

Estates with Large Qualified Fund Concentrations

Do you have clients who have qualified funds that make up a large percentage of their net worth? The estate and income tax burden to the heirs deplete the assets significantly and make the receipt of qualified funds one of the most tax inefficient vehicles to inherit.

Let's look at a client with a \$25 million IRA rollover. He is 70 years old, single, has one son and lives in California. He has no other assets (just to keep this simple).

What happens when Dad dies?

- Estate tax first.
- Assume he has his entire \$13.6 million exclusion to use at his death.
- Uncle Sam is owed \$4.5 million.
- Son must use the IRA assets to pay the estate tax.
- He withdraws just under \$9 million, pays income taxes of \$3.3 million to Uncle Sam and \$1 million to California. This leaves him with what is required to pay the estate tax liability and a reduced IRA balance of \$14 million.

For the next 10 years, the son leaves the \$14 million IRA growing at 6% and does not withdraw any money from it. The account grows to \$25 million at the end of year 10.

Thanks to the Secure Act, he must withdraw 100% of the IRA balance.

- He owes \$9.2 million to Uncle Sam.
- He owes \$3 million to California.
- His total income tax is \$12.2 million — 49% of the account value.

He inherited a \$25M account and at the end of 10 years only gets \$12 million in his hand to spend.

That is an annual return of -6.5% each year for 10 years.

Inherited IRA balance	Estate tax owed	Income taxes on withdrawal for estate tax	End of year one IRA account balance	End of year 10 IRA balance at 6% growth	Income taxes owed on full withdrawal	Net to Son
\$25,000,000	\$4,500,000	\$4,300,000	\$14,000,000	\$25,000,000	\$12,200,000	\$12,800,000

10 years

\$25,000,000

\$12,800,000

-6.50 annually

Do you think this is what Dad envisions knowing his son would inherit a \$25,000,000 estate?

What can Dad do to improve the outcome for his son?

Dad could buy insurance owned by an Irrevocable Life Insurance Trust (ILIT) to pay future estate and income taxes. He needs a death benefit totaling \$16 million (\$4 million for estate taxes and \$12 million for income taxes), which would cost \$270,000 annually at preferred.

To make a fair comparison here, let's assume Dad worked with you and listened to your advice 10 years ago, and bought a \$16 million life insurance policy at a cost of \$270,000 per year. He withdraws the premium and all the taxes on the withdrawal from the IRA account, so each year he withdraws \$385,000 from the account. We assume that the IRA account grows at the same 6% rate, and at age 70, the IRA is only worth \$19.6 million (not \$25 million as above). Paying for the insurance out the IRA funds means the IRA will not accumulate as much as it would without the insurance component.

Now Dad dies at age 70.

- The son inherits a taxable estate of \$19.6 million and another \$16 million in death benefit proceeds in the ILIT.
- Estate taxes owed are \$2.4 million. Son uses the ILIT funds to write that check and leaves the \$19.6 million in the IRA intact, and \$13.6 million in the ILIT.

Fast forward 10 years when son must withdraw 100% of the IRA proceeds.

- IRA = \$35 million and income taxes of \$17.2 million are due (\$12.9 million federal and \$4.3 million in California).
- ILIT proceeds have grown to \$18 million after taxes on growth retained in trust.

	Son inherited	Estate tax owed	Income taxes on withdrawal for estate tax	End of year one account balance	End of year 10 balance at 6% gross	Income taxes owed on full withdrawal	Net to Son
IRA	\$19,600,000		\$0	\$19,600,000	\$35,000,000	\$17,200,000	\$17,800,000
ILIT	\$16,000,000	\$2,400,000	\$0	\$13,600,000	\$18,000,000	\$0	\$18,000,000
Total	\$35,600,000			\$33,200,000			\$35,800,000

10 years

\$35,600,000

\$35,800,000

+0.10 annually

With planning we have neutralized the impact of estate and income taxes.

The real comparison is the net to Son with and without planning.

No Planning
\$12,800,000

+180.0% In Net to Son

Planning
\$35,800,000

Which outcome do you suppose dad and son prefer?

Now imagine that our tax law changes and the estate exemption decreases and income tax rates increase. The cost of not doing any planning will become even more costly.

This is an easy conversation to have with your clients who have qualified plan assets. Position this transaction as paid for solely from the IRA funds, not an added expense to the clients' lifestyle.

We can help you model out the numbers specific to your clients.

Reach out to your PartnersFinancial Advanced Sales team with any questions.

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