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CPAs and Consultants Concisors at Law

Beneficiary Maintenance Program Understanding Trust Income Tax


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Introduction

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Overview

- Revocable vs. Irrevocable Trusts
- Trust Protections
- Four Types of Disbursements from an Inherited Trust
- Limited Power to Vest
- Annual Tax Filing Requirements

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○ Overview

- Form 1041/Grantor Letter
- Capital Gains Tax & the Importance of Basis
- Federal Estate Tax Planning
- Required Distributions from Qualified Retirement Plans
- The Importance of Tax Planning and Coordination – WHY WE DO THIS!

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○ Revocable vs. Irrevocable Trusts

- Primary Trust - Revocable during Trustmaker's Lifetime
- "Sub Trusts" are created by the Primary Trust upon the happening of some event
 - Family Trusts: Created for a surviving spouse and family
 - Marital Trusts: Created for a surviving spouse only
 - Beneficiary Trusts: Created for adult children and/or other beneficiaries

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○ Trust Protections

- "Outright" Distributions remain the norm in the estate planning industry
- Easier for attorneys to wind down affairs
- Complete loss of Trust Protections
- One Way Street!!!
- Two Part Test to maintain protections:
 - Ownership
 - Control

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○ Trust Protections


- Creditor
- Catastrophic Law Suits
- Divorce
- Bankruptcy
- Nursing Home
- Bloodline
- Remarriage
- Federal Estate Tax

All reasons to maintain assets in "sub-trust" as opposed to outright distributions

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○ Beneficiary Trusts

- Generally two types – Trust Share or Inherited Trust
- Trust Share:
 - One beneficiary
 - Trustees = Beneficiary + Professional co-Trustee
 - Requires both trustees to transact business together – Practical Challenges
- Inherited Trust:
 - Cutting edge planning strategy
 - One beneficiary
 - One Trustee = Beneficiary
 - Utilizes a Distribution Protector
- Remember - Two Part Test to maintain protections:
 - Ownership – Inherited Trust with own EIN
 - Control – Trustee and Distribution Protector

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○ Distribution Protector

- Has the power to veto "distributions"
- Appointed by the beneficiary
- Terms of trust require the Distribution Protector to approve (or disapprove) all distributions
- Attorney serves as a Distribution Protector
- Important to notify the attorney (i.e. Jen) of all "distributions"
- It's the PROCESS that provides the Protections (BMP Program)

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○ Big Picture

Goal is to:

- Maintain Protections
- Maintain Control
- Ease of Use for Beneficiary
- Create no Adverse Income Taxes

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○ Four Types of "Disbursements"

- Expenses
- Withdrawals of Income under a Limited Power to Vest
- Distributions
- Loans (Promissory Notes)

Remember - ONE WAY STREET!

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○ Limited Power to Vest

- Goal is not to **distribute** the income from the Inherited Trust to maintain the Protections
- Income **distributed** loses Protections
- Income **distributed** to beneficiary is taxed at beneficiary income tax rates and added to their net worth
- Income retained in trust is taxed at higher trust income tax rates
- We want the best of both worlds – low taxes and maintain protections

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○ Limited Power to Vest

- Beneficiary has the right to demand a withdrawal of the income from the prior year
- Beneficiary does not have to exercise the demand
- Regardless of whether the beneficiary exercises the demand, the income is **attributed** to the beneficiary and taxed at beneficiary's individual tax rate – NOT the trust tax rate!

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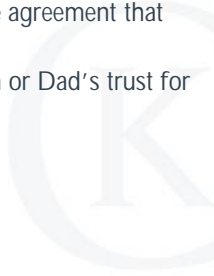
○ Limited Power to Vest

- Income for prior year is subject to attachment by creditors for that year
- At end of year, **undistributed** income becomes principal and is now once again protected
- Cutting edge concept and planning strategy
 - Need CPAs that understand 1041 world
- We receive calls from CPAs because they are initially alarmed.
- At the end of the calls we are asked “Why doesn't everyone do this?”

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Ⓚ Trust Document


- Trust of the decedent is the agreement that defines the Inherited Trust.
- The law firm restates Mom or Dad's trust for the beneficiaries.



© What Returns are Required Each Year?

- Form 1041
- Grantor Letter

© 1041 Form




Accumulates all income types

© Form 1041

- Rules are hybrid of 1040 & pass through for reporting
- New ID number created when trust is funded (provided through law firm)
- Always calendar year, cash basis taxpayer

Ⓚ The Most Important Thing

- DO NOT FILE your personal return until you have your Grantor Letter!!!



Ⓚ Grantor Letter

- Used to capture income for current year when Limited Power to Vest is in place
- Tracking mechanism for IRS ID numbers
- A K-1 should not be generated for this type of trust

Ⓚ Basis of Inherited Assets

- Asset reports are prepared by the law firm to help you track
 - Brokerage
 - Real Estate
 - Collectibles (art, coins), vehicles
- Taxed at capital gains or collectibles rate (28%)

IRAs, Pensions & Annuities

- No need to track basis
- Taxed at ordinary rates when distributed
- "Qualified Assets"

IRAs Held within Trust

- If established prior to 2020:
 - ROTH – take Required Minimum Distributions (RMD), but distributions are not taxable
 - Inherited IRA – stretch distributions are taxable when taken

IRAs Held within Trust

- After 1/1/2020
 - SECURE Act shortens distribution period for inherited IRAs to 10 years vs. stretch IRA over the beneficiaries lifetime
 - If RMDs have started ALAR rule applies
 - Opportunity to plan income

CK Planning Pitfalls

Plan for increases carefully

- Medicare bump if over 65
- QBI threshold
- Rental loss deduction (income threshold)
- AOTC threshold

CK Investments

- Important to align with specific beneficiary vs. decedent

CK BMP Program with CK

- Special pricing for WAC BMP clients
- Includes preparation of 1041 and Grantor Letter

 **Contact Corrigan Krause**

Corrigan Krause CPAs and Consultants
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Thank you!
Questions?
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