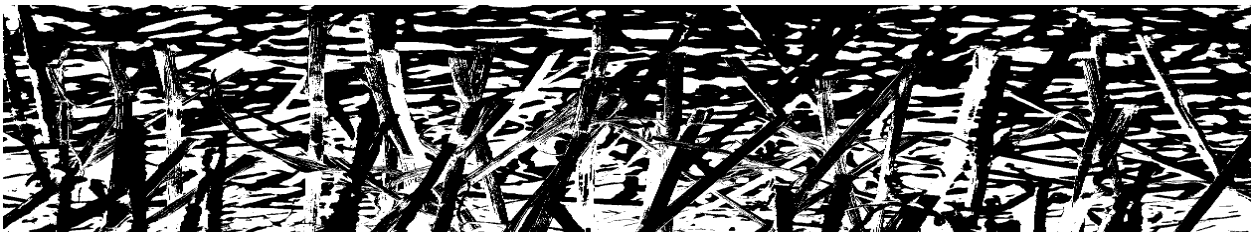

Jack Straw Fortnightly*

dog days

Legislation that would among other things[1] kill the "stretch" IRA passed the House on May 23 on a nearly unanimous vote.

Much gnashing of teeth in the financial services industry, but this has been a long time coming, and it may not be here quite yet.

The idea has been around for about ten years, and a version of this bill actually cleared the Senate Finance committee in November 2016, just after the election, but of course at the time there was no real expectation this would come to the floor for a vote.

The current House bill, H.R. 1994, would require complete distribution of a defined contribution plan within ten years after the account holder's death, regardless whether she was in pay status at the time.

Exceptions where the designated beneficiary is a surviving spouse, a minor child of the account holder, a disabled or chronically ill individual, or someone not more than ten years younger than the account holder. In each of those cases, you still get a minimum required distribution based on the age of the beneficiary, except that in the case of the minor child you fall into the ten-year rule when she attains majority.

No more "stretch" for adult children, or for more remote descendants, or for collaterals. The policy underlying sections 401 *et seq.* being, after all, to allow you to defer recognition of earnings as an incentive to save for retirement, not to create an inheritance.

There is a somewhat similar measure pending in the Senate, co-sponsored by the chair of the Finance committee, Chuck Grassley, and the ranking member, Ron Wyden. Senate bill 972 would require complete distribution within five years, not ten, subject to the same exceptions, spouse, minor child, etc. --

-- but also an exception that pretty much eats the rule: accelerated distribution would be required only to the extent amounts designated to any one beneficiary from the decedent's defined contribution plans aggregate more than $400k, indexed for inflation from 2019.[2]

So all you would really need are multiple beneficiaries.

Once the Senate bill clears committee and/or the upper chamber takes up the House bill, we are probably headed for a conference, where Jack will predict that something like the Senate version will prevail. And we will have accomplished not much on this particular front.

can't get there from here

So then that will be the new world order. No more "stretch," at the extremely, extremely, extremely high end. Otherwise business as usual.

The Joint Committee says the House bill should raise $15.7 billion over ten years.[3] We do not yet have a revenue estimate for the Senate bill, but given the $400k per beneficiary exception it should be close to zero, and then what really is the point.[4]

Of course there will be workarounds.[5] Roth conversions, as mentioned in footnote 3, but also for example charitable remainder trusts.

And what would that look like, one might ask.

For purposes of this exercise, let us suppose something like the House bill is enacted, *i.e.*, something that might actually matter to "ordinary" folks.

Let's say you name a testamentary charitable remainder unitrust with a net income exception as the beneficiary of the IRA. We would still be looking at a five or ten year payout, but into an exempt entity, so no immediate recognition event. Distributions from the unitrust would be taxed to the beneficiary as ordinary income only as they are made.

The IRA itself would be a "wasting asset" under most state principal and income statutes, which would typically characterize ten pct. of an annuity payout as current "income."

So if we took down the entire IRA in ten installments,[6] with a net income exception we would be looking at distributions well south of one pct. for the first few years, and then net portfolio income after that.

You could "flip" to a straight unitrust at some point, or you could set this up as a "spigot," with a tightly controlled flow of distributions.

For however long we can make this run, subject to the ten pct. remainder requirement, which these days would allow a life interest in one or two beneficiaries in their mid to late thirties.

This arrangement resembles the "stretch" -- actually, it could be seen as an improvement[7] --, albeit with a chunk going over to, shall we say, your private foundation rather than outright to the kiddos.

one point four, for now

On June 28, the Treasury and IRS issued proposed regs on the 1.4 pct. excise tax on "net investment income" of a handful of private colleges and universities, enacted as part of the 2017 tax bill.

Although this is sometimes called a tax on endowment funds, section 4968 does not mention endowments, as such, but instead frames the excise as a tax on net income from assets "other

than those which are used directly in carrying out the institution's exempt purposes," with a cross-reference to section 4940(c), the excise tax on net investment income of a nonoperating private foundation.[8]

There are forty-six pages of preamble in the notice of proposed rulemaking, rationalizing not quite twelve pages of regulatory text.

And sixteen express requests for comments on various issues. Much work still to be done, apparently.

The tax is imposed on schools that are holding non-charitable use assets of at least $500k per student, and that have at least 500 tuition-paying students. Apparently fewer than thirty colleges and universities currently meet this description, though of course things may change.

One of the stated objectives of the proposed regulations is to clarify some of the key terms so that those at the margins can determine whether they are in or out. Who is a "student," when is she "tuition-paying," etc. And which assets exactly are "non-charitable use."

This latter question is where things get interesting. Rent from on-campus dorms, maybe, comments requested. Interest on student loans, again maybe, comments requested, specifically on whether it makes a difference if the loan is at a "substantially" below market rate, in which case the spread might be viewed as a sort of scholarship. Much fun.

Comments are due October 01, none submitted yet.

[some wordplay involving "salt"]

Two lawsuits filed last week, both in the Southern District of New York, seeking to invalidate the recently finalized regs treating state tax credits given in exchange for contributions to charity as a *quid pro quo*, reducing the amount allowable as a charitable deduction.

Both the complaint filed by the attorneys general of New Jersey, New York, and Connecticut and the separate complaint filed later the same day by the village of Scarsdale argue that the regs violate the administrative procedure act by imposing an "arbitrary and capricious" rule that directly conflicts with the "plain statutory text" of section 170 -- at least, as it had been interpreted until now.

Probably the early skirmishing will be over standing, *i.e.*, did the plaintiff governmental entity itself suffer a legal harm the court can remedy.

On that point, the states are arguing that the regs directly target the workarounds they each enacted in 2018 specifically to respond to the SALT cap, offering credits for contributions to specified funds,[9] and that the regs will have the effect of reducing anticipated revenues those workarounds would have preserved. The village is saying contributions to a reserve fund they created under the state workaround legislation have in fact dried up since the regs were finalized.

Meanwhile, joint resolutions have been introduced in each chamber to disapprove the regs, so they would

not take effect. And of course there are bills that would repeal the cap. But all these are longshots.

7520 rate falling

The section 7520 rate for August is down to 2.2 pct., a drop of forty basis points from July, and down a hundred forty from a crest at 3.6 pct. last November and December.

The last time we were at 2.2 pct. was in October 2017, on the long stumble upward from a trough at 1.4 pct. in August and September 2016.

Jack has no expertise in yield curves and whatnot, but thinks maybe this does not look very good. Short and midterm AFRs are both now below two pct. Long term Treasuries are almost a full point off their high at 3.263 pct. in November 2018, having bottomed out at 1.94 pct. earlier this month.

Not to flog a dead horse, but the rather substantial increase in the ACGA recommended payout rates on charitable gift annuities that took effect a year ago was premised in part on the idea that the three pct. rate on long term Treasuries was somehow likely to hold.

bisy backson

I recently had an article published in Thomson Reuters' monthly Estate Planning magazine, arguing that section 112 of the uniform trust code, which extends the rules of construction for a decedent's will to the interpretation of a revocable trust functioning as a "will substitute" conflicts with the theory under which the revocable trust found acceptance at common law in the first instance, in ways that are likely to cause confusion.

The article expands (considerably) on an argument put forward in Jack Straw volume one, number three, in connection with the *Craig Trust* case out of New Hampshire.

I have posted a copy to SSRN and to the Greystocke Project page on my own website.

Two weeks ago I gave a day-long seminar on preparing the fiduciary income tax return, in an airport hotel just outside Pittsburgh, for one of those for-profit CLE providers out of Eau Claire, Wisconsin. And I am scheduled to do the same in Albuquerque at the end of October.

And in mid-September, for the same outfit, a day long seminar in Phoenix on the uses of trusts in tax-driven planning. For which I am preparing a deck of probably three or four hundred slides.

Just before flying out to Pittsburgh, I did an hour and a half webinar for another of these providers, on the subject of income splitting. I expect to be updating and revising those materials for future presentations to other audiences.

In a couple of weeks I will be repeating a webinar I did not long ago for that same provider on planning for intergenerational transfer of the family vacation home.

Also it appears I may be participating in a two-hour webinar in late September for yet another provider, on selected topics in fiduciary income taxation. And I seem

to be in conversation with yet another, other provider to do similar webinars for them. This may become a side gig.

obscurities

[1]

The bill would also repeal section 219(d), which disallows a deduction for a contribution to an IRA for the benefit of an individual aged 70-1/2 or older, and it would raise to 72 the age at which minimum distributions are required to begin.

You could still do a "charitable IRA rollover" at 70-1/2, but if you were taking deductions for additional IRA contributions after that age, these would reduce, dollar for dollar, the amounts excludible from income.

The bill would also afford a safe harbor to the fiduciary of a 401(k) plan who has chosen to meet its obligation as a "prudent investor" to secure a reliable stream of payments to a participant by purchasing a commercial annuity contract. Under section 204 of the bill, if the fiduciary has engaged in an "objective, thorough, and analytical search" for a "financially capable" insurer, it will be protected in the event the insurer later proves unable to meets its obligations under the contract.

Some folks are saying this latter is a "cave-in to the insurance lobby," which contributes heavily to campaign funds for both the chair and the ranking member of the Ways and Means committee. Jack disclaims any insight into this question.

Oh, and also a "fix" to the 2017 tax bill revision to the "kiddie tax," which as you may recall taxes unearned income in the hands of a child, not at the parent's marginal rate, but at the rate that would apply if the income were accumulated in trust.

The fix, section 501, was added as a "manager's amendment" after the bill had already cleared Ways and Means and was pending in the Rules committee.

The stated purpose of the "fix" was to protect kids who are receiving scholarships or benefits as survivors of deceased military or emergency services personnel. The straightforward approach would have been to provide that these benefits are not to be treated as "unearned" income for purposes of the "kiddie tax." Instead, the bill would simply repeal section 1(j)(4) altogether, returning us to the pre-2018 rules.

[2]

The measure that cleared the Finance committee in 2016 would have set a threshold of $450k, indexed for inflation, but per deceased account holder, not per distributee. As initially proposed by Sen. Wyden, the threshold would have been $150k.

By contrast, the rule proposed in S. 972 would allow a decedent to leave up to $400k of deferred income outright or in trust for each of an indefinite number of separate beneficiaries.

The mystery here is why Sen. Wyden is co-sponsoring this grievously weakened bill. Your correspondent has asked, but does not expect an answer.

[3]

As usual, we do not see the assumptions underlying the numbers, but it appears the estimate may not be taking into account the likelihood that a lot of folks are probably going to do Roth conversions, maybe in stages, get the five year periods running, so that the accelerated payout into an accumulation trust for multiple generations of skip persons does not trigger further income tax.

Also, to be clear, the revenue estimate describes only a timing difference. IRA distributions would be taxed eventually, even over a "stretch." Requiring a five- or ten-year payout simply accelerates those receipts, at the expense of revenues that would have been received outside the budget window.

[4]

The 2016 Senate bill carried a revenue estimate of only $3.2 billion over ten years for this item, but as noted above, that bill would have exempted accounts inherited from a decedent who had accumulations aggregating $450k or less.

The present bill would exempt up to $400k per beneficiary, which would leave a lot of room for avoidance planning and presumably drag the revenue estimate much lower.

But Sen. Grassley says the bill is "paid for." We have not yet seen the budget office estimates.

[5]

Or, since the effective date provisions exempt a "binding annuity contract" that is already "in effect" on the date of enactment, with an "irrevocable election" already in place as to the method and amount of payment to designated beneficiaries, you might see some handful of folks making these arrangements.

[6]

Incidentally, that is not what these bills would require. As long as you got the last dollar out by the end of year ten, or year five, whichever, you need not take out anything in the preceding years.

[7]

A "stretch" IRA for a beneficiary in her mid-thirties would require a payout of about two pct. in the early years, more as she got older.

[8]

Jack says you might be forgiven for asking whether this is a foot in the door for imposing an excise on investment income of, say, nonprofit hospitals. Picking off "the sector" one by one. But what really is "the sector," anyway.

[9]

These same three states, plus Maryland, also sued last year to have the SALT cap itself declared unconstitutional under the Tenth and Sixteenth amendments, as interfering with the states' power to tax. A motion to dismiss and a "cross" motion for summary judgment were argued June 18. No result yet.