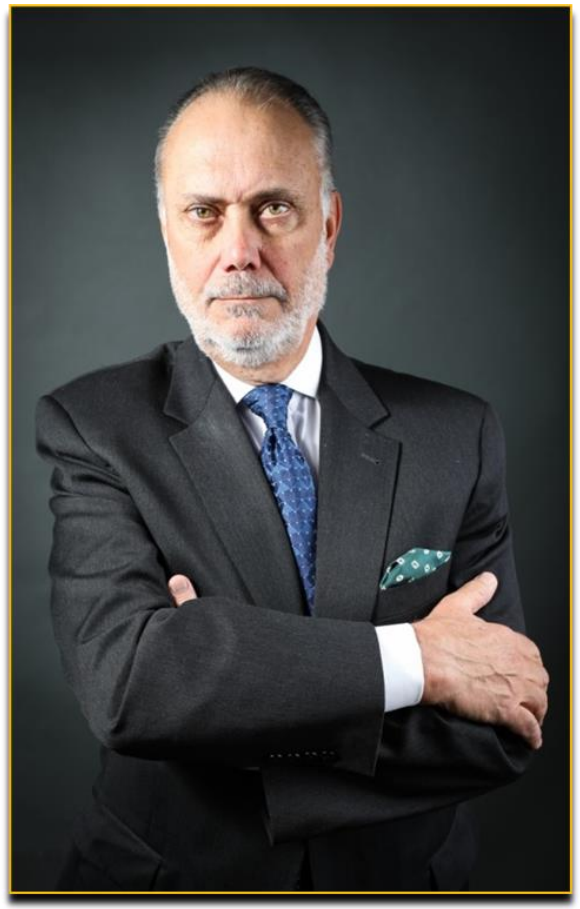
Estate Planning for Non-Probate Assets



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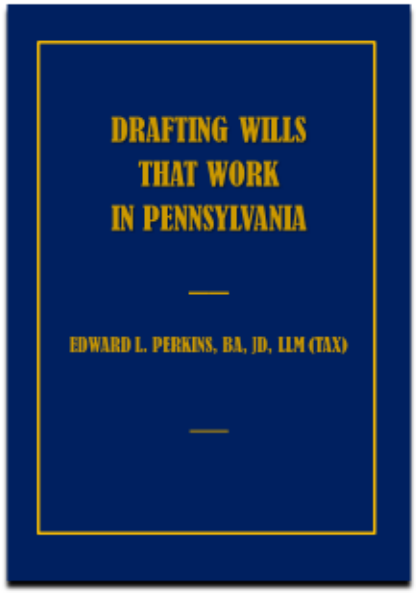
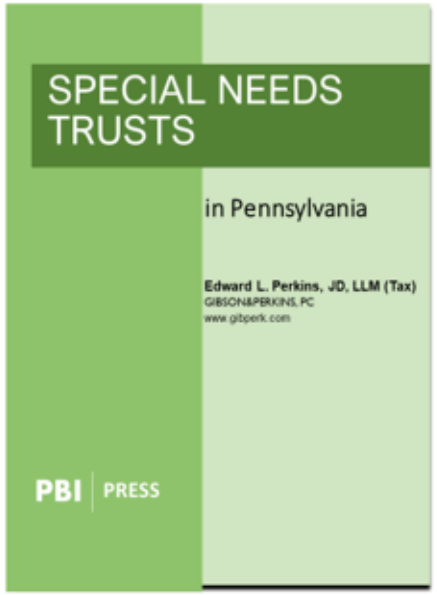
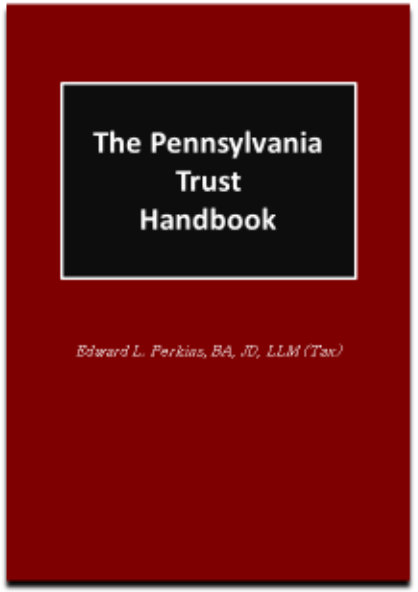
- PBI – Special Needs Trusts in Pennsylvania
- PBI - The Pennsylvania Trusts Handbook







Martin J Pezzner, BS, JD, CPA

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Martin J Pezzner has a wealth of experience as a practicing attorney for over twenty-nine years. After graduating Wilkes College with a Bachelor of Science in accounting, he was employed by the Internal Revenue Service in Philadelphia, PA as a Tax Revenue Agent (Field Agent) for five years.

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- If your question is *not answered* during the program you will receive an ‘ e-mail response after the program is concluded.
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tperkins@gibperk.com

Estate Planning for Non-Probate Assets

The Administration of Non-Probate Property - Overview

Probate Assets/Non-Probate Assets

Probate Assets

While a Will and the corresponding probate administration are generally the mechanisms we think of for distributing a decedent's estate, a Will only governs the passage of certain, not all, of a decedent's assets. These assets are known as "probate assets."

Probate assets include:

- Individually owned assets;
- Assets owned as a tenant in common with one or more other persons;
- Assets payable to the decedent's estate - (1) because the decedent designated the decedent's estate as the beneficiary of the assets or (2) because the decedent did not designate anyone as beneficiary of the assets;
- Amounts owed to the decedent; and,
- Household furnishings and other personal property.

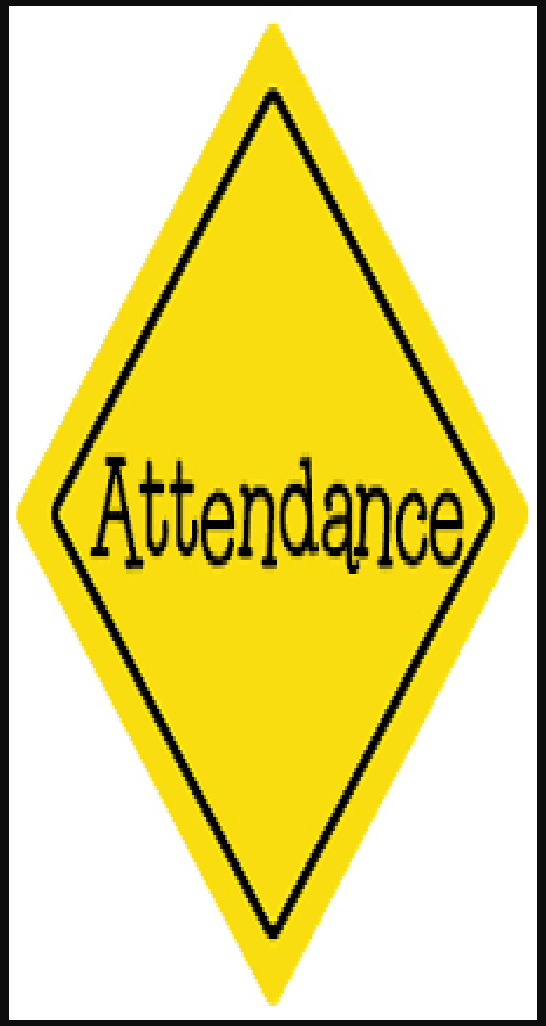
Non -Probate Assets include:

- Assets owned in the decedent's sole name but which have a payable on death ("POD") or transfer on death ("TOD") designation;
- Assets owned jointly by the decedent with a spouse or others, with rights of survivorship;
- Assets owned with a spouse in a special type of joint ownership called tenancy by the entirety;
- Assets owned at the time of the decedent's death by a Revocable Living Trust set up by the decedent; and,
- Assets owned by the decedent through contract rights which are payable to a designated beneficiary at death, including IRAs, 401(k)s, annuities, and life insurance policies.

The Administration of Non-Probate Property - Overview

House held Tenants by the Entireties	$ 400,000
W 401k Plan	350,000
H IRA	250,000
W Life Insurance	1,000,000
H Life Insurance	500,000
Other	10,000
Total	$ 2,510,000

Please Verify your Attendance



The Administration of Non-Probate Property - Who's Charge?

- ✓ Who is responsible for the administration of the non-probate assets?
- ✓ Who pays your fees?
- ✓ Who is responsible to file the Pennsylvania Inheritance Tax Return?

The Administration of Non-Probate Property - Taxes

"All Federal or State estate taxes, inheritance taxes, if any, or other death taxes, together with interest and penalties thereon, that may assessed by reason of my death shall be paid by my Executor out of the residue of my estate disposed of by this Will,

"All Federal or State estate taxes, inheritance taxes, if any, or other death taxes, together with interest and penalties thereon, attributable to my probate estate that may by reason of my death shall be paid by my Executor out of the residue of my estate disposed of by this Will,

The Administration of Non-Probate Property - Pennsylvania Inheritance Tax

- The estate representative is generally responsible to file the Pennsylvania Inheritance Tax Return and pay the inheritance tax due.
- If there is no Personal Representative, the person who inherits the non-probate asset is responsible for filing the Inheritance Tax Return, REV-1500.
  - The transferee of property should file a return if: no personal representative is appointed, if the personal representative does not file a return, or if the personal representative files a return but does not include the subject property.
  - A "transferee" means any person to whom a transfer is made and includes surviving joint tenants, beneficiaries, heirs, legatees, devisees, grantees, assignees and donees.
- Non-probate assets can be billed separately from the estate.
- Separate billing for non-probate assets may be requested on the Inheritance Tax Return, REV-1500, for Schedule F and G assets only. See the REV-1500, Schedule F and G instructions for further information.

REV-1500 (EX) MOD 03-19 (FI)

Decedent's Social Security Number

Decedent's Name:

RECAPITULATION

1. Real Estate (Schedule A) ..... 1.
2. Stocks and Bonds (Schedule B) ..... 2.
3. Closely Held Corporation, Partnership or Sole-Proprietorship (Schedule C) ..... 3.
4. Mortgages and Notes Receivable (Schedule D) ..... 4.
5. Cash, Bank Deposits and Miscellaneous Personal Property (Schedule E) ..... 5.
6. Jointly Owned Property (Schedule F) ☐ Separate Billing Requested ..... 6.
7. Inter-Vivos Transfers & Miscellaneous Non-Probate Property (Schedule G) ☐ Separate Billing Requested ..... 7.
8. **Total Gross Assets** (total Lines 1 through 7) ..... 8.
9. Funeral Expenses and Administrative Costs (Schedule H) ..... 9.
10. Debts of Decedent, Mortgage Liabilities and Liens (Schedule I) ..... 10.
11. **Total Deductions** (total Lines 9 and 10) ..... 11.
12. **Net Value of Estate** (Line 8 minus Line 11) ..... 12.
13. Charitable and Governmental Bequests/Sec. 2113 Trusts for which an election to tax has not been made (Schedule J) ..... 13.
14. **Net Value Subject to Tax** (Line 12 minus Line 13) ..... 14.

TAX CALCULATION - SEE INSTRUCTIONS FOR APPLICABLE RATES

15. Amount of Line 14 taxable at the spousal tax rate, or transfers under Sec. 2116 (a)(1.2) or (1.4) — X .0___ — 15.
16. Amount of Line 14 taxable at lineal rate — X .0___ — 16.
17. Amount of Line 14 taxable at sibling rate — X .12 — 17.
18. Amount of Line 14 taxable at collateral rate — X .15 — 18.
19. **TAX DUE** ..... 19.

Under penalties of perjury, I declare I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete. Declaration of preparer other than the person responsible for filing the return is based on all information of which preparer has any knowledge.

SIGNATURE OF PERSON RESPONSIBLE FOR FILING RETURN — DATE

The PA Department of Revenue does NOT accept electronic signatures. Please sign your return.

ADDRESS

SIGNATURE OF PREPARER OTHER THAN PERSON RESPONSIBLE FOR FILING THE RETURN — DATE

The PA Department of Revenue does NOT accept electronic signatures. Please sign your return.

ADDRESS

The Administration of Non-Probate Property - Federal Estate Tax

The first sentence of §6324(a)(2) provides as follows:

"If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, non-exercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under §2034–§2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax.

Life Insurance


ESTATE TAX RETURN
Date of Death
City or Township
LEGAL CAPACITY OF APPLIC
Name and ad

Life Insurance - Planning Issues - Beneficiary Designation

- There are typically two levels of beneficiary: primary and contingent.
- A primary beneficiary is essentially your first choice to receive the death benefit if you pass away.
- A contingent beneficiary is the backup; they're the person you would want to receive the payout in the case the primary beneficiary is deceased as well. So, if your spouse is your primary beneficiary and you both pass away in a car crash, the contingent beneficiary would receive the death benefit.
- If no named beneficiary is named generally the life insurance proceeds would be payable to the estate

Life Insurance - Planning Issues - Beneficiary Designation

If you want to have multiple life insurance beneficiaries, there are three ways to assign the death benefit each will receive:

Specific Percentage

Each beneficiary is named and assigned a percentage of the death benefit. Your 2 children, Bart and Lisa, are your beneficiaries. Bart would receive 50% of the payout, Lisa 50%. If Bart passes away before you, Lisa would receive 100% of the payout.

Per Stirpes

The death b

re you. Lisa would receive 50% of the payout and each of Bart

"In equal shares as there are children of mine then living and children of mine then deceased; to pay the share of a then deceased child to his or her then living descendants, per stirpes".

Per Capita

The death benefit is divided equally across each person that is eligible to receive a payout. Bart has 4 children and dies before you. Lisa would receive 20% of the payout and each of Bart's children would receive 20%.

Life Insurance - Planning Issues - Beneficiary Designation - Minor Beneficiaries

Minor Beneficiaries

If your intended beneficiary is a minor, some insurers won't let you directly name them as a life insurance beneficiary. In these cases, you can either:

- Name their legal guardian as the beneficiary.
- Designate a custodian for the proceeds through the Uniform Transfers to Minors Act. This person is then named as the beneficiary.
- Create a trust for the child and make the trust beneficiary. This has an added benefit as you can specify when trust proceeds are to be released and what they can be used for (for example, education expenses).

Special Needs Beneficiaries

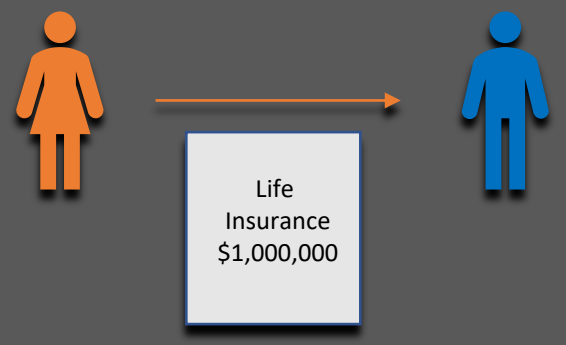
- If your intended beneficiary is a long-term dependent, such as a family member with special needs, you will likely want to set up a trust for them as well, even if they're not a minor.
- They could be disqualified from Medicaid and Supplemental Security Income by receiving over $2,000 as an inheritance.
- By setting up a trust as your beneficiary, you can avoid this issue and the trustee will manage the payout on your family member's behalf.

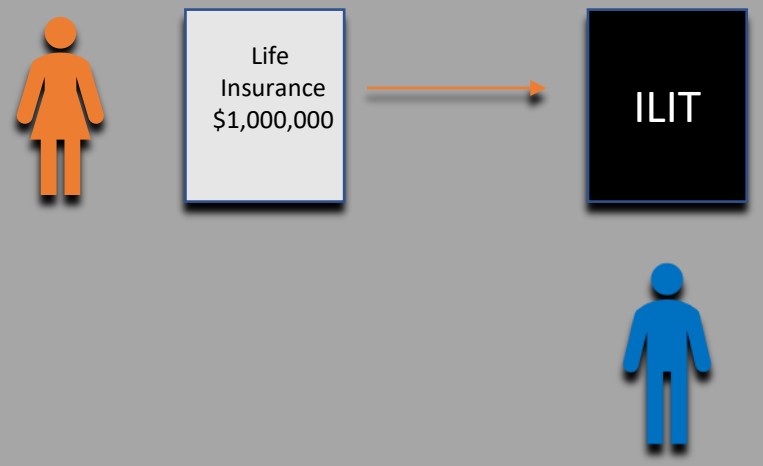
Life Insurance - Planning Issues - Why an ILIT?

An Irrevocable Life Insurance Trust is a trust established by the insured which both owns and is the designated beneficiary of the policy

An ILIT will both

- Remove the Life insurance from the federal taxable estate of both spouse
- Remove the life insurance proceeds from the estate of the Survivor for Pennsylvania Inheritance purposes.
- Also protects the life insurance proceeds from creditors
- Locks in disposition of proceeds

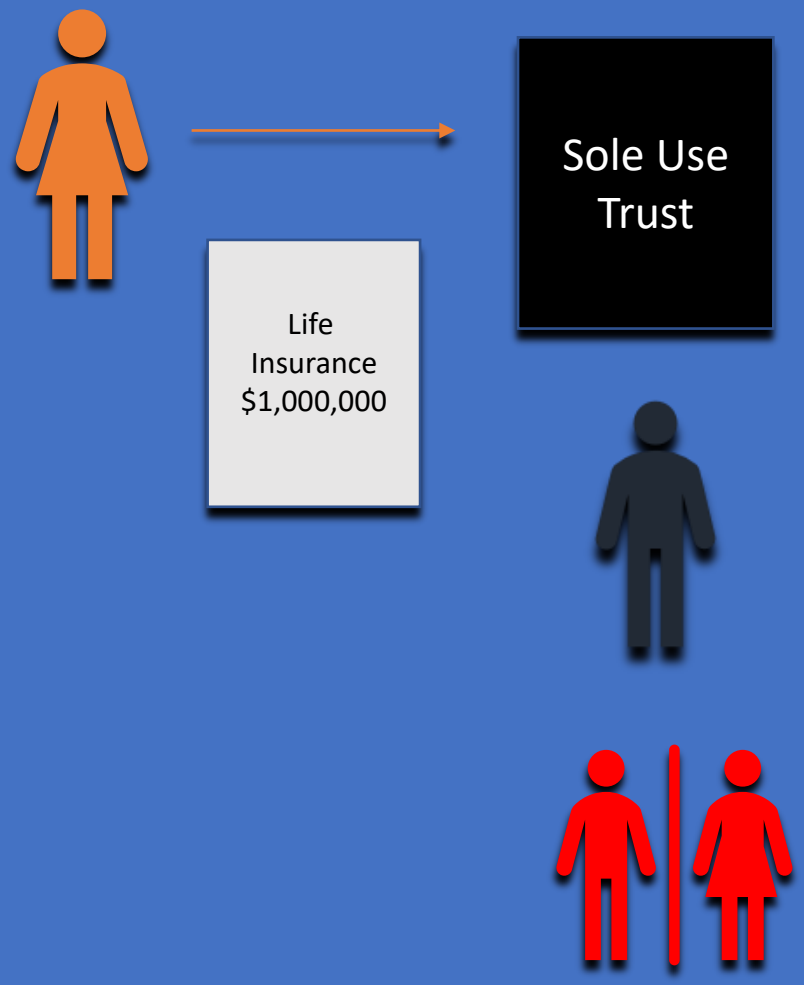




Life Insurance - Planning Issues - Spousal Sole Use Trust

Pennsylvania inheritance tax law allows a trust for the "sole use" of the surviving spouse to be taxed *entirely at the death of the surviving spouse,* rather than having to pay tax on the present value of the taxable remainder upon the first death, when the trust is created.

However, the estate can elect to pay the tax on the present value of the remainder, essentially prepaying the tax, and there are sometimes a benefit to making that election.



Joint Property

Joint Property - Federal Estate Tax - Advantages and Disadvantages

At this time, the owner's interest passes to the survivors without probate.

Tenancy by the entirety, another joint-owned property option, is when the parties are husband and wife. In this case, each spouse has an equal and undivided interest in the property.

If one spouse dies, the full title of the property automatically passes to the surviving spouse.

+ Avoids Probate

+ Creditor Protection

- Loss of Control of ultimate disposition

Joint Property - Federal Estate Tax -Spousal Tenancies

IRC §2040(b) establishes a special estate tax inclusion rule for "qualified joint interests."

A "qualified joint interest" is any interest in property held by the decedent's surviving spouse as: (1) tenants by the entirety, or (2) joint tenants with right of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

Additionally, the surviving spouse must be a U.S. citizen

One-half of the value of a qualified joint interest is includible in the estate of the first spouse to die.

Joint Property - Federal Estate Tax - Non-Spousal Tenancies

- When property is owned jointly with someone other than a spouse, the entire property is included in the estate of the first to die…

  …unless the other owner can show that he or she contributed enough to acquire a share of the property.

- This can have adverse estate tax consequences.

Joint Property - Pennsylvania Inheritance Tax

Jointly owned property with right of survivorship, except between husband and wife, including but not limited to real estate, securities, bank accounts, etc., is taxable to the extent of the decedent's fractional interest

Calculated by dividing the value of the joint property by the number of joint owners at the time of the decedent's death.

Joint property is taxable even though the decedent's name was added as a matter of convenience.

Further, if the decedent created the joint interest in the property within a year of his/her death, the full value of the property is taxable in the decedent's estate

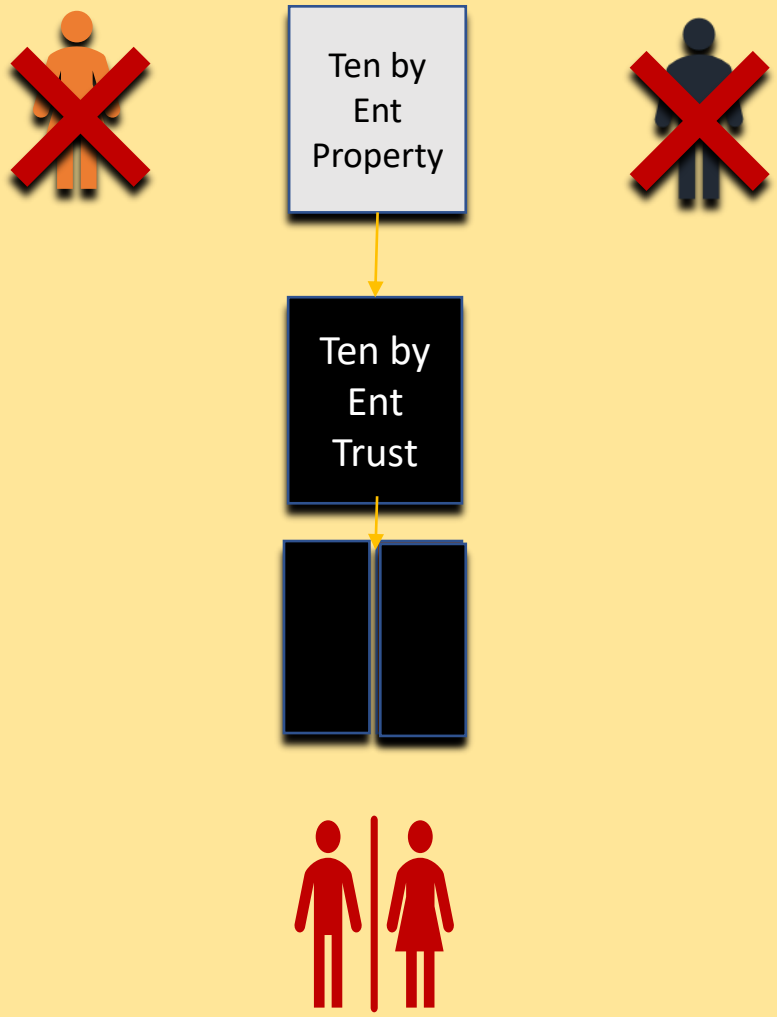
$$\frac{\$150{,}000}{\text{3 people}} = \$50{,}000$$

Joint Property - Planning Issues - Tenants by the Entireties Trust

Retains Tenants by the Entireties characteristics while both spouses are alive

Potentially protects one-half the value of the property after first spouse dies

Controls ultimate disposition of the property on death of the second spouse



Other Non-Probate Issues

Convenience Accounts

Adding a Child's name to a Bank Account for convenience

Joint property is taxable even though the decedent's name was added as a matter of convenience.

Further, if the decedent created the joint interest in the property within a year of his/her death, the full value of the property is taxable in the decedent's estate.

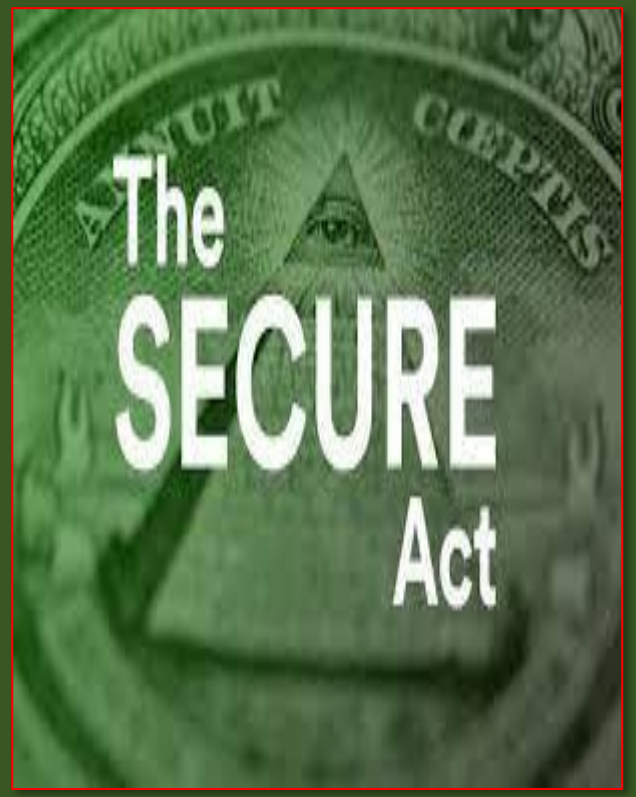
Designating Individual Beneficiaries of Investment Accounts

- When you name beneficiaries on your investment accounts, the accounts pass directly to the person or entity outside of your estate or trust.
- However, if there are no living beneficiaries at the time of your death, the account is distributed according to the investment company's hierarchy of beneficiaries.
- In this case, the investment account may go to someone other than your intended beneficiary.
- If the investment company cannot find a living beneficiary, the company will distribute the account to your estate or trust.

POD Accounts

- An individual with an account or certificate of deposit at a bank can designate a beneficiary who will inherit any money in the account after his or her death.
- A bank account with a named beneficiary is called a payable on death (POD) account.
- People who opt for POD accounts do so to keep their money out of probate court in the event that they pass away. intended beneficiary.

Retirement Plans



The SECURE Act and Inherited IRAs

If the owner died on or after January 1, 2020 the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) made major changes to IRA RMD rules

It also significantly changed some rules regarding inherited IRAs.

Types of Retirement Plans

Defined Benefit Plans

A defined-benefit plan is an employer-sponsored retirement plan which provide a fixed, pre-established benefit for employees at retirement based on factors such as salary history and duration of employment.

In 1980, 83% of private sector workers had a defined benefit plan as an option. In 2018, only 17% of private sector workers had the option.

Defined Contributions Plans

A defined contribution (DC) plan is a retirement plan that's typically tax-deferred, like a 401(k) or a 403(b), in which employees contribute a fixed amount or a percentage of their paychecks to an account that is intended to fund their retirements.

- ✓ 401(k)
- ✓ Traditional IRA
- ✓ Roth IRA
- ✓ SEP IRA

Defined Benefit Plans – Benefit Options

Single life payment. You receive a monthly payment for the rest of your life, and if you die, your beneficiaries receive no further payments.

Single life with term certain. You receive a monthly payment, and if you die before the specified term is over, your beneficiaries receive payments for a preset number of years.

50% joint and survivor. When you die, your surviving spouse will get monthly payments for the rest of their life that are equal to 50% of your original annuity.

100% joint and survivor. When you die, your surviving spouse will get monthly payments for the rest of their life that are equal to 100% of your original annuity.

Defined Benefit Plans -

A qualified plan lil
benefit pla
married pa
spouse, if a

This consent
days of when annuity
payments wi begin.

Plans must require a plan representative or notary witness the spouse's consent.

A QJSA is when retirement benefits are paid as a life annuity to the participant and a survivor annuity over the life of the participant's surviving following the participant's death.

The amount paid to the surviving spouse must be no less than 50% and no greater than 100% of the amount of the annuity paid during the participant's life.

IRAs and Defined Contribution Plans

IRA Basics

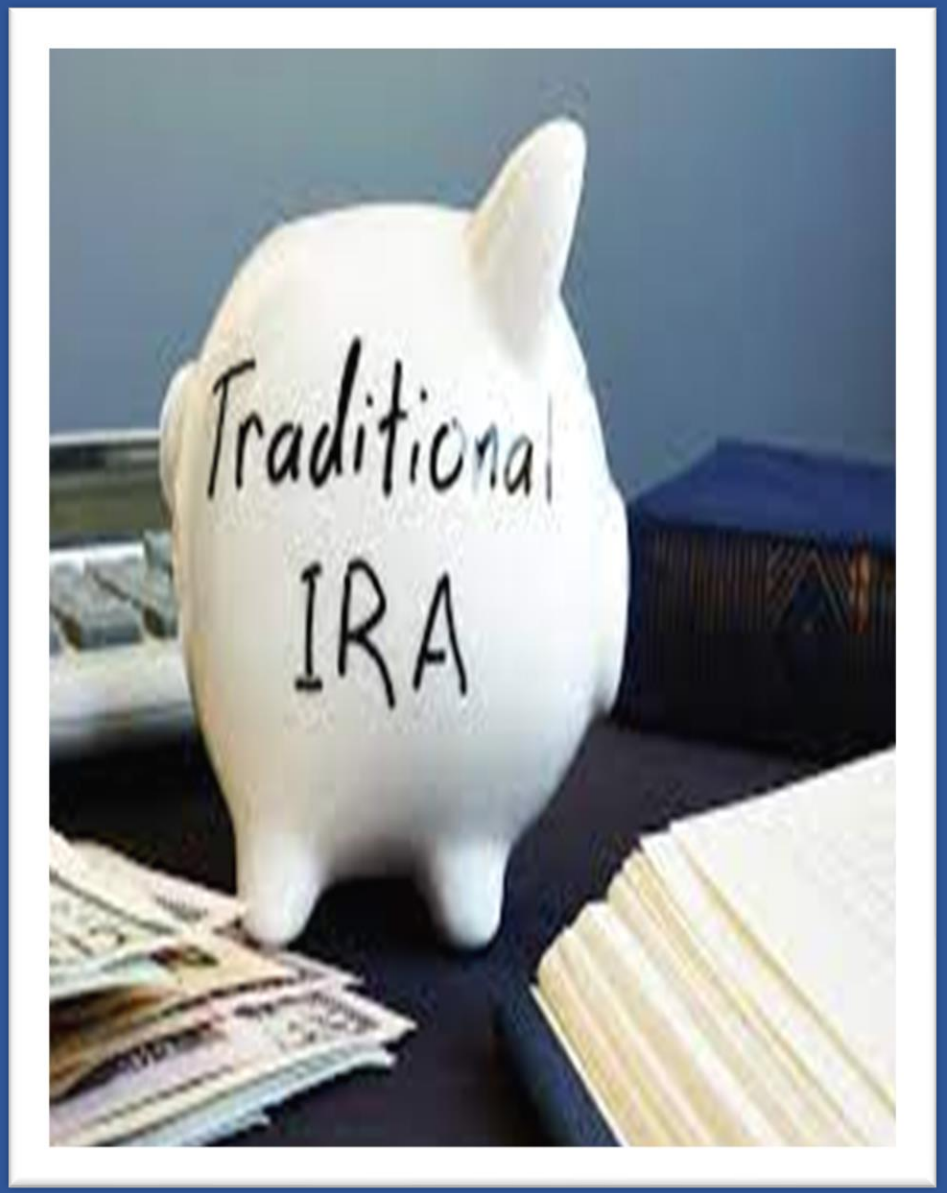
IRA Basics

First, a quick refresher on IRAs and how withdrawals from them work.

Types of IRAs

There are two basic types of IRAs.

- Traditional IRA
- Roth IRAs



Traditional IRAs

A traditional IRA offers a tax deduction in the years that the contributions are made to the account.

In other words, the contribution amount is used to reduce the person's taxable income in the tax year in which the contribution was made.

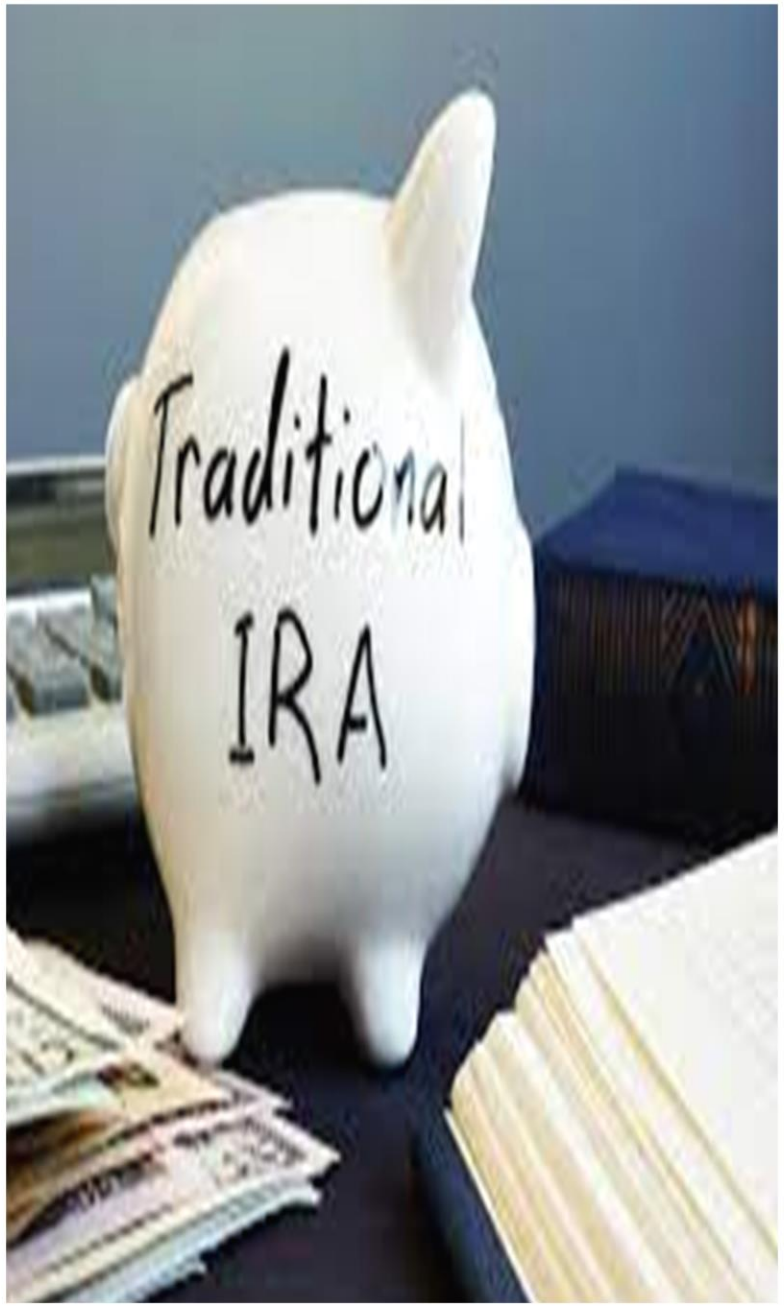
You can also make contributions that are not tax-deductible.

IRAs also grow tax-deferred, meaning the earnings and interest over the years are not taxed.

Traditional IRAs

However, when the money is withdrawn in retirement the amounts are taxed at the individual's income tax rate in the year of the **withdrawal.**

If the money is withdrawn before the age of 59½, there's a 10% tax penalty imposed by the IRS and the distribution would be taxed at the owner's income tax rate.



Roth IRAs

A Roth IRA doesn't offer an upfront tax deduction like traditional IRAs, but withdrawals from a Roth are tax-free at retirement.

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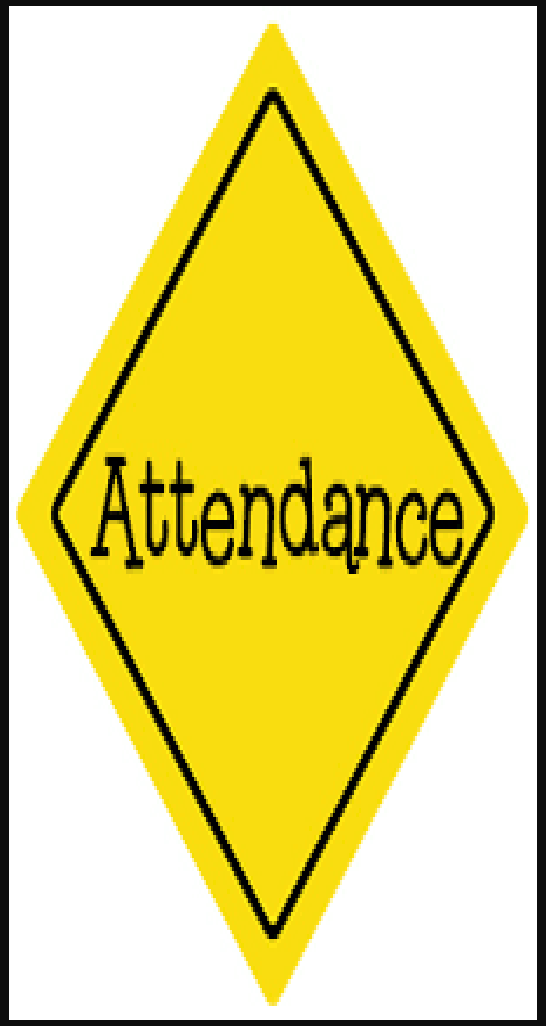


Required Minimum Distribution Rules

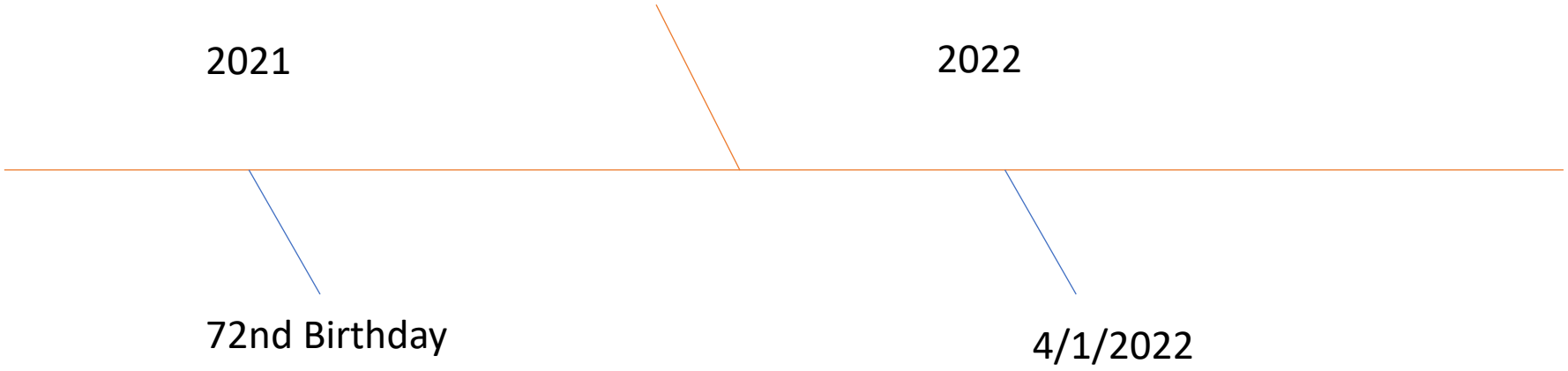
Required minimum distributions

- The IRS has established a minimum amount that account-holders must withdraw from an IRA and defined contribution plans, such as 401(k) plans each year.
- These mandatory withdrawals are called required minimum distributions (RMDs).
- RMDs are designed to eventually exhaust the funds in the account so that the accumulations won't last forever (and the IRS eventually gets its cut of some of the funds).
- RMDs apply to traditional IRAs.
- Roth IRAs generally don't require RMDs.

Required minimum distributions

- Typically, if you own a traditional IRA, you must begin your distributions by April 1st of the year after you reach age 72 (or 70½ if you hit that milestone before Jan. 1, 2020).
- This date is referred to as the "Required Beginning Date"
- After your first distribution

Note: That if you wait until April 1 to take your first-year distribution, you would have to take two distributions for that year: one by April 1 and the other by December 31.



Required minimum distributions

- RMD is generally determined each year by dividing the balance in the plan by the owner's remaining life expectancy.
- All RMD withdrawals will be included in taxable income
- If the owner fails to take their RMD, they can be subject to a 50% penalty on the amount they should have-but didn't-withdraw.

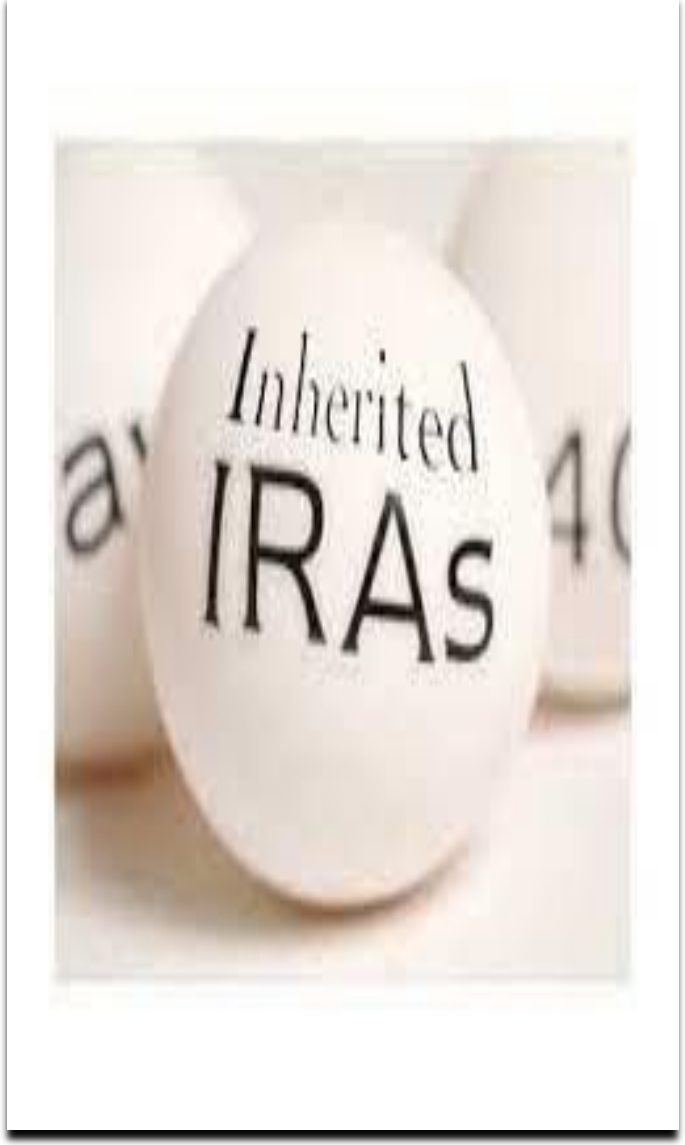
Minimum Distribution Rules - Inherited IRAs

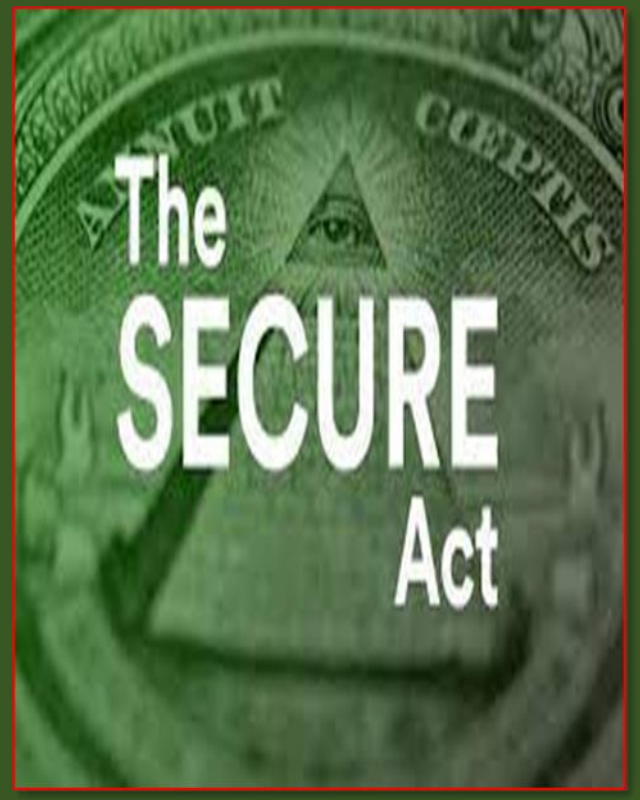
Inherited IRAs

- When the owner dies the designated beneficiaries are said to have "inherited" the IRA.
- If you inherit an IRA, you are generally required to take distributions from the account, which are taxable.

If the owner died before January 1, 2020

- If the owner died before January 1, 2020, and if the owner died before he or she was required to begin taking RMDs a beneficiary of an inherited IRA could "stretch" distributions by taking them over his or her lifetime.
- Alternatively, they could choose to take distributions within five years under so-called "five-year rule".





The SECURE Act and Inherited IRAs

If the owner died on or after January 1, 2020 the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) made major changes to IRA RMD rules- pushing back the age of for determining the RBD from 70½ to 72.

It also significantly changed some rules regarding inherited IRAs.

Starting with those inherited on after after Jan. 1, 2020, the SECURE Act requires the entire balance of the inherited IRA account to be distributed or withdrawn within 10 years of the death of the owner (the "ten year rule").

Exceptions to the 10-year rule

However, there are exceptions to the 10-year rule for certain types of beneficiaries (termed "eligible designated beneficiaries") :

- A surviving spouse
- A disabled or chronically ill person
- A child who hasn't reached the age of majority
- A person not more than 10 years younger than the IRA account owner

These beneficiaries are not obligated to empty the IRA within ten years, and the RMD can be calculated based on their own life expectancy.

Minimum Distribution Rules - Year of Death

If the Owner Died Before the Required Beginning Date -

There is no required minimum distribution in the year of the owner's death.

If the Owner Died on or After the Required Beginning Date

The IRA beneficiaries are responsible for figuring and distributing the owner's required minimum distribution in the year of death.

If the Owner Died on or After the Required Beginning Date

- You figure the required minimum distribution for the year in which an IRA owner dies as if the owner lived for the entire year.
- The IRA beneficiary is responsible for taking the year-of-death RMD.
- In other words, if the year-of-death RMD was not taken by the IRA owner (prior to death), it must be taken by the designated beneficiary.
- The RMD is reported as income by the beneficiary.
- An RMD that fails to be distributed by December 31 of the year of death are subject to the 50% federal penalty tax.

If the Owner Died on or After the Required Beginning Date

Unless the named beneficiary is the estate, the distribution is taken by the IRA beneficiary and is reported on her income tax return in the year of distribution.

Example: Moe, age 80, dies in 2021 prior to taking his 2021 RMD. Mo's daughter Lisa is his designated beneficiary. Lisa must take Mo's 2021 RMD by December 31 of the year of death. What's more, the RMD will be included in Lisa's 2021 taxable income.

If the Owner Died on or After the Required Beginning Date

- If there is more than one beneficiary each beneficiary is responsible for their portion of the RMDs if the deceased IRA owner did not take her year-of-death RMD,.
- To make it equitable, you can "split" the IRA into multiple inherited IRAs using each beneficiary's social security number.
- This ensures each beneficiary takes their portion of the RMD and pays the associated tax liability.

The Ten - Year Rule

The Ten -Year Rule

When Does the 10 year Rule Apply -

The 10-year rule applies if:

- The beneficiary is a designated beneficiary who is not an eligible designated beneficiary, regardless of whether the owner died before reaching his or her required beginning date.
- The beneficiary is an eligible designated beneficiary who elects the 10-year rule, if the owner died before reaching his or her required beginning date.

Designated Beneficiary

A "designated beneficiary" is someone named as a beneficiary of a retirement account

Beneficiary designations, for distribution purposes, do not become fixed until September 30 of the year following the year of an account owner's death.

No new beneficiaries can be named after the death of an account owner.

But beneficiaries who disclaim, or have had their benefits paid out to them in full prior to this date, will not be considered when determining death distribution options

The Ten -Year Rule

The 10-year rule requires the IRA beneficiaries to withdraw the entire balance of the IRA *by December 31 of the year containing the 10th anniversary of the owner's death.*

Example: If the owner died in 2021, the beneficiary would have to fully distribute the IRA by December 31, 2031.

The beneficiary is allowed, but not required, to take distributions prior to that date.

The Ten -Year Rule

Exception: If the owner died on after the RBD - Distributions based on the designated beneficiary's remaining life expectancy are required in the first nine years after the year of your death, then the remainder of the account must be distributed in the tenth year.

The Ten -Year Rule

If the 10-year rule applies, the amount remaining in the IRA, if any, after December 31 of the year containing the 10th anniversary of the owner's death is subject to the 50% excise tax detailed in Excess Accumulations (Insufficient Distributions), later.

The Ten -Year Rule

Note: The terms of most IRAs require individual designated beneficiaries, who are eligible designated beneficiaries, to take required minimum distributions using the life expectancy rules...

... unless such beneficiaries elect to take distributions using the 10-year rule, whichever rule applies.

The deadline for making this election is generally December 31 of the year the beneficiary must take the first required distribution using his or her life expectancy.

Exceptions to the 10 Year Rule

Exceptions to the 10 Year Rule - Eligible Designated Beneficiaries

However, there are exceptions to the 10-year rule for certain types of beneficiaries:

- A surviving spouse
- A disabled or chronically ill person
- A child who hasn't reached the age of majority
- A person not more than 10 years younger than the IRA account owner

These beneficiaries are not obligated to empty the IRA within ten years, and the RMD can be calculated based on their own life expectancy.

Generally, they have until Dec. 31 of the year following the IRA owner's death to start doing so.

Surviving Spouses

Special Rules for Surviving Spouses

Choices

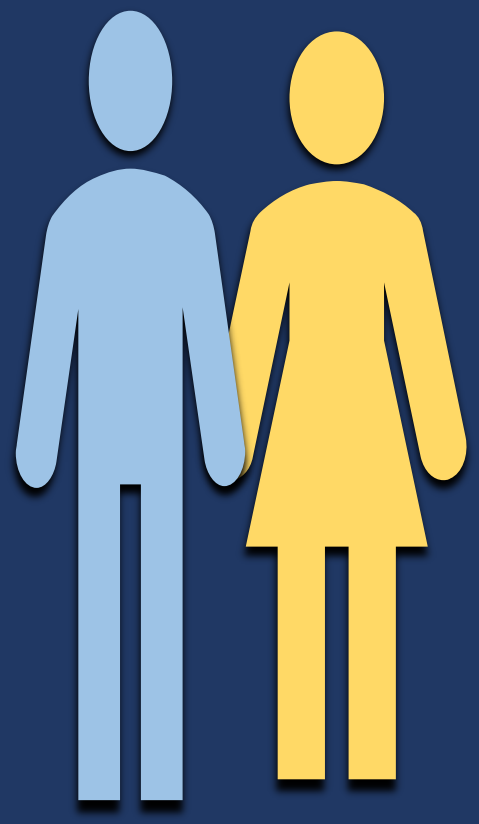
Spouses who inherit an IRA have more flexibility than non-spousal beneficiaries in regard to when they must withdraw the funds.

The surviving spouse typically has a 3 choices.

(1) The spouse can treat the IRA as their own, designating themself as the account owner.

(2) The spouse can also transfer the funds ("roll them over") into their own, pre-existing IRA.

(3) Finally, they can treat themselves as the account beneficiary.



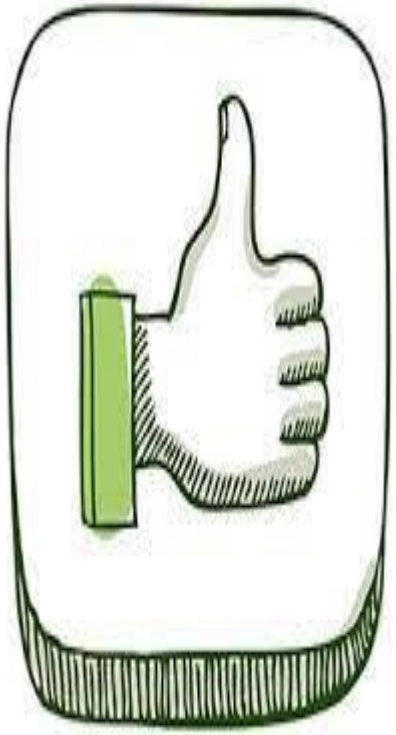
Surviving spouse becomes the IRA owner

If you are the surviving spouse and sole beneficiary of your deceased spouse's IRA, you can elect to be treated as the owner of the IRA and not as the beneficiary.

By electing to be treated as the owner, you determine the required minimum distribution as if you were the owner beginning with the year you elect or are considered to be the owner.

Advantages

- Becoming the owner of the IRA funds can be a good choice if the deceased spouse was older than the spousal beneficiary because it delays the RMDs.
- If the IRA was a Roth, and you are the spouse, you can treat it as if it had been your own Roth all along, in which case you won't be subject to RMDs during your lifetime.



Roll Over Option

Spousal beneficiaries also have the option to "roll over" the inherited IRA funds, or a portion of the funds, into their existing individual retirement account.

Spouses have 60 days from receiving the inherited distribution to roll it over into their own IRA as long as the distribution is not a required minimum distribution.

By combining the funds, the spouse doesn't need to take a required minimum distribution until they reach the age of 72.

Not All or Nothing

However, this is not an all-or-nothing decision.

You can parse the account and roll over some of it to your own IRA and leave the balance in the account you inherited, but there's no changing your mind.

If you make a rollover and need funds from it before age 59½, you'll be subject to the 10% penalty (unless some penalty exception other than death applies).

Surviving spouse acts as the beneficiary

Spousal beneficiaries can plan the RMDs from an inherited IRA to take advantage of delaying the RMDs as long as possible.

If the IRA owner died *before RBD*

If the IRA owner dies before the RBD, distributions to the spousal beneficiary don't need to begin until the year in which the original owner turned 72.

After which, the surviving spouse's RMDs can be calculated based on their own life expectancy.

This can be helpful if the surviving spouse is older than the deceased spouse since it delays RMDs from the inherited funds until the deceased spouse's RBD.

RMDs are based on the life expectancy of the IRA owner.

If the IRA owner died after RBD

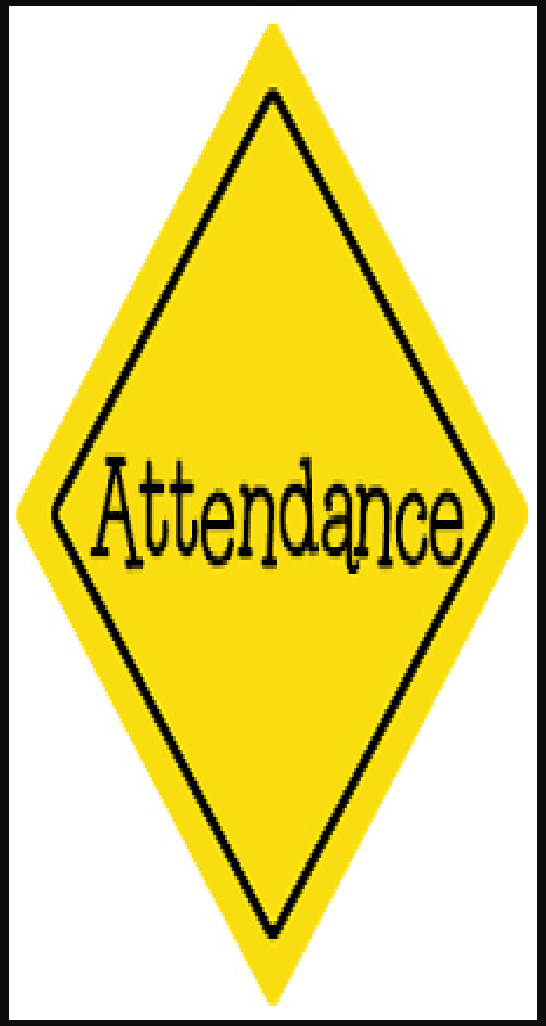
If the original owner had already started getting RMDs or reached their required beginning date (RBD) the spouse can continue the distributions as were originally calculated based on the owner's life expectancy.

However, the surviving spouse can also submit a new RMD schedule based on their own life expectancy.

This process would mean applying the life expectancy for their age found in the Single Life Expectancy Table (Table I in Appendix B of IRS Publication 590-B).

Ideally, spousal beneficiaries want to use the longer single life expectancy, so that the annual RMDs are smaller, resulting in a delay in paying taxes on the inherited IRA funds for as long as possible.

Please Verify your Attendance



Other Eligible Designated Beneficiaries

What if Your Beneficiary is a Nonspouse EDB?

- A child who hasn't reached the age of majority
- A disabled person
- A chronically ill person
- A person not more than 10 years younger than the IRA account owner

What if the Beneficiary is a Nonspouse EDB?

If the Owner dies before their Required Beginning Date

Minimum Distributions will be based on the EDB's remaining life expectancy.

If the Owner dies on or after their Required Beginning Date -

Required Minimum Distributions will be based on the greater of (a) what would have been the Owner's remaining life expectancy or (b) the beneficiary's remaining life expectancy.

What if the Beneficiary is a Nonspouse EDB?

If distributions are calculated each year based on what would have been Owner's remaining life expectancy …

… *the entire account must be distributed by the end of the calendar year in which the beneficiary's remaining life expectancy would have been reduced to one or less.*

If the beneficiary dies annual distributions based on remaining life expectancy must continue during the first nine years after the year of such an event.

But the entire account must be fully distributed in the tenth year.

IRAs and Qualified Plans - Planning Issues - Inherited IRAs - Minimum Distribution Rules - After RBD

Owner's Minor Child

A child who has not reached the age of 18 is permitted to make withdrawals fror an inherited retirement account using their own life expectancy.

However, as soon as the child reaches the age of 18, the 10-year rule for designated beneficiaries (who are not EDBs) goes into effect.

At that time, the child would have until Dec. 31 of the 10th year following their 18th birthday to withdraw all funds from the inherited retirement account.

A deceased retirement account owner's minor child may get an extension, up unt age 26, for the 10-year rule to go into effect, provided the child is pursuing a specified course of education.

Disabled Individual

According to the Internal Revenue Service (IRS),

"Section 72(m)(7) of the Code provides that an individual shall be considered to be disabled if they are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."

For adults (i.e., those 18 and older) the SSA defines "disability" as the inability to do any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

Chronically Ill Individual

The IRS Code Section 7702B(c)(2)(A) states that "the term 'chronically ill individual' means any individual who has been certified by a licensed healthcare practitioner as-

- ✓ Being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity,
- ✓ Having a level of disability similar to the level of disability described in clause (i), or
- ✓ Requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.

IRAs and Qualified Plans - Planning Issues - Inherited IRAs - Minimum Distribution Rules - After RBD

Any Other Individual Not More Than 10 Years Younger Than the Decedent

- This category is a unique catch-all that includes certain friends and siblings (depending on age) who are identified as beneficiaries of a retirement account.
- This final category also excludes most adult children (who are not disabled or chronically ill) from the five categories of EDBs.

Required Minimum Distributions (RMDs) are mandatory, and distributions must begin no later than 12/31 of the year following the owner's year of death

The Five-Year Rule

The Five -Year Rule

Who Does the 5 Year Rule Apply To

Application - the 5-year rule applies only if the owner died on or before his or her required beginning date.

If the Owner Died Before 2020 - The 5-year rule generally applies to all beneficiaries who are not taking life expectancy payments if the owner died before 2020.

If the Owner Died After 2019 - The 5 year rule also applies to beneficiaries who are not designated beneficiaries (such as an estate) if the owner died after 2019.

Note: If the owner died after 2019 and the beneficiary is an individual, the 10-year applies rule.

The Five -Year Rule

How It Works - The 5-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the fifth anniversary of the owner's death.

Example: If the owner died in 2018, the beneficiary would have to fully distribute the IRA by December 31, 2023. The beneficiary is allowed, but not required, to take distributions prior to that date.

If the 5-year rule applies, the amount remaining in the IRA, if any, after December 31 of the year containing the 5th anniversary of the owner's death is subject to the 50% excise tax detailed in Excess Accumulations (Insufficient Distributions), later.

Choosing Beneficiaries

Beneficiary Designations: 5 Critical Mistakes to Avoid*

1. Not Naming a Beneficiary at All
2. Failing to take into account special circumstances.
3. Failing to take income and death taxes into account
4. Getting the name wrong (or not exactly right).
5. Forgetting to update your beneficiaries over time.
6. Not reviewing beneficiary choices with legal and financial advisers.

* According to Kiplinger Retirement News Letter

Choosing Beneficiaries

A special rule applies to 401(k) plans and other "qualified plans" governed by ERISA

- The spouse of the owner is entitled to inherit all the money in the account unless he or she signs a written waiver, consenting to a different choice of beneficiary.
- It's not enough just to name someone else on the beneficiary form
- If the owner's spouse agrees to sign the waiver a plan representative or a notary public must act as a witness.
- A prenuptial agreement can't take the place of a waiver; the law says the spouse (not soon-to-be-spouse) must sign.
- A spouse who does sign a waiver can withdraw that consent if the other spouse later names a different beneficiary unless the signing spouse expressly gave up that right.

Choosing Beneficiaries

IRAs - Unless the owner lives in a community property state, they are free to name whomever they wish as their IRA beneficiary, even if they are married.

Choosing Beneficiaries

As discussed in regard to Life Insurance the choices are the same:

- Spouse
- Children

And the issues are the same:

- How to deal with Minors and those with Special Needs
- When is a Trust Appropriate?

What makes this more complicated are the fact that plan distributions are subject to income tax and the requirements of the "minimum distribution" rules

Life Insurance - Planning Issues - Beneficiary Designation

If you want to have multiple life insurance beneficiaries, there are three ways to assign the death benefit each will receive:

Specific Percentage

Each beneficiary is named and assigned a percentage of the death benefit. Your 2 children, Bart and Lisa, are your beneficiaries. Bart would receive 50% of the payout, Lisa 50%. If Bart passes away before you, Lisa would receive 100% of the payout.

Per Stirpes

The death b

re you. Lisa would receive 50% of the payout and each of Bart

"In equal shares as there are children of mine then living and children of mine then deceased; to pay the share of a then deceased child to his or her then living descendants, per stirpes".

Per Capita

The death benefit is divided equally across each person that is eligible to receive a payout. Bart has 4 children and dies before you. Lisa would receive 20% of the payout and each of Bart's children would receive 20%.

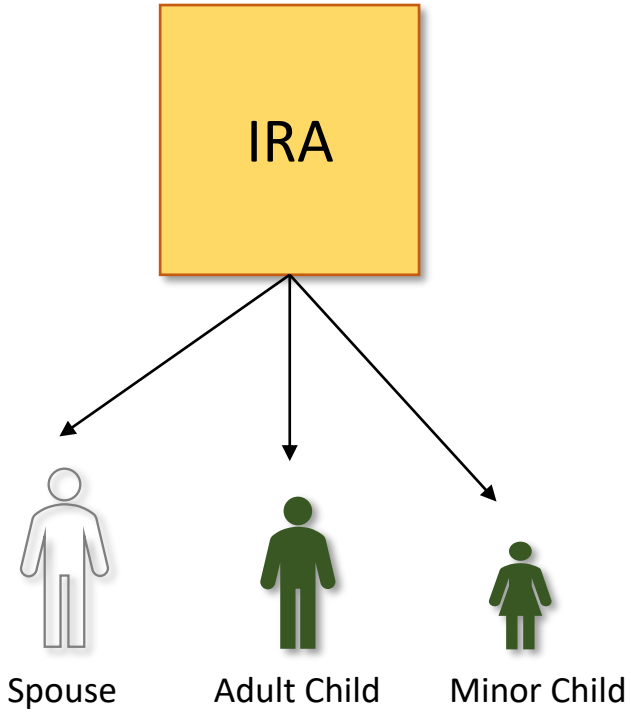
Splitting the Account

Splitting the Accounts.

General Rule - The general rule under the regulations is that when there are several beneficiaries on one IRA, then post-death required minimum distributions (RMDs) are based on the beneficiary with the shortest life expectancy.

When all beneficiaries are designated beneficiaries, this means you use the age of the oldest beneficiary.

In this case after the Secure Act the Ten Year Rule would apply

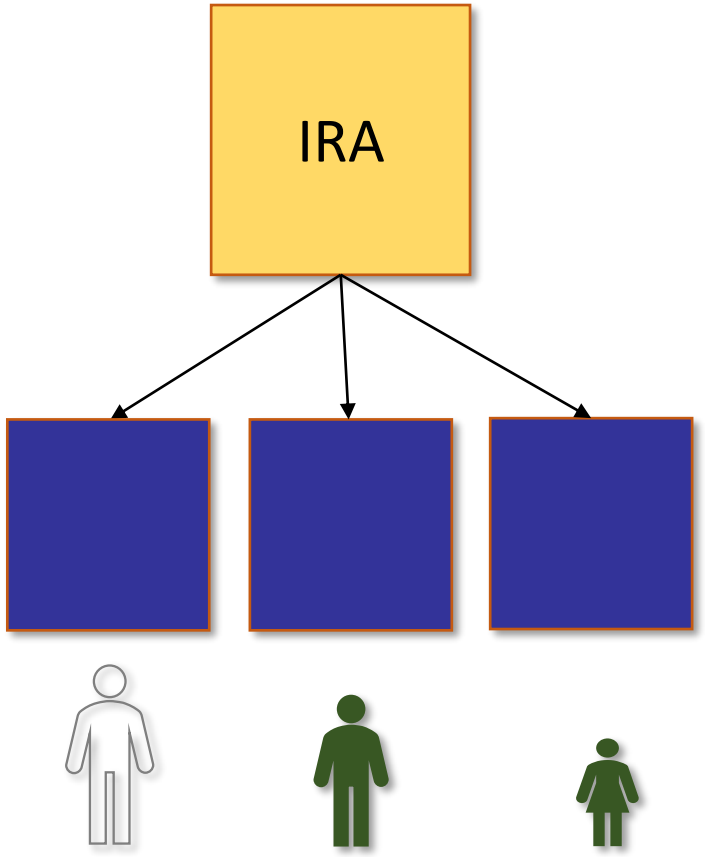


Splitting the Accounts

A single IRA can be split into separate accounts or shares for each beneficiary naming one beneficiary on each IRA.

These separate accounts or shares can be established at any time, either before or after the owner's required beginning date.

You have until December 31st of year after IRA owner's death.

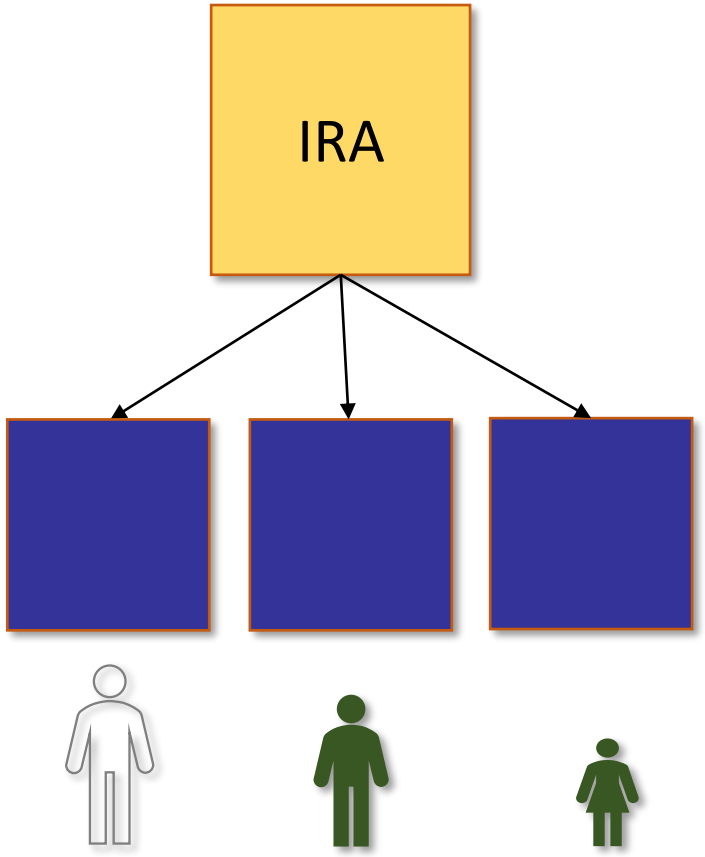


Consider "Splitting" when ...

Spousal Advantages - The distribution advantages available to a Spouse, are only available if the spouse is the sole beneficiary.

If the spouse is not the sole beneficiary, that spouse (for distribution purposes) will be treated as a non-spouse beneficiary.

Multiple Beneficiaries - If there are multiple beneficiaries, the IRA can be split into separate accounts for each one - a good move if one beneficiary is a non-spouse, subject to the 10-year rule, and the other is a spouse or in one of the other special categories.



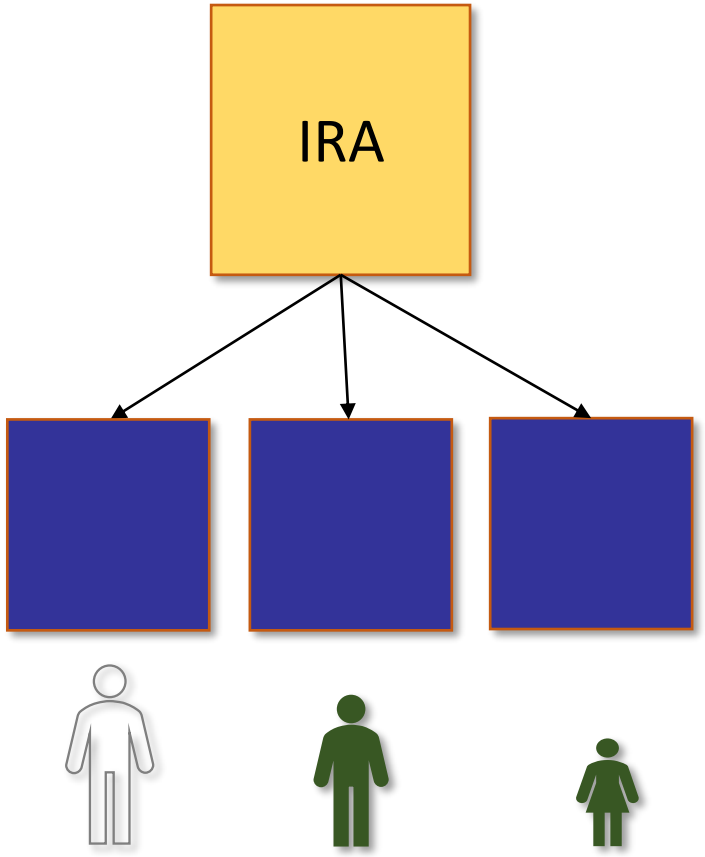
Consider "Splitting" when ...

Asset Allocation

When separate accounts are created by the IRA owner, he can allocate specific investments to the IRA for each beneficiary rather than leaving each beneficiary a certain percentage of the entire IRA.

Trust as Beneficiary

If a trust is the IRA beneficiary, the IRA cannot be split.



Trusts as a Beneficiary

Trust as a Beneficiary

When a trust is named as the beneficiary of an IRA, the trust inherits the IRA when the IRA owner dies.

Some good reasons to consider naming a trust as an IRA beneficiary instead of an individual include:

Working around beneficiary ownership limitations.

Perhaps the intended beneficiary is a minor who is legally unable to own the IRA.

Or, perhaps the IRA owner wants to support an individual with special needs who will lose access to government benefits if he or she owns assets in his or her own name.

A solution in both cases could be to name a trust as the IRA beneficiary, which will then become the legal owner in place of the minor or individual with special needs.

Trust as a Beneficiary

Solving for second marriage or other family structures.

- An IRA owner may wish for RMDs to benefit his or her second spouse during the spouse's lifetime, and then have the remainder of the IRA pass to his or her own children.
- If the IRA owner leaves the IRA outright to his or her spouse, he or she can be certain that his or her spouse will benefit, but he or she can't guarantee that his or her children will receive anything.
- If he or she instead leaves the IRA to a properly structured trust, his or her desire to benefit both sets of beneficiaries can be carried out.

Limiting a beneficiary's access.

The access of a beneficiary of an inherited IRA owned by a trust will be subject to the terms of the trust.

Naming successive beneficiaries.

When an individual IRA beneficiary inherits an IRA, she can name her own initial successor beneficiaries. If the IRA owner wishes to control the successor beneficiary beyond the initial beneficiary, the owner will need to set forth the succession terms in a trust and name the trust as the IRA beneficiary.

Providing creditor protection.

A person's own IRA has some level of protection from creditors, but this does not always carry through to the inherited IRA. The U.S. Supreme Court ruled in Clark v. Rameker (2014) that inherited IRAs do not qualify under the Federal Bankruptcy Code as exempt from the claims of creditors as "retirement funds." An inherited IRA held instead in a properly structured trust will not be an asset of the beneficiary and will have some protection from creditors.

Funding estate plans structured to minimize estate tax.

Most estate plans for wealthy individuals include trusts designed to minimize and postpone the payment of federal and state estate tax. For such estate plans to work as intended, the portion of these trusts that shelters an individual's federal or state estate tax exemption amounts needs to be funded upon the individual's death. Often, the only asset available to do this funding is an IRA.

Income Tax

- The trust must pay taxes on any income it holds and does not distribute past year-end.
- The income the trust distributes is taxable for the beneficiary who receives it.
- An irrevocable trust that has discretion in the distribution of amounts and retains earnings pays income tax that 37% of the excess over $13,450.

RMD Rules for Trusts Inheriting IRAs

Trust as a Beneficiary - RMD Rules for Trusts Inheriting IRAs

The post-death RMDs for a trust named as an IRA beneficiary will be calculated under either:

- the stretch payout rule
- the 10-year rule or
- the 5-year rule

The type of trust - Whether the trust is a "see-through trust" and whether it is a "conduit trust" or an "accumulation trust", and

The type of the trust beneficiary - regular "designated beneficiaries", or part of the new class of "eligible designated beneficiaries."

Trust as a Beneficiary

- A trust can't be a designated beneficiary even if it is a named beneficiary.
- However, the beneficiaries of a trust will be treated as having been designated beneficiaries for purposes of determining required minimum distributions certain requirements are met
- A trust that meets those requirements is sometimes termed a "see through trust".
- See through trusts are either "conduit trusts" or "accumulation trusts"

See Through Trust

In order for the trust beneficiaries to "designated beneficiaries" a trust must meet these requirements:

(1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.

(2) The trust is irrevocable or became, by its terms, irrevocable upon the owner's death.

(3) The beneficiaries of the trust are identifiable from the trust instrument.

(4) The trustee of the trust provides the IRA custodian or trustee with the documentation required by that custodian or trustee by October 31 of the year following the year of the owner's death.

Trust as a Beneficiary - RMD Rules for Trusts Inheriting IRAs

Conduit Trust

- A conduit RA distributions directly t

Accumulation

- An accum inside the trust for future di

PUPIA § 8149(d)

An amount received from an IRA or a plan with a payment provision like that of an IRA is allocated under PUPIA § 8149(d) which differentiates between payments that are required to be made and all other payments.

To the extent that a payment is required to be made (either under federal income tax rules or, in the case of a plan that is not subject to those rules, under the terms of the plan), 10% of the amount received is allocated to income and the balance is allocated to principal.

All other payments are allocated to principal because they represent a change in the form of a principal asset; PUPIA § 8149 follows the rule in PUPIA § 8144(2) which provides that money or property received from a change in the form of a principal asset be allocated to principal.

Trust as a Beneficiary - RMD Rules for Trusts Inheriting IRAs

Conduit Trusts

- If the trust beneficiary is an "eligible designated beneficiary" distributions made over life expectancy of the beneficiary
- If the trust beneficiary is an not "eligible designated beneficiary" all distributions from the IRA must be made within the 10-year period after the participant's death.
- If there are multiple income beneficiaries, all IRA distributions must be distributed to one or more of the income beneficiaries within the same 10-year period.
- The requirements for conduit trusts really defeat the purpose of having a trust because the trustee has no ability to accumulate the IRA distributions.
- Conduit trusts are particularly onerous in this post Secure Act era since everything would be required to be distributed to the beneficiary within 10 years.

Trust as a Beneficiary - RMD Rules for Trusts Inheriting IRAs

Accumulation Trusts

- An accumulation trust is one in which the trustee may accumulate IRA distributions inside the trust for future distribution to one or more beneficiaries.
- One critical aspect of Accumulation Trusts is that, when determining the applicable life (or lives) to use to determine the post-death distribution rules, (i.e., whether the trust will be considered an Eligible Designated Beneficiary and eligible to 'stretch', or a Non-Eligible Designated Beneficiary subject to the 10-Year Rule), the lives of all current income beneficiaries and (potential) future beneficiaries must be considered, and then must use the least favorable distribution schedule that would apply to any single beneficiary if they were named directly.
- As a result the total distribution of the IRA to the Trust must still be completed within 10 years of the participant's death

Trust as a Beneficiary - RMD Rules for Trusts Inheriting IRAs

Other Trusts

Trust that do not meet the requirements to be considered a "see through trust":

- If owner dies before the RBD - 5 Year rule applied - all distribution must be made within 5 years of DOD.
- If owner dies after the RBD - Distribution made based on Onwer's life expectancy; alternatively 5 year Rule can be elected.

Trust as a Beneficiary - RMD Rules for Trusts Inheriting IRAs

Minor or Disabled Beneficiaries

If any beneficiary of a trust meets the definition of a minor or disabled beneficiary, it would be advisable to create separate trusts for these beneficiaries to take maximum advantage of their respective life expectancies.

Trust Income Tax Treatment of IRA Distributions

IRA distributions are considered taxable income and as such are taxed to the trust.

The maximum tax rate for trusts in 2022 is 37% and is reached with only $13,450 in taxable income.

However, if the trust distributes any portion of its income, that income is taxed directly to the beneficiary of the trust.

Since much more taxable income is needed to reach the maximum individual tax rates, it is better for the trust to distribute the income to the beneficiary.

However, as stated before, this generally defeats the purpose of a trust.

Trust as a Beneficiary – The Application of the RMD Rules

EXHIBIT A: REQUIRED MINIMUM DISTRIBUTIONS RULES FOR TRUSTS AS IRA BENEFICIARIES

	See-Through Trusts[3]		Other Trusts
	Conduit Trust	Accumulation Trust	
Key Trust Terms	Must distribute all IRA distributions to an individual trust beneficiary when received	Allows for the accumulation of IRA distributions within the trust, rather than immediate payout	Do not meet definition of see-through trust; likely accumulate IRA distributions; identity of beneficiaries does not matter
RMD Distributions to the Trust	**For an "eligible designated beneficiary (EDB)"[4]:** Payout based on the life expectancy of the beneficiary (stretch IRA rules still apply) **For a beneficiary that is not an EDB:** 10-year Rule – 100% distribution to the trust within 10 years of the owner's death	10-year Rule - 100% distribution to the trust within 10 years of the owner's death[5]	**If the IRA owner dies before age 72:** 5-year Rule – 100% distribution to the trust within 5 years of the owner's death **If the IRA owner dies at age 72 or later:** Payout to the trust based on the actuarial life expectancy of the IRA owner, or the trust can elect to use the 5-year rule
Distributions to Trust Beneficiaries	Distributed immediately to conduit beneficiary after trust receives IRA distributions Results in a non-EDB receiving 100% of the IRA proceeds by the end of year 10	Trust terms govern the timing of distributions to trust beneficiaries May be different than the timing and amounts of IRA distributions to the trust	

The Applicable Multi-Beneficiary Trust

An applicable multi-beneficiary trust is a trust

- Which has more than one beneficiary;
- All of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the distribution period, and
- At least one of the beneficiaries of which is an eligible designated beneficiary who is either disabled or chronically ill.

applicable multi-beneficiary trust

An "applicable multi-beneficiary trust" (AMBT)

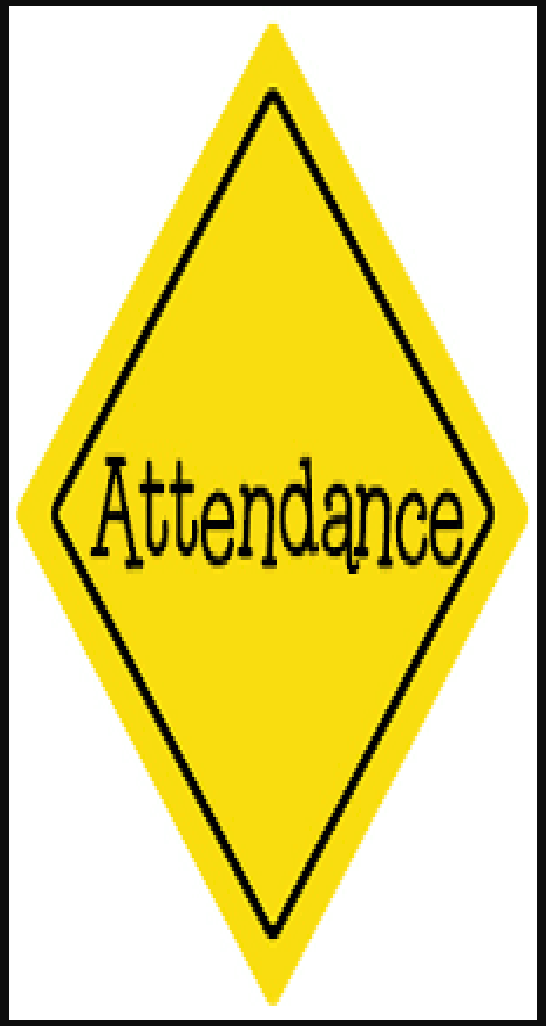
For beneficiaries of retirees dying after 2019, the Code now provides a safe harbor to allow distributions to disabled or chronically ill EBDs under the life expectancy rule.

This is an exception to the rule that IRAs payable to an Accumulation Trusts must be distributed within 10 years.

The plan may make distributions to the trust over the life expectancy rule, chronically ill EDB, if either:

- The trust that is to be divided immediately upon the death of the owner into separate trusts for each beneficiary, in which case the separate account rules apply to each portion of the trust, or
- Alternatively, if no beneficiary of an AMBT other than disabled or chronically ill EDBs has any right to plan benefits until the death of all the disabled or chronically ill EDBs.

Please Verify your Attendance



Inherited IRAs

Note: If you are not a spouse and you inherit an IRA, you have to set up a new account no later than December 31 of the year following the year of the original IRA owner's death

Make sure that the title of this new account conforms to tax law.

The account title should read:

"[Owner's name], deceased [date of death], IRA FBO [your name], Beneficiary"
(FBO means "for the benefit of").

Do not put the account in your own name–if you do, the entire balance is treated as a distribution, and you owe taxes on the lump sum. It's very difficult to undo this error

Conversion of a Traditional IRA to a ROTH IRA

Roth IRAs

A Roth IRA doesn't offer an upfront tax deduction like traditional IRAs, but withdrawals from a Roth are tax-free at retirement.

If you inherit a Roth IRA, it is completely tax-free if the Roth IRA was held for at least five years (starting Jan. 1 of the year in which the first Roth IRA contribution was made).

If you receive distributions from the Roth IRA before the end of the five-year holding period, they are tax-free to the extent that they represent a recovery of the owner's contributions.

However, any earnings or interest on the contribution amounts are taxable.

Pre Death Distributions - are *not subject* to the Required Minimum Distribution Rules.

Post Death Distributions are *subject* to the Required Minimum Distribution Rules.

Converting Traditional IRA Savings to a Roth IRA

Advantages of Roth IRA Conversions

You Might Save on Taxes in the Long Run

- When you convert some or all of the money in your traditional IRA to a Roth, you have to pay income tax that year on the converted amount.
- Even so, converting could be a smart move if you end up in a higher marginal tax bracket in later years or if tax rates rise overall.
- Once you pay tax on that money, it's tax free ever after, no matter how tax rates may change.
- And all the money that you earn in that account is tax free as well.

Money in a traditional IRA grows tax free until you withdraw it. But once you take it out, you have to pay taxes on both the original contributions and what they earned over time.

You'll Escape RMDs and Harsh Penalties

- With traditional IRAs, you must start taking RMDs at age 72.
- Otherwise, you'll face a big tax penalty: 50% of the amount that you failed to withdraw. And, of course, you'll owe income tax on whatever you take out.6
- With a Roth, on the other hand, RMDs are never necessary during your lifetime. If you have other sources of income and don't need the money in your Roth for living expenses, you can keep it intact for your grateful heirs.

Converting Traditional IRA Savings to a Roth IRA

RMD Rules for Inherited Roth IRA

If you're a spouse beneficiary, you can:

- Treat the Roth IRA as your own.
- Take out the entire amount by the fifth year after the owner's death.
- Take RMD over life expectancy.

As a non-spouse beneficiary, you can:

- Withdraw the full balance by the fifth year following the owner's death.
- Ten Year distribution

Other Retirement Plan Issues

Non-Qualified Deferred Compensation Plans

Income in Respect of a Decedent –

The recipient of payments under an NDC plan after the death of the employee must report the amount received as ordinary income because it is treated as income in respect of a decedent (IRD) under §691(a).

The recipient may be entitled to a deduction (the IRD deduction) for any federal (but not state) estate tax attributable to the inclusion of the value of the deferred compensation in the decedent's federal gross estate

Death Benefit Only Plans

Generally, the present value of the right of a beneficiary to receive payments under an NDC plan after the employee's death is includible in the federal gross estate of the employee under §2039(a) because the employee was either currently receiving payments under the plan or was entitled to receive payments under the plan in the future.

The present value of the benefit may be excluded from the gross estate if the plan qualifies as a "death benefit only plan" (DBO plan).

To qualify as a DBO plan, the employee must not be entitled to any benefits under the plan or any other plan maintained by the same employer that is required to be aggregated with the plan.

Plans required to be aggregated with a DBO plan include any retirement plan benefiting the employee, except for plans qualified under §401(a), §403(a), or §403(b).

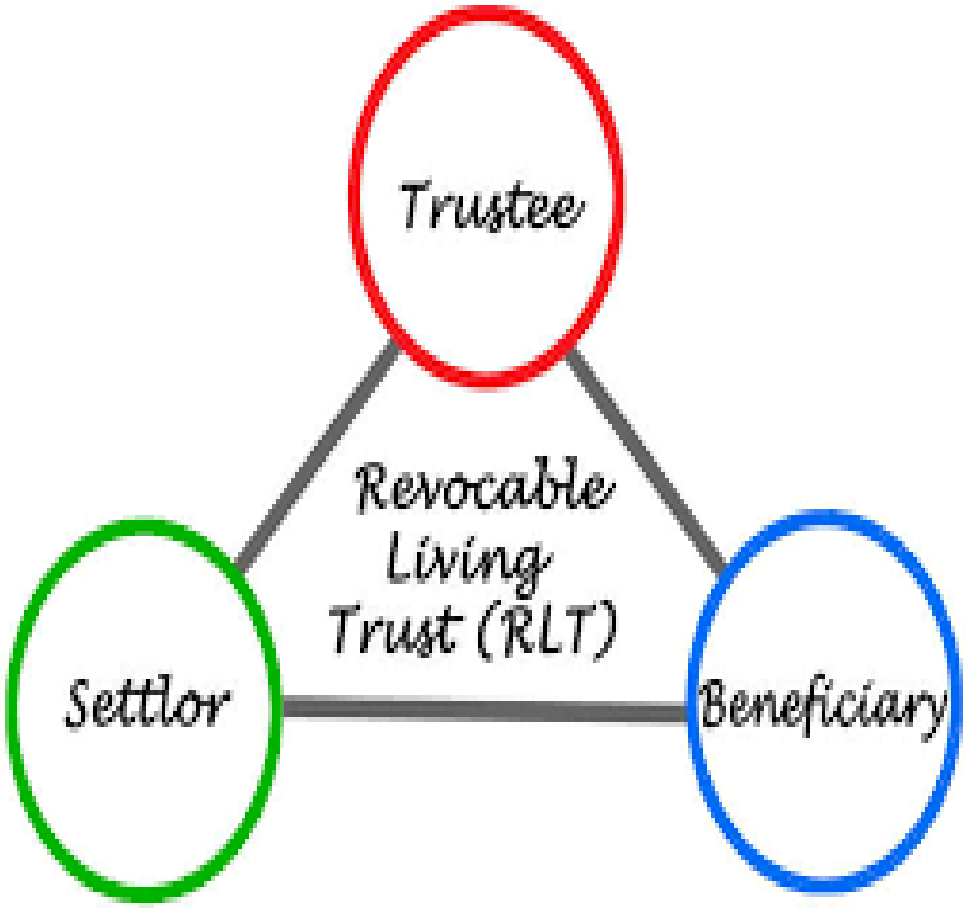
Although the IRS has attempted to aggregate disability income plans with DBO plans in order to include the benefit in the decedent's gross estate, taxpayers have successfully challenged this position in the courts.

Living Trusts

Other Non-Probate Assets - Living Trusts

A revocable living trust is a useful estate planning device which can achieve many estate planning objectives discussec in the previous material including:

- Management of property;
- Serving as a will substitute;
- Avoiding ancillary probate;
- Minimizing probate fees; and
- Implementation of tax planning.



Revocable Trust Treated as Part of the Estate

- ✓ Section 645 provides for an Election to treat Revocable Trust as part of the Grantor's Estate for income tax purposes
- ✓ This election allows a QRT to be treated and taxed (for income tax purposes) as part of its related estate during the election period. Once the election is made, it cannot be revoked.
- ✓ The trustees of each qualified revocable trust (QRT) and the executor of the related estate, if any, use Form 8855 to make the election.
- ✓ A "qualified revocable trust" (QRT) is any trust (or part of a trust) that was treated as owned by a decedent (on that decedent's date of death) by reason of a power to revoke that was exercisable by the decedent (without regard to whether the power was held by the decedent's spouse).

A decedent's estate has several income tax advantages not available to a revocable trust. These include:

- The option to adopt a fiscal year for income tax purposes and thereby permit an executor to defer the reporting of income and plan for the use of deductible expenses.
- The ability to take advantage of the charitable set aside deduction under Internal Revenue Code ("IRC") §642(c).
- Recognition of loss upon the satisfaction of a pecuniary bequest with assets having a fair market value less than basis under Code §267(b).
- Not being subject to the active participation requirements of the passive loss rules for tax years ending less than two years after decedent's date of death.

Questions

- If you have any questions during the program, please type them into the chat box and I will try to address them during the program.
- If your question is *not answered* during the program you will receive an ‘ e-mail response after the program is concluded.
- If you have questions after the program is concluded please e-mail your question to –

mp

tedperkins@gibperk.com
610 565 1708 Ext 104

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Thank you for attending our program.

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Please complete this form, which helps us comply with the requirements of issuing CPE and CLE in various jurisdictions.

THE
END