ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning for Your Retirement Savings

About Our Guest IRA Expert

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Brad has been a member of Ed Slott's Master Elite IRA Advisor Group℠ since 2010. He is a Million Dollar Round Table (MDRT) lifetime qualifier. He is the author of the #1 best-selling book, *Safe Money Matters*, and he hosts Safe Money Radio each week on several stations in Missouri and Arkansas.

He was named the 2018 Safe Money Radio Advisor of the year, and in 2019, Brad was recognized with the Missouri House of Representatives Resolution from State Representative Lynn Morris.

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Join the Retirement Planning Conversation

Learning to Lean on Life Insurance

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Guest IRA Expert

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The SECURE Act's snapping of stretch IRAs may be a blessing in disguise. Recent events have dimmed the allure of extended tax deferral, which had been the key advantage of spreading IRA distributions over many years.

Going forward, the combination of retirement planning and estate planning should be reviewed. Multiple assets might be used in a comprehensive approach to provide tax-risk diversification, and many clients will benefit by including permanent life insurance in this mix.

Imperfect 10

In brief, the SECURE Act limits most non-spouse beneficiaries of retirement accounts to 10 years of further compounding. By that deadline, accounts must be emptied with distributions added to the recipient's other taxable income and taxed at ordinary rates.

The catch: *What will those ordinary income tax rates be in 2030, 2040, etc., when today's clients are taking required distributions and their beneficiaries continue to take withdrawals?* Deferring today's income that would have been taxed at, say, 28% may not prove to be a wise choice if the money eventually will face 30%, 40%, or even 50% in tax on distributions.

Future tax rates are unknowable, but it's likely those rates will be moving higher rather than lower. Already, a tax-rate hike in 2026 is a matter of law. Current tax rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37% will revert to previous rates of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.

Meanwhile, the COVID-19 pandemic of 2020 and the resulting economic lockdown has led to enormous stimulus by the federal government. As Ed Slott has recently stated, *"Taxes are going to go up! We just wrote a 2 trillion dollar check from an account with no money in it."*

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Going Low

If tomorrow's tax rates are likely to be higher, it follows that today's tax rates are relatively low. Therefore, clients may want to take advantage of low tax rates for 2020.

One basic tactic is to encourage clients to fill up a low tax bracket

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with traditional IRA withdrawals. For example, a married couple can have taxable income (after deductions) up to $171,050 and remain in the 22% bracket this year.

Example: Annie and Robert had taxable income of $125,000 in 2019 and expect a similar total this year. They could take, say, $45,000 from their IRAs this year and owe only $9,900 in tax, at 22%.

After-tax, Annie and Robert would net over $35,000 from $45,000 in IRA withdrawals. This might be spent if cash flow is tight or moved to a Roth IRA via a conversion, putting some money into a potentially tax-free asset.

A better choice, for some clients, would be to put that $35,000 into a permanent life insurance policy. This can go on for multiple years, as long as they can take money from their IRAs at modest tax rates.

Avoiding Taxes

Annie and Robert could buy a policy on the older spouse, payable to the younger. Or, a second-to-die policy could eventually go to their children.

Depending on the age and health of the insured individuals, the insurance policy likely would have a death benefit well into six or even seven figures.

Further, the life insurance proceeds would be free of income tax. (It's possible that the tax-free treatment of insurance death benefits might be revoked, but it's much more likely that Congress will address tax rates rather than life insurance outcomes.)

Beyond income tax changes, estate tax vulnerability might be increased by future legislation. Concerned clients could avoid estate tax by holding the policy in an irrevocable life insurance trust, a plan that offers other benefits such as protection from creditors.

The bottom line is that a properly structured life insurance policy is guaranteed to provide beneficiaries with a substantial payout that can avoid income tax.

The amount passed on to beneficiaries probably will be much larger than the ultimate payout from an inherited IRA, after tax, especially considering what future tax rates on IRA distributions might be.

In Case of Emergency

What's more, a permanent life policy can be much more versatile than an IRA. Any growth in the policy's cash value account could be tax-free. If there's a need, that cash value can be tapped, untaxed, via certain amounts of withdrawals and policy loans. Such access may help provide needed money without having to take taxable distributions from an IRA and possibly move into a higher bracket.

Also, various riders might be added to a life insurance policy. A long-term care rider, for example, could deliver funds if the policyholder requires specified services.

While it's true that a long-term care payout would reduce the eventual death benefit, having this source of money may be a better choice than relying upon future beneficiaries to pay nursing home bills.

Bountiful Benefits

Moving money from a tax-deferred IRA to a tax-free life insurance policy, at today's tax rates, can deliver more money to heirs than holding on to an IRA, under current rules. In addition, using life insurance keeps more control in the hands of the policyholder and the eventual policy beneficiaries.

A life insurance policyholder has no required minimum distributions (RMDs) at any age, whereas IRA owners take RMDs after age 72. Insurance beneficiaries also have no constraints on how they use death benefits received; IRA beneficiaries either have RMDs or a 10-year limit before a 100% drawdown.

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Life insurance is regulated, to be sure, but the rules aren't as strict as they may be for IRAs. For instance, most new non-spouse IRA beneficiaries must track the account and deplete it fully by the 10-year deadline, or face a 50% penalty. Life insurance proceeds have no comparable deadlines or penalties.

Stretching an IRA can be complicated for clients in second marriages, with children from a former spouse. A qualified terminable interest property (QTIP) trust may be used to provide for both the surviving spouse (income) and the children (remainder) but setting up the trust can be complicated, and the beneficiaries will have conflicting goals.

Drawing down an IRA to provide life insurance for one side can be a simpler solution, while the other side can inherit other assets when the remarried parent dies.

Yet another factor to consider is that some clients will have a loved one with special needs. Often, naming a special needs trust as the policy beneficiary, with detailed instructions, is a more efficient way to provide lifelong care than naming a special needs trust as IRA beneficiary.

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All things considered, the perilous parlay of probable future tax rates and curtailed stretch IRA opportunity makes a traditional IRA a poor estate planning vehicle. A series of low-taxed withdrawals leading to life insurance premium payments is an increasingly attractive way to provide for retirees and their heirs.

Sooner Than Later

With all of the benefits, life insurance has drawbacks as well. Mainly, people in poor health often have problems getting coverage at a reasonable cost, especially as they grow older. Therefore, clients should be encouraged to act soon, in starting this IRA-to-insurance gambit. They never will be younger than they are now, and they may not get healthier.

Moreover, the life insurance landscape can be intimidating, with so many types of policies available and so many features that can be included or excluded. Advisors can play a key role by finding the right coverage for clients to acquire, once they move money out of tax-deferred territory.

Part of an advisor's job is to help clients realize that a successful retirement is not based solely on having sufficient assets, going in. After all, assets can be depleted by lavish spending, a contested divorce, uninsured theft, vicious bear markets, and so on.

A truly rewarding retirement typically results from drawing down those assets in desirable ways, whether that's checking off a bucket list or working on a golf game. Such an asset drawdown will be easier for seniors to enjoy if they know they have provided life insurance for their children and grandchildren. They should be tapping their tax-deferred accounts to acquire tax-free life insurance for their loved ones — *leaving a legacy of real money.*

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Advisor Action Plan

- Begin annual tax planning with clients as soon as practical.
- Get an idea of what their taxable income for the year is likely to be.
- Calculate how much they can withdraw from their IRAs while remaining in a relatively low tax bracket.
- Explain why it's better to take low-taxed IRA withdrawals now, rather than risk later withdrawals at higher tax rates.
- Suggest life insurance premiums as a possible use for the after-tax withdrawn amounts.
- Help individual clients choose a life insurance policy suitable for themselves and their beneficiaries. ■

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