim and Elaine had other funds (Paycheck Protection loan and saved outside assets). They have $400,000 in a rollover IRA from prior jobs. They use the standard deduction.

They sit with down with Michelle, their CPA. Michelle tells them about the ability in 2020 to carry back losses, but the carryback won't help Tim and Elaine, since they had spent 5 years getting the business running well. They could carry the loss forward, but they are uncertain about future profits. Instead, they decide to convert a substantial portion of their IRA to a Roth and pay very little (or even virtually nothing). This is how it might look:

- **Loss:** $150,000; plus
- **Standard deduction:** $24,800; plus
- **10% bracket:** $19,750

- **Total conversion:** $194,550
- **Total federal tax:** $1,975
- **Effective tax rate on conversion:** 1%

The net effect of this conversion is to fund a Roth with $194,500 paying about $1,975 of federal tax. Assuming they are both 50, this could be a massive windfall, especially if they don't spend or use the Roth. Here's a comparison at 6% return:

Item	Taxable IRA	Roth	Difference
Beginning balance	194,550	194,550	0
Balance at age 72	701,068	701,068	0
RMD at 72	27,385	0	-27,385
Total RMDs to age 90	858,945	0	-858,945
Total federal tax on RMD (20%)	-171,789	0	+171,789
Balance at age 90	717,337	2,121,152	1,403,814
Reinvested AT RMD	916,541	0	
10-year balance	1,284,642	3,798,659	2,514,018
Taxes to heirs (25%)	-321,160	0	+321,160
Total to heirs	963,481	3,798,659	2,514,018
GRAND TOTAL (REINV RMD)	**$1,880,023**	**$3,798,659**	**$1,918,637**

As the above illustrates, the Roth has an enormous edge in not having an RMD and also allowing all growth, even to the heirs, to be tax-free. Tim and Elaine's Roth conversion could net their heirs $1.9m more. In addition, the Roth has the creditor protection afforded IRAs. All that for burning up a loss and paying $1,975 of tax. That is making lemonade from lemons.

IDEA 53

Use The 2020 RMD Suspension To Make Roth Conversions

The CARES Act suspended the Required Minimum Distribution (RMD) requirement on IRAs and qualified plans for 2020. This suspension is effective for both regular and inherited IRAs. This particular provision offers some interesting planning opportunities with the reduction in taxable income caused by the absence of the RMD. Generally, RMDs from an employer retirement plan or IRA are required to begin by April 1 of the year after the plan participant or IRA owner reaches age 70½ (age 72 for those who reach age 70½ after 2019). If an employee continues working after RMD age, RMDs from an employer retirement plan maintained by the current employer can be deferred until April 1 of the year after retirement.

RMDs are not required from a Roth IRA during the lifetime of the IRA owner but are required from Roth 401(k)s other than those of your active employer. RMDs are also generally required for beneficiaries after the death of the plan participant or IRA owner. In general, a 50% penalty applies to an RMD that is not taken within the appropriate time-frame. The waiver offered by the CARES Act includes any RMDs for 2019 with an April 1, 2020 required beginning date that were not taken in 2019. This one-year suspension does not generally affect how post-2020 RMDs are determined and applies regardless of whether or not an individual has been impacted by the pandemic.

The suspension of RMDs offers an opportunity to use this 'Mulligan' to make Roth conversions. If Mildred has a normal $46,000 RMD, and doesn't need it, she can use the 'room' the suspension of her RMD creates in her tax bracket to make a Roth conversion. If Millie's taxable income for 2020 would have been $82,000 with her RMD, she would be in the 22% bracket. Not taking her RMD would give her the additional 'room' of $48,400 (the amount to go to the upper end of the 22% bracket in 2020) to convert to a Roth. Note this amount would not be subject to RMDs and would go tax-free to her heirs.

The suspension of the RMD offers some great planning opportunities for 2020.

CONCLUSION

IRAs, both Traditional and Roth, are wonderful planning tools. They can provide tax savings opportunities, beneficiary protection, and even assist with the creation of a family dynasty. We thought the preceding 50+ Ideas would be helpful to you, whether you are an IRA owner, a beneficiary of an IRA, or a professional advisor. At Sequoia Financial Group, we like to look at the big picture. We look holistically at how the IRA integrates with both the tax and estate plans, and how the investments in the IRA correspond to outside investments. If you would like information on managing an IRA, tax planning for IRAs or the estate planning consequences of IRAs, or if you'd like to schedule a complimentary consultation with a fiduciary, fee-only advisor, please feel free to contact us. We'll try to answer any questions you may have. Also, check out our other Financial Literacy tools.

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In life there are things we can change and things we cannot change. We just need to have the knowledge to know the difference.

Our concept of Reducing Uncertainty™ embraces that idea: We cannot change market fluctuations, taxes and mortality. While we cannot change these things, we can manage how we react to them. For example, we can convert to a Roth IRA to reduce taxes. We can use proper beneficiary designations to give our heirs the most from our IRAs. We can also use multiple Roth conversions to gain opportunity during market fluctuations.

50 Good IRA Ideas is intended to take some of our best ideas on IRAs, Roth IRAs and qualified plans and make them useful for you. Of course, IRAs are only part of an integrated plan, which includes taxable investments, financial planning, estate planning and tax planning. But the IRA (especially the Roth) is a very powerful tool to reduce the uncertainty in our financial lives and aid in maximizing family wealth.

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