Inherited IRA Special Needs Trusts: Solutions, Options, & Cost Savings

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National Conference on Special Needs Planning & Special Needs Trusts | October 13-15, 2021

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Today's Topics

Inherited IRA Special Needs Trusts

- The Three-Step Transfer
- Case studies: Funding SNTs with Inherited Qualified Assets
- Options & Cost Savings

Investing & Monitoring SNT Accounts

- Deciding to Invest & Delegate
- 7 Things to Avoid in SNTs
- Suitability, Diversification, & Risk
- Allocation Models
- Investment Proposal Summaries
- Fiduciary Code of Ethics

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Inherited IRA Special Needs Trusts

Self-Settled SNT under 42 U.S.C. §1396p (d)4(a)

- Irrevocable trust agreement created during the lifetime
- Created for the sole benefit of an individual with disabilities under 65
- Established by an individual, parent, grandparent, guardian, or court
- Medicaid Reimbursement stipulations
- Must be funded with trust beneficiary's own funds before age 65

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Inherited IRA Special Needs Trusts

Funded with Inherited IRA under IRS PLR 2006 200 25 *

- Inherited IRA is put into beneficiary's name at current institution
- Funds are moved to a like named account at receiving institution
- Transferred into an SNT IRA account by Letter of Authorization

Timing counts: The three-step transfer must be completed quickly, so that funds don't remain in the beneficiary's name to affect benefits eligibility

** A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. A PLR is issued to establish with certainty the federal tax consequences of a particular transaction before the transaction is consummated or before the particular taxpayer's return is filed. A PLR may not be relied on as precedent by other taxpayers or IRS personnel. Some tax and legal practitioners may view the holdings of a PLR as an indication of the IRS position on a certain issue, and should be consulted prior to an individual using a PLR for guidance.*

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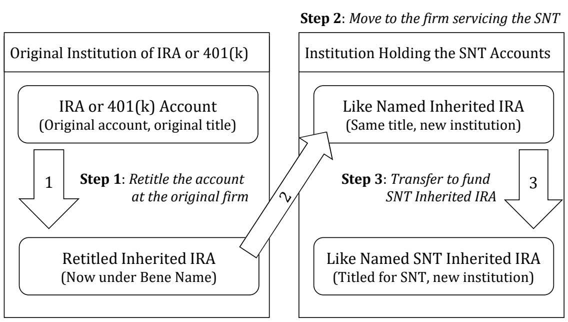
Three-Step Transfer



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Case Study on Inherited Qualified Assets

The disposition of assets inherited from an IRA or 401(k) can have a dramatic impact on the beneficiary by determining taxes paid, the availability of stretch payout options, the type of SNT funded, etc.

Let's look at four scenarios around the beneficiaries of a $1MM IRA

- A decedent named two beneficiaries before passing away in 2020
- The beneficiaries were the decedent's adult son and daughter
- Each child is a 50% beneficiary and the son is a special needs individual

How can the inherited funds be used? What is the impact of that use?

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Case Study: The Daughter's Beneficiary IRA

The daughter receives $500K, half of the $1MM IRA/401(k), into a beneficiary IRA under her SSN

Decedent's IRA or 401(k): $1MM

Daughter listed as beneficiary

Daughter's Beneficiary IRA
(Receives half of assets: $500K)
- Non-taxable transition
- 10 year set payout
- No stretch provision

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Case Study: The Son's Inheritance: 3rd Party SNT IRA

Option 1
Moving the son's inherited assets ($500K) into a 3rd party SNT IRA

The 3rd party SNT is created with it's own TIN, and is named as the beneficiary of the IRA or 401(k)

Decedent's IRA or 401(k): $1MM

SNT listed as beneficiary

Non-taxable Transfer

Funds 3rd Party SNT IRA
$500,000

3rd Party SNT: $500,000
- No Medicaid clawback
- RMDs required
- Distributions taxable

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Correct Titling is Critical

Correct titling enables a quick, smooth transfer process

- "John Doe Jr SNT as Beneficiary for Jonathan Doe IRA"

Incorrect titling creates negative outcomes

- Time, effort, and documentation to correct
- Delay of the transfer process at a critical stage
  - Assets delayed while under the beneficiary's name can effect benefits eligibility

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Case Study: The Son's Inheritance: 1st Party *Non-IRA* SNT

Option 2
Moving the son's inherited assets ($500K) into a 1st party SNT

Funds pass to an inherited IRA for the son, under his SSN, *then* to a 1st party SNT with it's own TIN

Decedent's IRA or 401(k): $1MM

Son listed as beneficiary

Son's Inherited IRA
Distributions taxed appx 30%

Less $150,000 in taxes

1st Party SNT: $350,000
- Traditional Non-IRA SNT

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Case Study: The Son's Inheritance: 1st Party SNT IRA

Option 3
Moving the son's inherited assets ($500K) into a 1st party SNT

Funds pass to the inherited IRA for the son, under his SSN, *then* are transferred to an SNT IRA per LOA

Decedent's IRA or 401(k): $1MM

Son listed as beneficiary

Son's Inherited IRA
Opened under his own SSN

Non-taxable transfer with LOA
Per IRS PLR 2006 200 25

1st Party Inherited IRA SNT
Opened under it's own TIN
$500,000 with stretch RMDs

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Use a Non-IRA SNT account to receive RMDs

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Summary: Inherited Qualified Assets

Named Beneficiary	**Daughter's Bene IRA**	**Son's 3rd Party SNT IRA**	**Son's 1st Party Non-IRA**	**Son's 1st Party SNT IRA**
Type of Account	Inherited IRA (No SNT)	3rd Party SNT IRA directly funded by son's inheritance	Trad. 1st Party Non-IRA SNT Funded by son's inherited IRA	1st party SNT IRA funded by son's Inherited IRA via "3 Step Transfer"
Taxable Event	No	No	Yes	No
Medicaid Clawback	N/A	No	Yes	Yes
Set Payout / Stretch	10 Year	Stretch *	N/A	Stretch *
RMDs Required	No	Yes	No	Yes

* *While the transition to an inherited IRA in the beneficiary's name is not taxable, distributions are taxable.*

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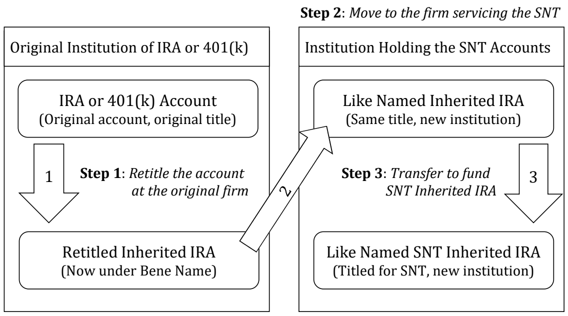
Three-Step Transfer



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Estates Named as Beneficiary

What if the estate is the beneficiary of qualified assets?

- Executor may be able to assign an IRA to a beneficiary
- Estate beneficiary establishes an Inherited IRA
- Assets are then transferred by LOA to the beneficiary
  - "John Doe Jr SNT as Beneficiary for Jonathan Doe IRA"
- Non-taxable transfer
- IRS PLR 2003 43 030

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Important Items to Remember

1. Timing is critical
   - Assets in a client's name at month-end may effect benefits eligibility
   - Start early in a month and finish as quickly as possible
   - A transfer in under 10 business days is possible with preparation
2. Prepare thoroughly
   - Prepare the documentation for all steps before you initiate
   - Have the trust established, TIN in hand, and trust accounts open
     - Remember: Correct titling on each account is key to a smooth transfer
   - Be ready with completed transfer forms, court orders, LOAs, etc.
3. Work with a fiduciary
   - If you plan to invest assets, invest time in finding a fiduciary to help
   - Confirm that the firm serving you allows Bene IRAs to be held in SNTs

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Options and Cost Savings

Options

- Types of SNTs: 1st Party / Self-settled, 3rd Party, and Pooled
- Disposition of Assets: In-Kind vs Cash
- Pairing with an ABLE account for additional tax savings
- Investing & Monitoring in SNT Accounts

Cost Savings

Capital can be preserved for the beneficiary through…

- Tax advantages
- Non-taxable transfers
- ABLE accounts
- Minimizing fees
- Limiting accounting costs
- Prudent investing

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Delegation to a Fiduciary for SNT Accounts

"Delegation. For a fiduciary without substantial investment expertise, it is both a good plan and protective against liability, to select an investment advisor."

National Guardianship Association

"The prudent investor rule is a test of conduct and not of resulting performance."

(760 ILCS 5/5) (Ch. 17, para 1675)

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7 Things to Avoid in SNT Accounts

1. Inappropriate Assets
2. Incorrect Mutual Fund Asset Classes
3. Proprietary Investments
4. Over-Concentrations
5. Alternative Investments & Limited Partnerships
6. Fees & Commissions
7. Conflicts of Interest

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#1: Inappropriate Assets

Avoid investing exclusively in stocks and annuities

1. Individual stocks
   - Market / Systemic Risk
   - Firm / Company Risk
   - Degrees of risk may vary, but no stock is immune
2. Annuities
   - Lack necessary liquidity
   - Create difficulties in accessing funds
   - Assets may be "locked up" for many years
   - Liquidation penalties and surrender charges are common
   - High internal costs

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#2: Incorrect Mutual Fund Asset Classes

Mutual fund share classes determine costs and fee structures

Share classes include:

- A Shares: Front-end fees, lower expenses
- B Shares: No front-end fees, back-end fees, higher expenses; Convert to A shares after a period
- C Shares: No front-end fees, small back-end fees, high expense ratios; No conversions or discounts
- I Shares: No front- / back-end fees, low internal fees/expenses

Index Funds

Active vs Passive Management

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#3: Proprietary Investments

Investment products created/sold by Advisor's firm

- Often mutual fund or annuity products
- Advisor may be incentivized to push proprietary products
- May create a conflict of interest

Red Flag: Portfolios invested heavily in proprietary investments

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#4: Over-Concentrations

A large percentage or entire portfolio consisting of

- CDs – Inflation Risk
- Single stock holdings – Market Risk
- One asset class - For example:
  - All *Growth* Funds
  - All *Tech* Funds / FAANG Stocks → Facebook, Apple, Amazon, Netflix, Google
  - All Oil-based Investments

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#5: Alternative Investments & Limited Partnerships

- Low or no liquidity
- High up-front costs
- High internal fees
- Can be a "black box"
- K-1 tax reporting
- Difficult and costly to re-register or terminate
- Hedge funds
- Cryptocurrencies → Bitcoin, Bitcoin Cash, Ethereum, Cardano, Etc.

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#6: Fees & Commissions

Fees

- Allow you to know the cost of management
- Usually charged as a flat rate – a percentage of assets
- Compare rates: Fees can be as high as 3%
- Gold Standard: 1% or less for asset management

Commissions

- May be variable with total fees depending on several factors
- May create conflicts of interest
- Incentivizes more transactions, not necessarily more care
  - Excess trading / churning increases accounting and record-keeping costs
- In a commission account, total fees should still be 1% or less

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#7: Conflicts of Interest

- Personal bias
- Commission accounts
- Proprietary investments
- Self-dealing

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How to Avoid These Issues

Standardize processes & document decisions

- Use objective methods for assessing risk, determining investment models, and evaluating performance

Implement proper controls

- Regular monitoring and review of accounts
- Information security and document retention

Delegate: Work with a fiduciary

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Suitability: Evaluating Client Needs

- Time horizon
- Age & health
- Sources of income and total investable assets
- Annual expenses (individual & guardianship)
- Expected short fall (if any)
- Anticipated large withdrawals
  - Education, housing, vehicle, etc.
- Limitations or restrictions on investments

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Deciding Whether to Invest

- Use objective standards & logical decision-making
- Tools to determine suitable investment options
  - Standardized questionnaire
  - Objective scoring system
  - Quantifiable risk categories
  - Data-driven investment models
- Ask common sense questions
  - How does this meet the beneficiaries' needs / goals?
  - Is this the right level of risk / time-frame for the client?
  - How long will the funds last?
  - What are the client's income needs?

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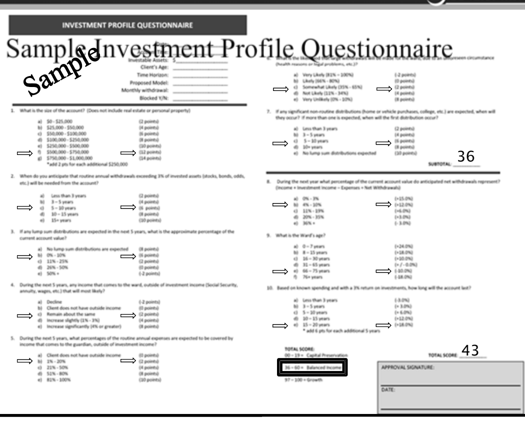
Sample Investment Profile Questionnaire



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ALLOCATION MODELS

CAPITAL PRESERVATION

FIXED INCOME	100%
Ultra Short Term Fixed Inc.	24
Short Term Fixed Income	60
Intermediate Term Fixed	15
Cash	1

INCOME

FIXED INCOME	70%
Short Term Fixed Income	29
High Yield Bonds	10
Intermediate Term Fixed	20
Long Term Fixed	10
Cash	1
EQUITY	**30%**
Large Cap Value	10
Large Cap Growth	9
Mid Cap Blend	6
International Equities	5

BALANCED INCOME

FIXED INCOME	50%
Short Term Fixed Income	19
High Yield Bonds	7
Intermediate Term Fixed	18
Long Term Fixed	5
Cash	1
EQUITY	**50%**
Large Cap Value	15
Large Cap Growth	14
Mid Cap Blend	10
International Equities	10
REIT	1

BALANCED GROWTH

FIXED INCOME	40%
Short Term Fixed Income	4
High Yield Bonds	7
Intermediate Term Fixed	18
Long Term Fixed	10
Cash	1
EQUITY	**60%**
Large Cap Value	15
Large Cap Growth	17
Mid Cap Blend	8
Small Cap Blend	6
International Equities	10
Emerging Markets	3
REIT	1

GROWTH

FIXED INCOME	25%
Short Term Fixed Income	5
High Yield Bonds	7
Intermediate Term Fixed	6
Long Term Fixed	6
Cash	1
EQUITY	**75%**
Large Cap Value	20
Large Cap Growth	20
Mid Cap Blend	10
Small Cap Blend	8
International Equities	10
Emerging Markets	4
REITS	3

The above allocation examples are for illustrative use only and are not intended as investment advice. The use of an asset allocation model does not guarantee a profit or protect against a loss in declining markets. You should discuss your individual situation with your financial advisor to find the right balance between risk and potential reward.

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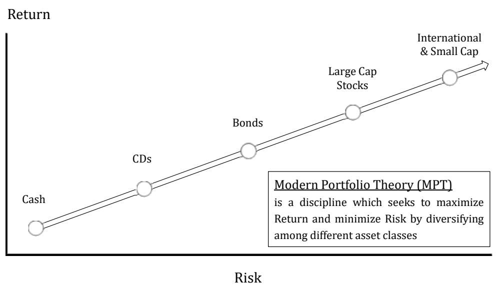
Balancing Risk & Return



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Investment Policy Statements & Proposals

- Investment allocation models
- Investment selection & future considerations
- Investment time horizon
- Rebalancing frequency
- Annual costs

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Investment Proposal Summary

Sample Special Needs Trust

Account Name	Special Needs Trust
Total Investable Assets	$500,000
Type of Account	Trust
Monthly Withdrawal	N/A
Time Horizon	2 - 5 years
Risk Tolerance	Conservative - Moderate
Allocation Model	Income
Benchmark Model	70% Barclays Aggregate Bond Index / 30% S&P
Rebalancing Frequency	Semi-Annual
Blocked / Restrictions	n/a
Performance Reporting	Quarterly in Person Reviews

Oppenheimer & Co. Inc. Conservatorship accounts have the following costs and benefits:

- Oppenheimer's Annual Management Fee is 0.85%
- We provide opportunities for increased income for the client through proper asset allocation
- Oppenheimer holds approximately 9 – 12 securities in the portfolio, reducing annual accounting costs
- Each Oppenheimer model maintains proper diversification & receives regular rebalancing
- Provide standardized performance reports quarterly
- Ongoing monitoring & risk evaluation to keep in compliance with the Uniform Prudent Investor Act (UPIA)

This proposal is for illustration purposes only and is not a representative of the performance of any specific investment, and there is no guarantee that the hypothetical rate of return can be achieved.

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Fiduciary Code of Ethics

1. Employ and provide the client information on the Prudent Practices when serving as an investment fiduciary
2. Act with honesty and integrity and avoid conflicts of interest, real or perceived
3. Ensure the timely and understandable disclosure of relevant information that is accurate, complete and objective
4. Be responsible when determining the value of services and form of compensation

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Fiduciary Code of Ethics

5. Know the limits of expertise, and refer clients to colleagues and/or other professionals in connection with issues that go beyond the scope of knowledge and skill set
6. Respect the confidentiality of information acquired in the course of work, and not disclose such information to others, except when authorized or otherwise legally obligated to do so. Do not use confidential information acquired in the course of work for personal advantage
7. Not exploit any relationship or responsibility that has been entrusted

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Conservators' Responsibilities

- Confirm investment goals and objectives
- Approve appropriate asset allocation strategy
- Establish or approve an explicit, written IPS
- Prudently select service providers
- Incur only reasonable expenses
- Monitor the activities of the overall investment program, including service providers
- Avoid conflicts of interest
- Documentation

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Monitoring Accounts

- Performing regular reviews with your delegated Advisors are:
  - A fiduciary responsibility
  - An important tool
  - A best practice
- A fiduciary advisor should assist you on an ongoing basis with:
  - Periodic due-diligence and Suitability Reviews
  - Documentation
- Your advisor may provide standardized documentation

Advisory Account Portfolio
Review Log
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Personal Information

Financial Advisor: Darryl J. Lynch & Peter C. Palumbo	FA#: ZV4
	Branch: Bellevue, WA / St. Louis, MO
Client Name: Sample McExample	Conservator/Trustee: Pacific Northwest Guardians
Date of Meeting: 10/10/2019	☐ Phone ☐ In ☑ Out

Attendees: Darryl Lynch & Peter Palumbo of Oppenheimer; Joe B. Conservator, CEO of PNG

Account#:	Type:	Model:	Fee:	Blocked?
G71-XXXXXXX	Guardianship	Balanced Income	0.90%	Yes

Topics discussed during review meeting:

Economy in general	☐	Specific securities in portfolio	☑
Direction of financial markets	☑	Short term outlook / recommendations	☐
Investment objectives	☑	Long term outlook / recommendations	☑
Risk tolerance	☑	Changes in personal / financial profile	☐
Change in model	☐	Performance of the account	☑

Performance of the Portfolio

FY19 TYD performance: Portfolio is up +X.YX%

Notes on the Portfolio

Due to large gains in ABC fund, the account automatically re-balanced to the model at end of Q4.

Concentrated positions (if so, explain)

None at this time. Account diversified according to 2019 Balanced Income model standards.

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Joe B. Conservator — Conservator/Trustee Signature — 10/10/2019 Date of Review

Darryl J. Lynch — Financial Advisor's Signature — 10/10/2019 Date of Review

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