The IRA Witch Project – Planning with IRAs

Robert J. Naberhaus III, Esq.

Dean Mead, P.A.
7380 Murrell Road, Suite 200
Viera, Florida 32940
321-259-8900
Rnaberhaus@deanmead.com
www.deanmead.com

(The author wishes to thank Kristen M. Lynch, Esq., Lester B. Law, Esq. and Edward A. Waters, Esq. for their assistance with these materials)

I. Minimum Required Distribution (MRD) Rules

Congress wants tax-favored IRAs to be used for the owner's retirement, not to build wealth for future generations – hence the MRD rules under IRC §401(a)(9) and related regulations. The MRD is the amount that must be distributed from the IRA in a particular year.

A. Lifetime MRDs.

1. MRDs begin when the IRA owner attains age 70 ½ (or upon the IRA owner's death if sooner). This age is referred to as the IRA owner's Required Beginning Date (RBD).

a. MRD must be distributed by December 31 each year.

b. However, MRD upon attaining RBD must be distributed by April 1 of the following year.

2. Each year's MRD is determined by dividing the prior year-end IRA account balance by a life expectancy factor published on the applicable IRS table.

3. There are 3 IRS tables:

a. Uniform Lifetime Table – used to determine lifetime MRDs for most IRA owners and assumes a beneficiary who is 10 years younger.

b. Joint and Last Survivor Table – used to determine lifetime MRDs for IRA owners whose sole beneficiary is a spouse who is more than 10 years younger.

i. The IRA owner does not make an election to use this, it is used automatically if the IRA owner's much younger spouse is named primary beneficiary on January 1.

ii. Death or divorce of the spouse changes the applicable table to the Uniform Lifetime Table for subsequent years.

c. Single Life Table – used to determine post-death MRDs (see section I.B below) other than the MRD for the year of the IRA owner's death (which is determined by the applicable table in a or b above).

i. If the designated beneficiary is a non-spouse individual, you only use the table factor for the first MRD year and in all subsequent years the applicable factor is simply the prior year's factor reduced by 1. This is referred to as the "fixed-term method" for calculating the beneficiary's age.

ii. If the designated beneficiary is a spouse who has not rolled the IRA over into their own IRA, then you still use the Single Life Table but the spouse's age is redetermined each year – this is known as the "recalculation method" and life expectancy never runs out as long as the spouse is alive.

4. IRC §4974(a) and Reg. §54.4974-1 impose a penalty for failing to timely take an MRD equal to 50% of the MRD.

5. Lifetime MRD rules DO NOT apply to Roth IRAs.

B. Post-Death MRDs (applies to both traditional and Roth IRAs).

1. MRD depends on 4 factors:

a. Did IRA owner die before or after RBD?

b. Did IRA owner designate a beneficiary?

i. Any person or legal entity (charity, estate, corporation, etc.) can be a valid beneficiary of an IRA and be entitled to the IRA at the owner's death, however…

ii. Only a "Designated Beneficiary" (DB) may take distributions from an IRA based on individual life expectancy, and to be a DB, the beneficiary must be one of the following:

- Individual.

- A trust that meets certain requirements specified in the IRC – "See-through Trust".

iii. Identification of DB must be ascertained by September 30th of the year after the year of the IRA owner's death. Pay out "bad beneficiaries" early if you can to ensure a DB.

iv. If multiple DBs, considering creating separate accounts so that each DB can use their life expectancy to determine payout rate.

- DBs shares need to be expressed as fractional or percentage shares.

- Separate accounts need to be established by December 31st of the year after the year of the IRA owner's death.

- There must be pro-rata sharing of post-death gains and losses.

c. Is the DB the IRA owner's spouse?

d. Does the IRA Agreement offer all the payout options allowed by law?

2. Death BEFORE RBD – These rules are summarized in a helpful diagram attached to these materials as "Exhibit A".

a. No DB – "5 year rule" applies and IRA must be distributed by the end of the fifth calendar year following the IRA owner's death.

i. Same 5 year rule applies if the beneficiary actually designated is the IRA owner's estate, a trust that is not a "See-through Trust" or other non-individual beneficiary – there is no DB!

ii. 5 year rule does not require annual MRDs.

b. DB is Non-Spouse or “See-through Trust” for Non-Spouse – Distributions are based on the DB's life expectancy using the Single Life Table or the DB can elect to have the 5 year rule apply. If using the life expectancy method, MRDs must begin by the end of the calendar year following the calendar year of the IRA owner's death.

c. DB is Spouse or “See-through Trust” for Spouse* – Spouse has 3 options:

i. Spousal rollover into spouse’s own IRA (*available only if Spouse is DB and not a “See-through Trust” for Spouse):

- Spouse controls beneficiary designation and spouse’s beneficiary’s life expectancy determines payout rate after spouse’s death.

- Spouse can delay taking distributions until spouse’s RBD.

- Spouse’s MRDs are determined using Uniform Lifetime Table rather than Single Life Table.

ii. Spouse can leave IRA in the name of the deceased IRA owner (“inherited IRA”):

- Spouse can delay MRD until the deceased IRA owner’s RBD; an older spouse may take this option over rollover to defer MRD.

- Spouse’s MRDs are determined using the Single Life Table with spouse’s age redetermined each year under the "recalculation method".

- Spouse may not be able to name new beneficiaries, and even if so, they may not be able to use individual life expectancies and be treated as DBs upon spouse's death.

- If spouse is younger than 59 ½ and needs the IRA monies, this option (as opposed to rollover) allows spouse immediate access to the IRA without being subject to the 10% early distribution penalty; if rolled over and there is a need for a withdrawal before reaching 59 ½, such withdrawal would be subject to the 10% penalty.

iii. Spouse can receive distributions using the 5 year rule.

3. Death AFTER RBD – These rules are summarized in a helpful diagram attached to these materials as "Exhibit B".

a. In all cases, if the MRD for the year of IRA owner's death had not been fully paid to deceased IRA owner prior to death, the remaining MRD must be distributed to the IRA beneficiary by the end of that year. Remaining MRDs (except in case of rollover) must commence by December 31 of the year after IRA owner's death.

b. No DB – IRA must be distributed over the remaining life expectancy of the IRA owner using the Single Life Table and the fixed-term method.

c. DB is Non-Spouse or "See-through Trust" for Non-Spouse – IRA may be distributed over the longer of the DB's life expectancy or the remaining life expectancy of the IRA owner.

d. DB is Spouse or “See-through Trust” for Spouse* – Spouse has 3 options:

i. Spousal rollover into spouse’s own IRA (*available only if Spouse is DB and not a “See-through Trust” for Spouse):

- Spouse controls beneficiary designation and spouse’s beneficiary’s life expectancy determines payout rate after spouse’s death.

- Spouse can delay taking distributions until spouse’s RBD.

- Spouse’s MRDs are determined using Uniform Lifetime Table rather than Single Life Table.

ii. Spouse can leave IRA in the name of the deceased IRA owner (“inherited IRA”):

- Spouse’s MRDs are determined using the Single Life Table with spouse’s age redetermined each year under the “recalculation method”.

- Spouse may not be able to name new beneficiaries, and even if so, they may not be able to use individual life expectancies and be treated as DBs upon spouse’s death.

- If spouse is younger than 59 ½ and needs the IRA monies, this option (as opposed to rollover) allows spouse immediate access to the IRA without being subject to the

10% early distribution penalty; if rolled over and there is a need for a withdrawal before reaching 59 ½, such withdrawal would be subject to the 10% penalty.

iii. IRA can be distributed over the remaining life expectancy of the IRA owner using the Single Life Table and the fixed-term method.

4. MRDs After Death of Beneficiary:

a. The successor beneficiary (as opposed to the Contingent or Secondary Beneficiary shown on an IRA beneficiary designation form) is the beneficiary who inherits the remaining IRA when the original beneficiary, having survived the IRA owner, later dies before withdrawing all the IRA.

b. The terms of the IRA agreement dictate whether the original beneficiary may name the successor beneficiary or whether the IRA agreement designates a certain beneficiary or class of beneficiaries (e.g., estate, spouse, or children of designated beneficiary, etc.); most IRA providers do not allow the original IRA owner to designate the successor beneficiary.

c. The death of the original beneficiary has no effect on the MRDs as the successor beneficiary simply steps into the shoes of the original beneficiary and continues to withdraw the IRA using the original beneficiary's life expectancy method.

II. Designating IRA Beneficiaries to Coordinate with Estate Plan

Oftentimes clients have a significant portion of their assets held in an IRA(s). The following issues should be addressed:

A. Is the IRA beneficiary designation integrated with the estate plan?

1. ACTEC Commentary on Model Rule 1.1 (competency): *A lawyer who is engaged by a client in an estate planning matter should inform the client of the importance of giving the lawyer complete and accurate information* *regarding relevant matters such as the ownership and value of assets and the state of beneficiary designations under life insurance policies and employee benefit plans…*

Question: If the client makes the lawyer aware of the existence of an IRA, would not the failure of the lawyer to integrate the beneficiary designation into the estate plan be a breach of the lawyer's duty of competency and subject the lawyer to malpractice claims?

2. Customized Beneficiary Designations.

a. Standard beneficiary designation forms provided by the IRA custodian generally provide only for simple beneficiary choices that are not necessarily integrated with the estate plan.

b. Such forms do not usually contemplate a spousal disclaimer to fund a credit shelter trust, trusts for other beneficiaries, avoiding guardianship for minors, special rules for adopted persons or other custom provisions in the estate plan.

c. When preparing a customized beneficiary designation:

i. Review the applicable sections of the IRA agreement to make sure the beneficiary designation and payout method the client desires are permitted.

ii. Do not require the IRA provider or administrator to make legal or factual determinations in order to determine the IRA beneficiary.

iii. Put the responsibility upon the estate fiduciary (Personal Representative or Trustee) to inform the IRA provider whether certain factual circumstances exist such as the survival of a beneficiary, the existence of a trust for a beneficiary, how much of the IRA to allocate to a beneficiary when the beneficiary designation is tied to a formula, etc. AND be sure the will or trust appointing such fiduciary requires the fiduciary to carry out this duty.

iv. If necessary, include definitions of terms that may have a different meaning under Florida law (e.g., "per stirpes", etc.) than the law which may govern the IRA agreement, and include a governing law provision for purposes of determining the client's intent as it pertains to the beneficiary designation.

v. Hold the IRA provider harmless for relying upon the customized beneficiary designation and the determinations of the estate fiduciary.

vi. Request pre-approval of the customized beneficiary designation by the IRA provider – sometimes IRA providers will not accept custom beneficiary designations and the client has to decide whether to move the IRA to another provider or compromise the estate planning goals.

vii. File the beneficiary designation for the client using a form of delivery where you receive a delivery confirmation.

viii. Review the customized beneficiary designation every time you assist the client in making changes to their estate plan.

ix. Make sure the client understands that if they move the IRA to another provider they need to make sure they file a new customized beneficiary designation with the new IRA provider.

3. Using Disclaimers.

a. Disclaimer is the refusal by the beneficiary to accept the IRA and, if done properly ("qualified disclaimer"), is not treated as a gift because the disclaimant never owned the property.

b. Disclaimers are governed by IRC §2518 and Chapter 739 of the Florida Statutes (2015), make sure you comply with both to be safe. Read PLR 2008-46003 for a retirement plan disclaimer disaster and lesson on what not to do!!!

i. Disclaimer must be irrevocable, unconditional and in writing.

ii. Disclaimant must not accept the interest disclaimed or any of its benefits.

iii. Disclaimer must be timely and properly delivered to the appropriate party.

iv. Disclaimed property must pass, as a result of the disclaimer, to someone other than the disclaimant (exception for spousal disclaimers only).

v. Disclaimant cannot direct where the disclaimed property goes as a result of the disclaimer.

vi. Disclaimant must not be insolvent – asset protection issue.

c. Make sure you check to see if there are additional requirements or forms for disclaimers required by the IRA agreement or provider.

d. Delay acceptance of IRA distributions and investment control until disclaimer decision made; NOTE: taking MRD for year of IRA owner's death does not constitute acceptance of entire IRA under IRS safe-harbor (See Rev. Rul. 2005-36, 2005-26 IRB 1368) but making investment decisions is problematic.

e. Make sure beneficiary designation specifically states who the IRA beneficiary is in the event of a disclaimer as opposed to the death of the beneficiary.

f. Disclaiming IRA in favor of Trust for Spouse

i. Not to be used where control is an issue (second marriage), spouse has creditor issues, spouse cannot manage the IRA (due to incapacity or lack of financial wisdom) or spouse eligible for need based government programs.

ii. Name the spouse as Primary Beneficiary of the IRA but specify that, if the spouse disclaims, the Primary Beneficiary of the disclaimed portion of the IRA is the Trust.

iii. Allows spouse to delay decision whether to roll over IRA or use it to fund credit shelter trust for 9 months after IRA owner's death when spouse has all relevant facts (e.g., estate and income tax laws, spouse's available assets and needs, etc.).

iv. Spouse must also disclaim any powers of appointment held by spouse and any power spouse may have as Trustee or otherwise to spray trust distributions among other trust beneficiaries which is not limited by an ascertainable standard.

B. Does the estate plan clearly direct where estate taxes attributable to the IRA are charged? ***See Keith B. Braun, Esq. materials.***

III. Trust as Beneficiary

A. Why? Reasons to designate a trust as beneficiary of an IRA are the same with IRAs as they are with other assets:

1. Management of IRA for disabled, distrusted, minor or substance abuse beneficiaries.

2. Control of disposition of IRA and accumulated distributions on death of beneficiary (second marriage).

3. Shelter IRA for estate and GST tax purposes.

4. Creditor protection.

B. Requirements of a "See-through Trust". An IRA owner can name a trust as beneficiary and still have a "designated beneficiary" if the trust meets all of the following requirements:

1. Valid under state law.

2. Trust is irrevocable or becomes irrevocable on the IRA owner's death.

3. Trust beneficiaries are readily identifiable from the trust instrument.

4. Trustee provides a copy of the trust instrument or provides the IRA custodian with a final list of the trust beneficiaries (including contingent and remainder beneficiaries) by September 30 of the year following the IRA owner's death.

5. (THE HARD ONE) All trust beneficiaries that count are individuals (i.e., current, remainder and some contingent beneficiaries).

C. MRDs for "See-through Trust". MRDs will be based upon the life expectancy of the oldest trust beneficiary. Which beneficiaries "count"?

1. Most difficult requirement of a "See-through Trust" is determining which trust beneficiaries count in determining whether all beneficiaries are individuals and which beneficiary is the oldest.

2. Suppose IRA is payable to Revocable Trust (Typical Scenario) which subdivides into subtrusts (e.g., credit shelter trust, marital trust, descendants' separate trusts, etc.), do you count all beneficiaries of the Trust or just the beneficiaries of the subtrust(s) to which the IRA is allocated? The IRS has ruled (all PLRs) inconsistently on this issue.

a. If you name the subtrust directly as beneficiary of the IRA on the IRA beneficiary designation form rather than naming the Revocable Trust, only the subtrust beneficiaries count. See PLR 2006-07031.

b. If the trust instrument requires the IRA be allocated to a certain subtrust OR mandates the IRA cannot be paid to a certain subtrust or certain beneficiaries, regardless of the value of the IRA or any other factors, then those beneficiaries to which the IRA absolutely cannot be allocated should not count. See PLR 2006-20026.

c. If the Trustee has discretion as to where to allocate the IRA, then all Trust beneficiaries would appear to count but PLR 2002-21061 ruled that only the beneficiaries of the subtrust to which the retirement benefits were actually allocated counted but note there were sufficient other assets to fund all other Trust devises.

D. Separate Accounts Rule. When an IRA is payable to several individuals on the IRA beneficiary designation, the IRA can be divided into separate inherited IRAs, one for each beneficiary, and the MRDs for each inherited IRA will be determined based upon the life expectancy of its beneficiary.

1. Separate account rule will not apply when Revocable Trust is designated as beneficiary even though Revocable Trust divides the IRA among the beneficiaries = oldest beneficiary's life expectancy determines MRDs for all beneficiaries.

2. Can achieve separate account status and have each beneficiary's life expectancy apply if you divide the IRA among the beneficiaries on the IRA beneficiary designation and require MRDs to be distributed to each beneficiary's subtrust.

E. Beneficiary Finalization Date. September 30 of the year following the year of the IRA owner's death is the relevant date for purposes of determining trust beneficiaries.

1. Beneficiaries who receive their trust distribution prior to this date are not counted (e.g., pay out "bad beneficiaries" early such as older beneficiaries, charities, etc.).

2. Disclaimers prior to this date can also eliminate beneficiaries or powers of appointment that include older beneficiaries or non-individuals as permissible appointees.

F. Drafting Trusts for IRAs.

1. "Conduit Trust"

a. Trustee is required by the terms of the trust to distribute any distribution the Trustee receives from the IRA to the individual trust beneficiary (conduit beneficiary) or beneficiaries.

b. Trustee has no power to accumulate IRA distributions in the trust.

c. Conduit beneficiary is generally in the same position as if he or she had been named directly, except that beneficiary does not have power to decide when and how to take the benefits.

i. IRA is payable over life expectancy of the conduit beneficiary, except that if the spouse is the conduit beneficiary and the IRA owner died before his or her RBD, MRDs to trust can be deferred until IRA owner's RBD.

ii. MRD is not re-calculated for successor beneficiary if original conduit beneficiary does not live to normal life expectancy.

iii. Not ideal if a goal is to preserve assets for the remainder beneficiaries because if the conduit beneficiary lives to normal life expectancy the IRA will have been fully distributed.

d. Look only to the conduit beneficiary for purposes of determining whether the trust qualifies as a "See-through Trust". Remainder beneficiaries are not considered and, therefore, do not need to be individuals.

e. Uncertainty exists as to whether distribution of MRDs can be made "for the benefit of" the conduit beneficiary or whether distributions must be made directly "to" the beneficiary.

i. There is no reliable IRS guidance on this point.

ii. Significant for creditor protection purposes because once the MRD is paid, the conduit beneficiary's creditors can reach it.

f. Taxable distributions from the IRA which flow out to the conduit beneficiary carry out DNI and therefore are taxed at individual tax rates rather than the compressed trust income tax rates.

2. "**Accumulation Trust"**

a. Trustee has power to accumulate all or part of the MRD within the trust.

i. Prevents exposure of MRD to beneficiary's creditors.

ii. Preserves other goals of creating trust (see III.A above).

b. Trustee can have discretion on when and how much to pay to trust beneficiaries.

c. Assets can be retained inside the trust for later distribution to remainder beneficiaries.

d. Current and remainder beneficiaries are counted for purposes of determining whether the trust qualifies as a "See-through Trust", but what about "mere potential successor beneficiaries"?

i. Reg. §1.401(a)(9)-5, A-7(c) tells us we can ignore "mere potential successor beneficiaries" but neither the IRC nor the regulations give any guidance on determining "mere potential successor beneficiaries".

ii. Recent PLRs give some guidance on determining which remainder beneficiaries count:

- PLRs 200438044, 200522012, 200608032, 200610026 and 200708084 deal with an IRA designated to a trust which provides outright distribution (i.e., not a Dynasty type trust) to remainder beneficiaries. For example: Trust providing only for IRA owner's spouse for life, with remainder to IRA owner's children outright on spouse's death. If, on IRA owner's death, spouse and children are living, these PLRs indicate you only have to count spouse and children as trust beneficiaries because of the outright distribution to the remainder beneficiary who is living on IRA owner's death – thus you do not have to count the contingent remainder beneficiaries that might take should a child predecease spouse.

- In PLR 201021038, the IRS refused to give retroactive effect for federal tax purposes to a local state court order which permitted reformation of a trust to remove charities as permissible appointees of a limited power or appointment. The purpose of the reformation action was to qualify the trust as a "See-through Trust". Because the reformation was not given retroactive effect for tax purposes, the trust, as it existed on the date of the decedent's death, had a potential beneficiary who was not an individual and thus, the trust failed to qualify as a "See-through Trust".

- PLR 201021038 seems to represent a change in the position of the IRS with respect to reformations. See PLRs

200235038 and 200620026. Without the ability to reform a trust post-death to qualify as a "See-through Trust", practitioners must be extremely careful to draft the trust correctly the first time.

iii. Another way to close the universe of possible remainder beneficiaries is to include a "last man standing provision" in the accumulation trust.

- This provision provides for an accelerated termination of the accumulation trust if it should ever occur that only one trust beneficiary is still living, and requires immediate outright distribution to that beneficiary.

- For example: Trust provides for IRA owner's spouse for life, with remainder outright to IRA owner's issue who are living at spouse's death; provided, if at any time during spouse's life there is not issue living, then the trust terminates and is distributed to spouse – thus it is impossible for the assets to pass to anyone other than spouse and issue who are living on IRA owner's death.

- This might be a good solution for a credit shelter trust used in a first marriage where trust created only for tax reasons, or a trust in a second marriage where the trust's only purpose was to protect the children of the first marriage.

e. In accumulating distributions, consider that amounts accumulated in the trust will be taxed under the compressed income tax brackets for trusts.

i. Note that distributions from a Roth IRA would not be taxable to the trust.

ii. Thus, an accumulation trust which receives distributions from a Roth IRA does not have the income tax disadvantage present when an accumulation trust receives distributions from a traditional IRA.

f. Qualification as a "See-through Trust" depends on the substantive terms of the trust. DO NOT RELY on the "boilerplate" provisions designed to save an otherwise defective accumulation trust! Examples of common boilerplate ("notwithstanding any contrary provision of this trust agreement") provisions include:

i. Provisions removing a nonindividual beneficiary (e.g., charity, etc.) who might otherwise be directly named as a beneficiary.

ii. Provisions removing beneficiaries who are older than the current beneficiary.

iii. Provisions limiting the class of permissible appointees under a power of appointment to the issue of the current beneficiary (e.g., exclude spouse of beneficiary, charities, grantor's older descendants, etc.) – Use disclaimer instead.

iv. Better to segregate the IRA into a separate trust having qualifying "See-through Trust" terms that follow the underlying trust as closely as possibly but eliminate problematic provisions (such as a power of appointment which includes spouses of issue or charities as potential appointees).

G. Special Tax Issues with Trust as Beneficiary.

1. Funding Pecuniary Devises with IRA.

a. A traditional IRA (but not a Roth) is income in respect of a decedent (IRD) under IRC §691.

b. IRD is taxed to the recipient when it is received.

c. The Trustee's assignment of an IRA to a trust beneficiary in satisfaction of a pecuniary devise triggers the realization of income at the trust level under IRC §691(a)(2). Same rule applies even if pecuniary devise is charitable!

d. Pecuniary devises include not only cash gifts but also many optimal marital share formulas.

e. Avoid the issue by:

i. Not having IRA pass thru a pecuniary funding formula. Do not designate Revocable Trust generally as beneficiary of IRA if the Trust includes a pecuniary formula devise.

ii. If the IRA must pass to a trust, either make it payable directly to the trust on the beneficiary designation or specify clearly in the trust instrument which trust it must go to so that it does not pass through the funding formula.

iii. Use a fractional formula devise, fulfillment of which does not trigger immediate realization of IRD, rather than a pecuniary formula.

2. Marital Deduction Trusts. Spouse must be entitled for life to receive both the "income" of the trust and income of the IRA which is payable to the trust.

a. A distribution from a traditional IRA generally will constitute income for federal income tax purposes but that same distribution may be principal for trust accounting purposes (e.g., lump sum distribution, etc.).

b. In the event the terms of a trust do not define how distributions from an IRA are treated for trust accounting purposes, Fl. Stat. § 738.602 provides default rules:

i. Income may be determined under the so-called "trust within a trust" method where the investment income of the IRA is treated as income of the trust for trust accounting purposes; OR

ii. Income may be determined under the unitrust method which gives the income beneficiary a percentage (between 3% and 5%) of the total value of the IRA.

c. Both the "trust within a trust" method and the unitrust method are authorized by Rev. Rul. 2006-26 and will result in the allowance of a marital deduction.

IV. Charity as Beneficiary

A. Most Tax Efficient. If a client wants to make both charitable and non-charitable devises, it is most tax efficient to fund the charitable devises to the maximum extent possible with client's taxable IRAs.

B. Naming Charity on Beneficiary Designation. If charitable and non-charitable beneficiaries are named on the beneficiary designation, the general rule is that all beneficiaries must be individuals or no beneficiary can use the life expectancy payout method. There are 2 exceptions:

1. Separate Accounts – Beneficiaries can establish separate accounts by December 31 of the year after the year of the IRA owner's death; must be pro-rata sharing of gains and losses post death.

2. Pay out the charitable share by September 30 of the year after the year of the IRA owner's death.

** Consider having client set up separate IRAs during life for charitable and non-charitable shares as this does not depend on the actions of the beneficiaries.

C. Naming Charity Through a Trust. If charity's share is to be determined based upon the amount of a client's overall assets or other contingencies, it may be easier to name the charity as a beneficiary under the trust. Trust terms should:

1. Direct that no estate taxes get charged against or paid from the charitable share.

2. Direct Trustee to use the IRA first to the maximum extent possible to fund the charitable share and then use non-IRA assets only if the IRA is not sufficient.

3. Give Trustee authority to distribute assets in kind.

4. Define charitable share using fractional formula (AVOID pecuniary bequests).

V. Asset Protection Attributes of IRAs

A. Florida law.

1. Unlimited exemption for money or assets in a traditional or Roth IRA. F.S. § 222.21(2)(a).

2. Express language of the statute provides that the exemption applies to “owner, participant or beneficiary”.

3. IRA does not lose exemption if rolled over into another exempt account (e.g., Roth conversion, rollover IRA). F.S. § 222.21(2)(c).

4. Need to use a beneficiary designation.

a. Assets will not remain exempt if paid to estate, either because designated as such or because no beneficiary designation used.

b. However, a designation to pay proceeds to a testamentary trust or a decedent’s revocable trust will retain protection from decedent’s creditors. F.S. § 733.808, which was revised after *Morey v. Everbank*, 93 So.3d 482 (Fla. 1st DCA 2012), to clarify benefit remains exempt when paid to a Trustee unless trust specifically refers to 733.808(4) and directs that the exemption does not apply.

5. Inherited IRAs are now clearly protected in Florida as a result of legislation enacted in 2011, See F.S. 222.21(2)(c). Prior to this remedial legislation, at least one Florida case found inherited IRAs not to be exempt, even though the language of F.S. § 222.21(2) already seemed to clearly exempt inherited IRAs. See *Robertson v. Deeb*, 16 So.3d 936 (Fla. 2d DCA 2009).

a. What if beneficiary does not reside in Florida?

b. Consider a trust for the beneficiary who has current or potential exposure to creditor's claims and designate the trust as the IRA beneficiary to protect the IRA both in bankruptcy and if the beneficiary resides in a state where inherited IRAs are not exempt.

6. Roth Conversion

a. The owner of a traditional IRA must begin taking MRDs upon attaining age 70 ½. Once MRDs are distributed to the owner, they become subject to the owner's creditors. Because a Roth IRA owner is not required to take MRDs, an owner of a traditional IRA who is approaching age 70 ½ and is concerned about creditors might consider converting the traditional IRA to a Roth IRA.

b. The conversion may be subject to attack by creditors under Florida's fraudulent conversion laws but such an attack would be difficult because a fraudulent conversion claim requires not only a conversion but also a showing that the creditor converted the Roth IRA with the intent to hinder, delay, or defraud the creditor.

c. Since Roth conversions are usually motivated by economic and tax planning opportunities, it may be difficult for creditors to prove the requisite actual intent necessary for a successful fraudulent conversion claim.

d. Owner can pay resulting income taxes of conversion from non-exempt assets thus removing additional assets from the reach of creditors.

B. Federal Bankruptcy.

1. Traditional and Roth IRAs of the owner are exempt from the bankruptcy estate but are subject to an aggregate cap of $1,000,000 adjusted for inflation ($1,245,475 as of 2013); excludes amounts rolled into an IRA from a qualified plan.

2. Inherited IRAs are NOT exempt – The US Supreme Court, in a unanimous decision, resolved the conflict among the circuits as to whether the federal exemption covers inherited IRAs. *Clark v. Rameker* (U.S. S.Ct., June 12, 2014).

a. The Supreme Court held that the ordinary meaning of "retirement funds" within the meaning of the Bankruptcy Code should be properly understood as the sums of money set aside for the day on which an individual stops working.

b. The Court cited 3 legal characteristics of inherited IRAs that make them something other than "retirement funds":

i. A holder of an inherited IRA may never invest additional money in the account.

ii. A holder of an inherited IRA is required to withdraw money from the account no matter how far they are from retirement.

iii. A holder of an inherited IRA may withdraw the entire balance of the account at any time and use it for any purpose without penalty.

3. Improper management of an IRA by the owner will cause it to lose its exemption in bankruptcy (and likely under Florida law as well).

a. *In re Ernest Willis*, 411 B.R. 783 (Bankr. S.D. Fla. 2009), aff'd 424 Fed. Appx. 880 (11th Cir. 2011) – Debtor engaged in prohibited transactions with respect to his IRA 14 years prior to filing bankruptcy.

b. Specifically, in 1993, debtor borrowed money from his IRA to purchase a mortgage owed by a company in which he held a 50% interest, and repaid the loan 64 days later. Four years later, debtor engaged in a "check swapping" scheme using funds from his IRA which also constituted prohibited borrowing. Debtor also created two additional IRAs by rolling over funds from his initial IRA.

i. The court held that funds in the debtor's initial IRA ceased to be exempt as of the beginning of 1993 as a result of the prohibited transactions. Additionally, any funds in the two newer IRAs which were traceable back to the non-exempt initial IRA were held to be non-exempt.

ii. The court stated that a favorable determination as to the form of the IRA by the IRS under Section 7805 which is in effect at the time of filing the petition only creates a rebuttable presumption that the funds contained therein are exempt. The presumption may be rebutted by evidence that the IRA was operated improperly.

c. *Kellerman v. Rice* (9/14/2015), the United States District Court for the Eastern District of Arkansas held that an IRA was not exempt in bankruptcy because the IRA owner had engaged in prohibited transactions with the IRA.

VI. Other Florida Considerations

A. Elective Share Statute – Under F.S. §732.201-732.228, IRAs are subject to the elective share and surviving spouse may elect against the elective estate (which includes IRAs) if they are not left at least 30% of the decedent's elective estate (as defined in the statute). Designating spouse as IRA beneficiary counts dollar for dollar in satisfaction of elective share as opposed to a credit shelter or QTIP trust.

B. Power of Attorney Statute – The newest version of F.S. §709.2101-709.2402 enumerates powers that may be exercised by holders over IRAs, including but not limited to changing beneficiary designations if there is a separate signed enumeration next to this power.

C. New "IRA Divorce" Statute – Florida Statute Section 732.703 (2015) applies to IRA beneficiary designations made in favor of a former spouse for decedent's dying on or after July 1, 2012. This new law provides that the portion of the IRA beneficiary designation made in favor of the former spouse is void upon the dissolution or annulment of the marriage to the decedent. The statute does not apply, however, to the following:

1. Where the IRA disposition is governed by a superseding law such as the law of another state under the IRA agreement.

2. IRA with an irrevocable beneficiary designation.

3. IRA beneficiary designation in favor of the former spouse which was signed after the dissolution or annulment.

4. Where the court order dissolving or invalidating the marriage requires the decedent to acquire or maintain an IRA for the benefit of the former spouse, or prohibits the decedent from unilaterally modifying the IRA beneficiary designation.

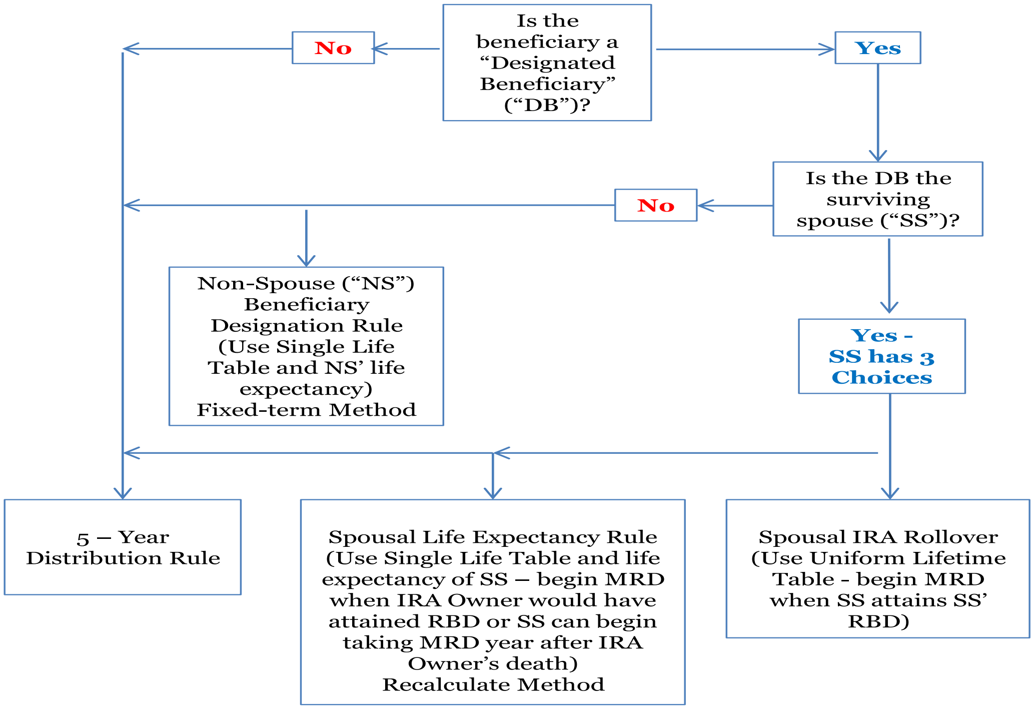
5. Where the decedent remarries the former spouse and they remain married until the decedent's death.

D. Guardianship F.S. §744 – IRAs in excess of $15,000 left to a minor outright instead of in trust are required to be supervised through a guardianship of the property; IRAs held by adult individuals that have been determined to be incapacitated will be governed by a guardianship unless there is a specific Durable Power of Attorney in place recognized by the court as a "less restrictive means".

“Exhibit A”

IRAs – The MRD Rules

Death of IRA Owner – **Pre-RBD**



Is the beneficiary a “Designated Beneficiary” (“DB”)?

No

Yes

Is the DB the surviving spouse (“SS”)?

No

Non-Spouse (“NS”) Beneficiary Designation Rule (Use Single Life Table and NS’ life expectancy) Fixed-term Method

Yes - SS has 3 Choices

5 – Year Distribution Rule

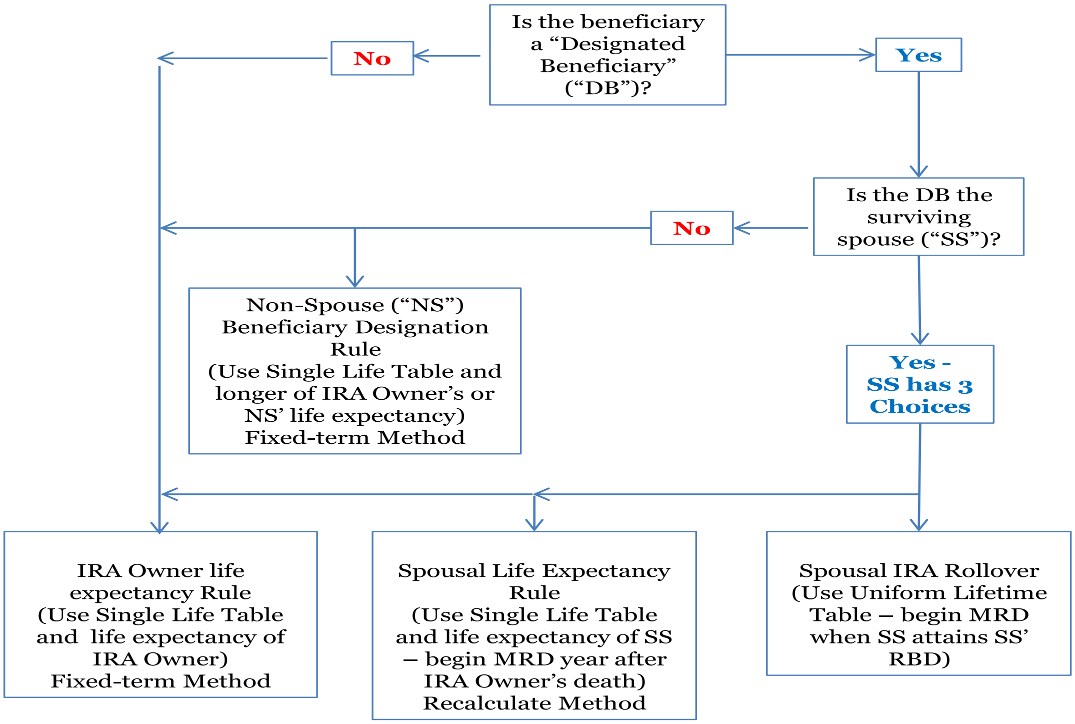
Spousal Life Expectancy Rule (Use Single Life Table and life expectancy of SS – begin MRD when IRA Owner would have attained RBD or SS can begin taking MRD year after IRA Owner’s death) Recalculate Method

Spousal IRA Rollover (Use Uniform Lifetime Table - begin MRD when SS attains SS’ RBD)

"Exhibit B"

IRAs – The MRD Rules

Death of IRA Owner – **Post-RBD**



Is the beneficiary a "Designated Beneficiary" ("DB")?

No

Yes

Is the DB the surviving spouse ("SS")?

No

Non-Spouse ("NS") Beneficiary Designation Rule (Use Single Life Table and longer of IRA Owner's or NS' life expectancy) Fixed-term Method

Yes - SS has 3 Choices

IRA Owner life expectancy Rule (Use Single Life Table and life expectancy of IRA Owner) Fixed-term Method

Spousal Life Expectancy Rule (Use Single Life Table and life expectancy of SS – begin MRD year after IRA Owner's death) Recalculate Method

Spousal IRA Rollover (Use Uniform Lifetime Table – begin MRD when SS attains SS' RBD)