Retirement Planning

IRA distributions to a CRT can provide asset protection and retirement income.

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The Setting Every Community Up for Retirement Enhancement Act (SECURE Act) that took effect in January of 2022 was designed to prevent older taxpayers from outliving their assets by increasing access to certain tax-advantaged accounts. A consequential part of the SECURE Act eliminated an estate planning tool designed to stretch individual retirement account (IRA) payments over the lifetime of the IRA beneficiary, replacing it with the requirement of full distribution of an IRA to its beneficiary (or beneficiaries) within 10 years following the year of the IRA owner's death.

A noteworthy estate planning technique has arisen in response to this new 10-year distribution requirement that attempts to recreate a "stretch IRA" by using a charitable remainder trust (CRT). Utilizing a CRT can lengthen (or stretch) the time for payments to the beneficiary and provides income tax advantages also. The payment made from the CRT (referred to generically as the "payout") is made instead to the CRT lifetime beneficiary, replacing the distribution that would have been made from the IRA.

There are two basic types of CRTs:

- A charitable remainder annuity trust, or CRAT; and
- A charitable remainder unitrust, or CRUT.

Payments can be structured as either a fixed percentage of the value of the CRT assets at inception (an annuity trust, or CRAT), or a fixed percentage of the value of the CRT assets on an annual basis (a unitrust, or CRUT). A CRUT is the preferred type of trust due to its innate flexibility regarding both design and payout options.

IRA owners can fund a CRT by distributing either their entire IRA balance at one time or, alternatively, over several years (not to exceed 10). A CRUT is preferred because it allows the owner to make additional contributions following the initial year and the beneficiary is not required to make withdrawals. While the IRA distribution to fund a CRUT is considered taxable income, the IRA owner can offset a portion of the income with a charitable income tax deduction. The proceeds of the trust

can be used to pay income to the IRA owner's beneficiaries.

The CRT beneficiary receives a payout over his/her lifetime with the remainder passing to a charity of the original IRA owner's choice, including a donor advised fund established by the original IRA owner.

Payments made to the CRT lifetime beneficiary are considered taxable income, and furthermore, are subject to the "tiering" rules set forth at Internal Revenue Code §664(b). These rules determine how distributions to the beneficiary are taxed since a CRT will often have a mixture of various types of taxable income.

For example, assume that a CRT has investments that generate ordinary income, capital gains, and tax-free interest income. The tiering rules determine how the distribution is taxed to the CRT's lifetime beneficiary:

- First, ordinary income;
- Then, income from capital gains;
- Next, tax-free interest income; and
- Last, any tax-free return of basis.

As an enhancement to this plan, two basic strategies using life insurance that can augment CRT assets are available.

First, if all IRA assets are subject to tax, then IRA proceeds (typically, a post-tax amount) can be used to purchase a life insurance policy within the CRT. Life insurance inside of a CRT will boost the assets available to a successor lifetime beneficiary and/or the charitable remainder beneficiary.

Second, payouts to the CRT's lifetime beneficiary can be redirected to a wealth replacement trust (WRT), which is merely another name for an irrevocable life insurance trust. At the death of the lifetime beneficiary, the remainder of the CRT passes to the charity named in the CRT, but since a life insurance policy was funded with part of the CRT distributions (typically, the post-tax amount), the WRT has essentially replaced assets contributed initially to the CRT for the benefit of family members. The life insurance policy distributions will be income tax-free.

By designating a CRT as recipient of IRA distributions, the SECURE Act's 10-year payout can be altered effectively for asset protection, estate planning, retirement income, and charitable planning purposes.

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