Price & Farrington's Estate and Tax Planning *Fast*Facts

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Estate, Tax and Family Wealth Planning for Advisors and Clients

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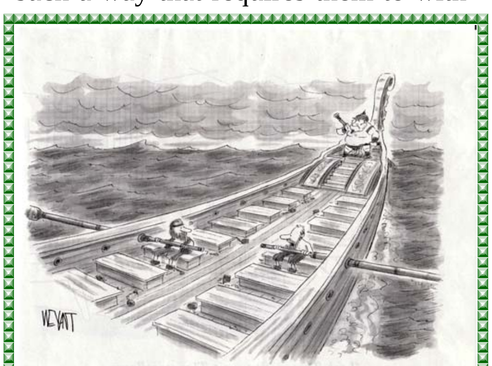
Tax-Qualified Plans: *Maximizing Your Planning Opportunities*

Planning for tax-qualified plans, which include IRAs, 401(k)s and qualified retirement plans, requires a careful examination of the potential taxes that impact these assets. Unlike most other assets that receive a ***"basis step–up"*** to current fair market value upon the owner's death, IRAs, 401(k)s and other qualified retirement plans *do not step-up* to the ***date-of-death value***. Therefore, beneficiaries who receive these assets do so subject to ***income tax.*** If an estate is subject to ***estate tax,*** the value of these assets might be further reduced by the estate tax. And if you name grandchildren or younger generations as beneficiaries, these assets might be further reduced by ***generation-skipping transfer tax***. These "hits" could result in a potential total tax rate of 70% or more.

Let's examine some strategies available to help reduce the impact of these taxes.

☑ ***Structure Accounts to Provide the Longest Term Payout Possible.***

This is the most simple and the most common option. With this strategy you name beneficiaries in such a way that requires them to withdraw the least amount possible as ***required minimum distributions (*****RMDs*****)***—that must be made in order to avoid significant penalties. To achieve this maximum ***"stretch-out"***, you should name individuals who are young (e.g., children or grandchildren, although there are special considerations when naming grandchildren or younger generations) as the ***designated beneficiary*** of your tax-qualified plans. The beneficiary should take only those minimum distributions that are required by law. The younger the beneficiary, the smaller those required minimum distributions are, resulting in a longer stretch-out.



"At this point, I'm just happy to still have a job."

You can do this by naming the beneficiaries individually or by directly naming their shares of a trust.. Often, the surviving spouse is named as the ***primary beneficiary*** so that he/she may ***roll over*** the account into the surviving spouse's name and treat it as his/her own account. If you are concerned about ***creditor or divorce protection***, you can name a ***trust*** for the survivor's benefit rather than naming the survivor individually.

☑ ***Name a Retirement Trust as Beneficiary to Ensure the Longest Term Payout Possible.***

Naming a beneficiary outright to accomplish tax deferral with a tax-qualified plan has several disadvantages. If the beneficiary is very young, the distributions must be paid to a ***guardian***. If the beneficiary has no guardian, the court must appoint one. Another disadvantage is the potential loss of creditor protection or bloodline protection, particularly where the named beneficiary is the surviving spouse. A third practical disadvantage is that many beneficiaries take distributions much larger than the RMDs, often consuming this "found

Charles P. Farrington and Glenn D. Price

money" in only a couple of years.

By naming a trust as the beneficiary of your tax-qualified plans, you can ensure that the beneficiary defers the income and that these assets remain protected from creditors or a former son or daughter-in-law. A ***stand-alone Retirement Trust*** (separate from your revocable living trust and other trusts) can help accomplish your objectives while maximizing tax deferral. *The trust can either pay out the RMD to the beneficiary or it can accumulate these distributions and pay out trust assets pursuant to the standards you set in advance (e.g., for higher education, etc.).*

Take the Money Out During Lifetime and Pay the Income Tax, Then Gift the Remaining Cash Either Outright or Through an Irrevocable Life Insurance Trust (ILIT).

If you want to make gifts through an ILIT, this strategy makes the most sense where you are in good health and are able to obtain ***life insurance*** at reasonable rates. Unlike with the IRA or retirement plan, the beneficiaries will receive the life insurance proceeds free of income and estate tax and, under certain circumstances, free of generation-skipping transfer tax (GSTT).

Take the Money Out During Lifetime and Buy an Immediate Annuity to Provide a Guaranteed Annual Income, to Pay the Income Tax, and to Pay for Insurance Owned by a Wealth Replacement Trust.

Another option is to withdraw your IRA or qualified plan and purchase an ***immediate annuity*** which will generate a guaranteed income stream during your life (or during your and your spouse's lives). You can use this income stream to pay the income tax triggered by the withdrawal, and also to pay the premiums on life insurance owned inside of a ***Wealth Replacement Trust***. Again, this strategy makes the most sense if you are in good health and able to obtain life insurance at reasonable rates. The beneficiaries will receive the life insurance proceeds from the Wealth Replacement Trust free of income and estate tax and, under certain circumstances, free of GSTT. Alternatively, it might make more sense to use other assets to purchase the immediate annuity, saving the IRA for family members. This strategy makes the most sense when you can defer the income tax on the IRA or qualified plan for many years by naming a very young beneficiary.

Name a Charitable Remainder Trust (CRT) as Beneficiary With a Lifetime Payout to Your Surviving Spouse; the Remaining Assets Pass to Charity at the Death of Your Spouse.

The CRT is an IRS-authorized irrevocable trust that allows transfer of ownership of assets to the trust in exchange for an income stream to the person or persons of your choice (typically you, or, if you are married, your spouse or you and your spouse) for life or for a specified term up to twenty years. At the end of the term, the balance of the trust property ("the remainder interest") transfers to a specified charity or charities,. This is both an income and estate tax planning strategy.

With this option, a testamentary CRT may be established *on the death of the first spouse*. The survivor is guaranteed an annuity for his or her lifetime to help maintain his or her lifestyle if the family's income stream be otherwise insufficient. The property in the CRT passes to the charity(ies) on the second death.

Give the Accounts to Charity at Death.

Another relatively simple option is for you to give the accounts to charity at your death or at the death of you and your spouse if you are married. The strategy is especially attractive if you intend to make gifts to charity at your death and the question is simply what assets you should select. As a tax-exempt entity, a qualified charity does not pay income tax and therefore receives qualified retirement plans free of income tax.

In other words, if your beneficiary is in a 35% tax bracket, a $100,000 IRA is worth only $65,000 in his or her hands, but is worth the full $100,000 if given to charity. Therefore, it makes economic sense to give these assets to charity and give to your children or other beneficiaries assets that are not subject to income tax and which receive a step-up in basis to their date-of-death value at your death.

These are a few of the more common planning solutions for tax-qualified plans. The right solution for you will depend upon your goals and objectives as well as your particular circumstances.

Ponderables

The future is a mirror without any glass in it.

Xavier Fornere 1838

The things we remember best are those better forgotten.

Gracian 1647

The future is something which everyone reaches at the rate of sixty minutes an hour, whatever he does, whoever he is.

C.S. Lewis 1942

To endeavor to forget anyone is a certain way of thinking of nothing else.

La Bruyere 1688

When we are tired, we are attacked by ideas we conquered long ago.

Nietzsche

In plucking the fruit of memory one runs the risk of spoiling the bloom.

Joseph Conrad 1919

Oxford Book of Aphorisms John Gross 1983

"Stop! Wait! Government's no longer the problem — it's the solution!"

Speaking Engagements

For over fourteen years my law partner and I have regularly made presentations to private and public groups on a broad range of estate, tax, asset protection, retirement, business and family wealth preservation planning topics. The presentations are informative, entertaining and in plain English. Our goal is to educate and motivate the attendees to achieve the very best planning for themselves and their families.

If you would like us to address your clients, colleagues, fellow employees or members of an organization, don't hesitate to contact us at (425) 451-3583 to discuss specific arrangements. ***GDP***