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FUNDING AN SNT WITH TAX DEFERRED ASSETS

2025 NATIONAL CONFERENCE
ON SPECIAL NEEDS PLANNING
AND SPECIAL NEEDS TRUSTS

STETSON UNIVERSITY COLLEGE OF LAW

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Sorry, but . . . .

Annuities and IRAs

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OUR AGENDA

- Nonqualified Annuities
- Inherited IRAs
- Trust-like Features of Annuities
- Medicaid and Annuities
- Annuitized IRAs

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ANNUITIES

- You MUST understand annuities in a Medicaid practice
- Trust ownership can be useful
- Qualified vs Nonqualified
- What they are – a bit like a loan

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ANNUITIES

- IRC § 72
- Encourage retirement savings
- Police against nefarious tax schemes
- Many similarities to IRC § 401(a)(9)

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ANNUITIES

The Parties

- Holder – The Owner
- Annuitant – Technically, the measuring life
- Beneficiary – The person who will benefit

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ANNUITIES

Classification

- Qualified v. Nonqualified
- Immediate v. Deferred
- Other features

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ANNUITIES

If Deferred

- Accumulation Phase
- Distribution Phase
- Annuity Start Date ("ASD")
- Different tax rules pre/post ASD

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ANNUITIES

Rules During Holder's Life

- Tax Deferral during accumulation/life
- Annuity held by trust – Agent for natural person – look at beneficiaries
- Income received as an annuity
- Income NOT received as an annuity

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ANNUITIES
Rules During Holder's Life

- **Income received as an annuity – 1/18/1985 Force Out Rules**
- **After ASD**
- **Exclusion ratio**
- **Investment in the K ÷ Expected return**

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ANNUITIES
Rules During Holder's Life

- **Income received as an annuity**
  - **The exclusion ratio: Tax-free return**
  - **The rest: Ordinary income**
  - **If a trust apply usual tax rules**

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ANNUITIES
Rules During Holder's Life

- **Income <u>NOT</u> received as an annuity**
  - **Amounts drawn out before ASD**
  - **Last In/First Out (LIFO) (TEFRA '82)**
    (Effective 8/18/192 . . . Look at the 8/1/1982 outline attachment!)
  - **If a trust apply usual tax rules**

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ANNUITIES
Rules During Holder's Life

- **Income NOT received as an annuity**
- **Example:**
  - **$100,000 investment**
  - **ASD 10 years out**
  - **In 5 years dip in when worth $130,000**
  - **Take out $40,000/4% surrender chg**
  - **Receives $38,400**
  - **$30,000 ordinary income**

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ANNUITIES
Rules During Holder's Life

- **Gratuitous Transfers**
- **Except: To spouse**
- **Except: Grantor trust/estate includible**
  - **Because I said so**
  - **Underlying policy**

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ANNUITIES
Rules At Holder's Death

- **Force-out Rules**
- **Beneficiary Taxation**

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ANNUITIES
Rules At Holder's Death

- How fast?
- Holder dies before ASD
  - Five year rule
- Holder dies after ASD
  - At least as rapidly as

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ANNUITIES
Rules At Holder's Death

EXCEPTIONS!

- Spouse is primary beneficiary
  - Death before ASD – continue
  - Lump sum (if allowed in K)
  - Death after ASD – At least as
    Death after ASD – Spouse LE

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ANNUITIES
Rules At Holder's Death

EXCEPTIONS!

- Designated beneficiary
  - May elect DB's life
  - Must receive first install w/in one year
  - Must elect within 60 days
  - Election counters constructive receipt

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ANNUITIES
Rules At Holder's Death

EXCEPTIONS!

- **Trust are not humans! NOT DBs**
  - **Either 5 year rule or "at least as rapidly as"**
  - **If Trust is Holder, then death of Primary Annuitant triggers**
  - **If Trust changes Primary Annuitant: Immediate tax**

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ANNUITIES AND TRUST RECAP

- **Trust can hold as "agent" – type of trust irrelevant**
- **Exception to gratuitous transfer rule**

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ANNUITIES AND TRUST RECAP

- **If Trust is beneficiary – either 5 year or at least as rapidly as**
- **If trust is Holder, then death of Primary Annuitant triggers**
- **If trust is Holder – Don't change PA**

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TRANSFERRING AN INHERITED IRA

- Poor/No Planning by Parent
- Any Circumstances Rule
- D4A Exception

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D4A Trusts

- Recap
- Tax Status as Grantor Trust
- IRC § § 673 and 677

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Treas. Reg. § 1.671-3(a)(1)

- If Grantor treated as owner of whole trust --

All tax attributes taxed to Grantor in same manner “Had the trust not existed”

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Revenue Ruling 85-13

- Reiterates Treas. Reg. § 1.671-3
- For tax purposes, treat the trust as if it simply did not exist

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The Inherited IRA

- Trusts are routinely named as beneficiaries
- Extensive SECURE Act (and 2.0) rules
- This is NOT a rehash

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The Inherited IRA

- But what about an inherited IRA (woops)?
- Generally, IRC § 691(a) IRD when received; totally when transferred
- Disabled bennie in a tough spot

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The Letter Rulings

- PLRs 2006-20025 & 2011-16005
- IRAs inherited by disabled beneficiaries
- D4As were grantor trusts due to IRC § 677 (income accumulation)

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The Letter Rulings

- PLRs 2006-20025 & 2011-16005
- Discussed 691(a)(2) (Transfers trigger total tax)
- Discussed Rev. Rul. 85-13

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The Letter Rulings

- PLRs 2006-20025 & 2011-16005
- Conclusion: Not a transfer under IRC § 691(a)(2) because to a grantor trust
- Under Rev. Rul. 85-13 not a "sale or disposition"

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The Letter Rulings

- PLR 2008-26008
- Beneficiary a minor (not disabled)
- Irrev Trust with mandatory distributions at certain ages
- Same reasoning used

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The Inherited IRA

- Dave's story
- The Trust – Yay Peak Trust!
- Estate Recovery
- The remainder beneficiaries

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SWITCHING GEARS

GOING OFF SCRIPT!

- We've talked about <u>inherited</u> IRAs – We have support for transferring to trust
- What about <u>owned</u> IRAs to D4A or other grantor trust?

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SWITCHING GEARS

TRANSFERRING AN OWNED IRA TO TRUST

- No support; even though 85-13 says to "treat as if trust doesn't exist"
- Irrev Grantor Trust: 5 year lookback and tie up IRA

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SWITCHING GEARS

TRANSFERRING AN OWNED IRA TO TRUST

- D4A: Payback; Not good if CS
- What about annuitized IRAs?
  - Friendly inheritance rules for spouse
  - If no spouse, annuity can STILL mimic D4A

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SWITCHING GEARS

Besides . . . .

- Rules tend to conflate annuities and trusts
- What about annuitized IRAs?
  - Great for a CS or a disabled child

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SWITCHING GEARS

So . . . .

- Let's discuss Medicaid and Annuities (I may have a surprise)
- Then let's look at annuitized IRAs

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SWITCHING GEARS

MEDICAID AND ANNUITIES

- Countable Assets?
- Transfer Rules

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Countable?

- Irrevocable
- Nonassignable

See POMS SI 01110.100B &
42 USC § 1396p(c)(1)(G)(i)(II)(ii)(I)
("irrevocable and nonassignable")

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42 USC § 1396p(c) – The Transfer Rules

(c)(1)(A) through (J) -- The general transfer prohibitions

(c)(2)(A) and (B) – The Exceptions to (1)

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Transfer?

- DRA 2005 added 1396p(c)(1)(F) & (G)
- Subparagraph (F)
  - Remainder Beneficiaries: State, Spouse, Disabled Child (More to follow)

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Transfer - Subparagraph (G)

- Individual Retirement Annuity (Qualified)

OR

- Purchased with IRA proceeds (Qualified)

OR

- Nonqualified Proceeds
  - Irrevocable/nonassignable
  - Actuarially sound
  - Equal Periodic Payments

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Subparagraph (G) and Qualified Assets

- Most of us focus on the THIRD category
- But think about the FIRST and SECOND (Qualified assets)
- The qualified assets do not need to comply with "actuarially sound" – Simply the more generous IRA life table rules

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ANNUITIZING AN IRA

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DC = DEFINED CONTRIBUTION

DB = DEFINED BENEFIT

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5,786 lectures on SECURE Act

DC vs DB

NONE! Well, not many

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SNEAK PEEK AT OUR DISCUSSION OF A FEW MINUTES FROM NOW:

Does it make sense to annuitize the I/S IRA ?

- **Make noncountable**
- **Avoid cash-out (defer taxes)**
- **Annuity payments either to SNF or to Spouse (MMMNA)**
- **Upon death of I/S, spouse rolls to own IRA**

Hold that thought. First some rules . . . .

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THE DB RULES SYNOPSIS

- **SECURE Act made few changes to DB rules**
- **RBD:**
  - **If 72 on or after 1/1/2023 – age 73**
  - **75 if born on or after 1/1/1959**
- **ASD: Date annuity payments begin (no later than RBD)**

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PERMISSIBLE FORMS OF ANNUITY UNDER DB RULES

- Straight Life – Maximizes payout; no beneficiaries; not Medicaid attractive
- Joint life of owner and spouse – Lowers payout; spouse can have lump sum payout at death of owner; spouse named ahead of state
- Joint life of owner and another – Recall a disabled child can be remainder ahead of state
- Period certain: Yuck!

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CALCULATING THE ANNUITY STREAM

- DITCH THE SSA ACTUARIAL TABLES!
- “Period certainty” limitation -- “Borrow” the denominator from the appropriate IRS DC Life Table

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THE IRS LIFE TABLES

- Uniform Lifetime Table
  - Owner + Spouse within 10 years of age of owner
  - Owner + Spouse not sole remainder beneficiary
  - Owner not married
  - E.g., owner is 72 – ULT assigns 27.4 years
- Compare to “stingy” SSA Period Life Table:
  12.3 (Male) 14.36 (Female)

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THE IRS LIFE TABLES
(Continued)

- **Joint Life and Last Survivor Expectancy Table**
  - **Owner is 10 or more years older than beneficiary spouse**
  - **Think: Michael Douglas (79) and Catherine Zeta Jones (54) OR Heidi Klum (47) and Tom Kaulitz (31)**
  - **E.g., Owner (72) and Spouse (60) – ULT assigns 28.8 years**

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Death Benefit Options

- **Nonspouse Beneficiary**
  - **Leave annuity stream as is, or**
  - **Cashout (and pay tax!) (an exception to nonincreasing payments rule)**
- **Spouse Beneficiary**
  - **Same as above OR**
  - **Rollover PV into own IRA (spousal rollover)**

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ANNUITIZING AN IRA

A COST – BENEFIT ANALYSIS

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INSTITUTIONAL SPOUSE IRA

- MOST COMMON APPROACH: Cash it in and tax the tax hit!
- Annuitize it under (c)(1)(G)
- Name on the Check Technique

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A CRITIQUE OF THE NOC TECHNIQUE

MEDICAID ISSUES

- Look at Spring/Fall 2020 NAELA Journal

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A CRITIQUE OF THE NOC TECHNIQUE

MEDICAID ISSUES

- 1395r-5(d)(2)(A) <u>NON</u>trust Property
  Name on check rule: What is his is his, and what is hers is hers

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A CRITIQUE OF THE NOC TECHNIQUE

MEDICAID ISSUES

- **1395r-5(d)(2)(B) <u>Trust</u> Property**
  - **Income as provided under the trust**
  - **Otherwise "Name on Check"**

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A CRITIQUE OF THE NOC TECHNIQUE

TAX ISSUES

- **IRC § 408(b)(1): IR Annuity must be nontransferable**
- **Treas. Reg. § 1.408-2(b)(7): Must be for <u>exclusive</u> benefit of individual (and later on) beneficiaries**

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ANNUITIZING UNDER (c)(1)(G)

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ANNUITIZE INSTITUTIONAL SPOUSE ANNUITY AND . . .

CONS

- Annuity payments become income for MA purposes
- May end up going to SNF

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ANNUITIZE INSTITUTIONAL SPOUSE ANNUITY AND . . .

PROS

- Different life tables apply (much longer stretch)
- Much younger spouse
- Tax deductible to extent NH expenses paid exceed 7.5% of AGI

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ANNUITIZING THE INSTITUTIONAL SPOUSE IRA: THE COST-BENEFIT ANALYSIS

- How long is I/S expected to live? Using that guesstimate, how much will go to SNF as PML?
- What is tax savings by not cashing in?

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SCENARIO 1

Harry, 72, and headed to Shady Grove Health & Rehab.

Sally (Harry's wife), 60, and very healthy.

Harry owns $350,000 IRA. SS Retirement $2,000/mo.

Sally works. $75,000/yr. Is an accountant.

IRA is only obstacle to what should have been routine married couple Medicaid planning matter.

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OPTIONS

1. Cash in the IRA. Tax liability: $135,000. Net IRA proceeds: $215,000.

2. Annuitize the IRA.
   A. Use Joint & Last Survivor Table: 28.8. Annuity stream of about $1,000/mo to Harry.
   B. 4 Years later, Harry dies. PV of annuity is $300,000. Sally now 64, 11 years from her RBD. Sally estimates FV in 11 years to be $630,000.

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SCENARIO 2

Same facts, except both Harry and Sally are 74. Sally's monthly SSRB is $1,100.

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OPTIONS

1. Cash in the IRA. Added tax liability: $95,000. Net $255,000 to use in standard planning.

2. Annuitize. Using Uniform Life Table divisor is 25.5, yielding a stream of about $1,100/mo.
Harry dies 2 years later at 76. PV of annuity is about $320,000. Sally rolls to her DC-type IRA.
When Sally dies, the kids can inherit, and you'll know what to do because of all the DC-type seminars you have been to.

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SCENARIO 3

Sally was recently hit by a school bus and killed. Their child Sandy, aged 45, is on SSDB. Harry's IRA is worth $350,000. UL Table denominator: 25.5

If annuitized, Harry's IRA would yield about $1,100/mo (based on 25.5 divisor).

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OPTIONS

1. Cash in the IRA. The net after taxes would be about $228,000. This could be gifted to Sandy sanction-free.

2. Annuitize the IRA and name Sandy Beneficiary. Yield to Harry, about $1,100 monthly. Sandy's life benefit would be limited to $671.

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NEWS FLASH!

3 years later . . . Harry has taken his light into another room . . .

There is about $310,000 available for cash-out that net of taxes will yield about $205,000 to Sandy . . . Unless she wants the $671 monthly for the rest of her life.

I'm thinking she's sorry she didn't take $228,000 back when we qualified Harry for Medicaid.

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DONE!

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QUESTIONS?

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