Recent Developments in Estate Planning for Retirement Benefits: Planning in a Post-SECURE World

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PRELIMINARIES

Abbreviations, Symbols, and Terms Used in this Outline

This Outline assumes that the reader is generally familiar with the "minimum distribution rules" of the Internal Revenue Code of 1986 as amended through 2019 (the "Code") and regulations thereunder. For fuller explanations, see the applicable sections (indicated by the "¶" symbol) of the author's book *Life and Death Planning for Retirement Benefits* (8^{th} ed. 2019; www.ataxplan.com).

§ Refers to a section of the Code, unless otherwise indicated.

Accumulation Trust	A trust that is not a conduit trust. ¶ 6.3.07.
ADP	Applicable Distribution Period. The time period over which benefits must be distributed under the minimum distribution rules. See Reg. § 1.401(a)(9)-4, -5.
AMBT	Applicable multi-beneficiary trust. § 401(a)(9)(H)(v).
Code	Internal Revenue Code of 1986, as amended through May 31, 2021.
Conduit trust	Trust under which all retirement plan distributions received by the trust during the lifetime of the trust's individual beneficiary must be distributed forthwith to such beneficiary. ¶ 6.3.05; Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2.
DB	Designated Beneficiary. Reg. § 1.401(a)(9)-4, A-1; ¶ 1.7.03.
D/CI beneficiary	Disabled or chronically ill beneficiary. § 401(a)(9)(E)(ii)(III), (IV).
EDB	Eligible Designated Beneficiary. § 401(a)(9)(E)(ii).
IRA	Individual retirement account or individual retirement trust under § 408.
IRS	Internal Revenue Service. Used more or less interchangeably with "Treasury."
Non-DB	A beneficiary who is not a designated beneficiary. ¶ 1.7.03, ¶ 1.7.04.
QRP	Qualified retirement plan under § 401(a). See "Appendix E" of *Life and Death Planning for Retirement Benefits*.
Participant	In the case of an IRA, the IRA owner. In the case of employer-created retirement plans, the employee.
PODB	Plain old designated beneficiary.
PLR	IRS private letter ruling.
Reg.	Treasury Regulation.
RBD	Required Beginning Date (for commencement of lifetime distributions). ¶ 1.4.01.
RMD	Required minimum distribution under § 401(a)(9).
See-through trust.	A trust which qualifies for "designated beneficiary" treatment under the IRS's "minimum distribution trust rules." See PART V of this Outline.
Treasury	The United States Treasury Department. See "IRS."

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Preface: A Happy Children's Fairy Tale

Once upon a time, estate planners had a wonderful surprise gift for clients. When the client showed up with a large IRA asset, an "ugly duckling" that came laden with the indebtedness for unpaid income taxes, the planner could turn the asset into a swan. The swan was called the "stretch IRA"— deferring those taxes for decades after the client's demise with a life expectancy payout to the client's children or grandchildren. And the client and the family and the estate planner lived happily ever after.

The rest of this Outline contains the horror story about the monster that took away the happy ending: The SECURE Act of December 2019. Planners' new message for clients: "You shouldn't have accumulated so much money in your retirement plans. Your children will be punished for this mistake. In the meantime, you will be paying me for damage control."

PART I: ESTATE PLANNING FOR RETIREMENT BENEFITS UNDER SECURE: A HORROR STORY FOR CLIENTS, PLANNERS, BENEFICIARIES, AND TRUSTEES

A. Introduction to the post-SECURE world; and the newest news

Signed into law December 20, 2019, SECURE has radically changed the estate planning landscape for clients' retirement benefits. Except for a few types of beneficiaries, the life expectancy payout is gone with the wind, replaced by a maximum 10-year post-death payout period for most retirement benefits. As of June 1, 2021, there is still no authoritative guidance on many questions arising under the new law (see Appendix A).

However, we do have a "preview" of some of what such guidance may eventually provide; see "IRS Publication 590-B: Distributions from Individual Retirement Arrangements (2020)," mentioned throughout this Outline.

Planners are hard pressed to complete the now urgently needed estate plan reviews.

For over 30 years, the go-to estate plan for the owners of tax-favored retirement plans was the "stretch IRA": Make your IRA or other retirement plan payable to a "designated beneficiary" (or see-through trust) and the designated beneficiary (or trust) could leave the plan in its tax-deferred status for years or decades after your death, withdrawing the benefits only gradually by taking annual distributions over the oldest trust beneficiary's life expectancy. With the life expectancy of a 50-year-old son or daughter being 34.2 years, or that of a grandchild or great-grandchild being potentially as long as 80 years, this estate plan was understandably popular. It was as if the income tax on that IRA never had to be paid at all, so negligible was the effect of dribbling out the plan distributions in little bits over many decades.

After SECURE, planners no longer have that gift to give clients. Though a life expectancy payout is still available for certain strictly limited classes of "eligible designated beneficiaries," long-term deferral is off the menu for most estate plans. The planner's role from now on is strictly damage control and "playing the corners," looking for any way to trim that tax bill. The swan has turned back into an ugly duckling.

Has this at least simplified the complicated world of minimum distributions and the "RMD trust rules?" Not at all. The definition of designated beneficiary hasn't changed. The definition of see-through trust hasn't changed (see PART V). All that has changed is the payout period for those beneficiaries: With the exception of five particular types of beneficiaries ("eligible designated beneficiaries") (EDB), the life expectancy payout has been replaced by a 10-year payout rule. So, the 50-year old son or daughter who inherits Mom's IRA will now have to withdraw the entire account within 10 years after Mom's death instead of over the 34.2-year life expectancy payout period that would have applied if Mom had died before 2020.

But more than that: Planners now need to know and focus on, to a much greater degree than was previously necessary, how trusts are taxed. In the old days, when an IRA was payable to a trust, the expectation was, the trustee would withdraw the small-ish required minimum distribution (RMDs) from the IRA each year and pass it out to the trust's beneficiary. The taxable income would come into, and then go right out of, the trust, and the beneficiary would pay the income tax on each year's itsy bitsy RMD. All you needed to know (not really, but almost) was that the income went out to the beneficiary and the income tax was the beneficiary's problem. The mindset was, the income tax is deferred so long , and paid in such small amounts to a beneficiary in a probably low-ish bracket, that there really is no income tax to worry about.

Forget that mindset. Under SECURE, the taxable income inherent in the client's IRA is going to hit the IRA beneficiary like a ton of bricks within 10 years after the client's death. And if the IRA is payable to a trust the taxable income is going to hit the trust like two tons of bricks. Post-2019, the estate planning lawyer needs to learn to navigate fiduciary income tax; see PART II for that. And trustees will enter a whole new universe of problems: see Part III, Case #8.

Some planning guidelines have emerged. See the 4-step process (below), the "ABCD" chart (Appendix C),and the "trust forms you will need" in this PART II(C).

B. The New 4-Step Planning Process for Retirement Benefits

If your estate planning client owns an IRA or other retirement-plan assets, here are the considerations that must be dealt with to create the best plan.

Step 1: Who is/are the client's intended beneficiary(ies)?

If there is only one intended beneficiary (as in, "I have one child, no spouse, no charitable intent, and I want to leave everything to my child," or "I am leaving my entire estate to charity"), move on to Step 2.

If there are more than one, a planning decision must be made: Would it be advisable to steer the retirement benefits to one or more particular beneficiary(ies), and use other assets for the other beneficiary(ies)? For example:

- If there is a charity in the mix, it is likely the best plan to steer the retirement benefits to the charity and nonretirement assets to the human beneficiaries.

- If there is an "eligible designated beneficiary" in the mix (spouse, disabled/chronically ill beneficiary, minor child, not-more-than 10 years younger individual), consider whether the life expectancy payout available to such EDB makes it advisable to steer the benefits to that one.

Step 2: For a beneficiary who is to receive retirement benefits, should the person be named directly as beneficiary of the plan? Or should the benefits be left in trust for him or her? If the plan is to leave benefits to the beneficiaries through a trust, work with the client to consider why this is being done, the price that will be paid for doing it this way, and whether the goal is worth the price.

Use the "ABCD Chart" (Appendix C) to work out the pros and cons of each alternative and refer to the trusts-you-will-need menu (section C below).

Step 3: Consider whether to advise the client to consider drawing down the retirement plan (or converting it to a Roth IRA) during life.

Prior to SECURE it would be unusual for an estate planner to advise a client to stop funding, or start drawing down, retirement benefits. This aspect of the client's plan will become more important, since drawing down benefits during life (or converting to a Roth) will be for some clients the best way to avoid having the benefits "melt down" upon his death.

Step 4: In drafting the trust, what (if any) guidance or release of liability should be given to the trustee regarding timing of distributions?

A trust to be named as beneficiary of a retirement plan does not need to state that the trustee "shall withdraw the required minimum distribution." The trustee must withdraw the RMD whether the trust tells him to or not, just as the trustee has to file tax returns, submit accounts, and abjure self-dealing even if these requirements are not stated in the trust instrument. Nevertheless it can be advisable to include the "shall withdraw the RMD" language just to alert the trustee to the obligation, show the planner/drafter was aware of it too, and clarify how the RMDs fit in with the trust's dispositive provisions.

Beyond those considerations, the purpose of including in the trust instrument specific language dealing with retirement benefits is to assure a specific favorable tax treatment for the benefits. For example, directing that charitable bequests shall be fulfilled with retirement benefits or proceeds thereof will normally help assure the charitable income tax deduction for the trust (see ¶ 7.4.06 of *Life and Death Planning for Retirement Benefits*). Similarly, requiring the trustee to pass out all retirement plan distributions to the life beneficiary of the trust will achieve "conduit trust" treatment for the trust thereby assuring the life expectancy payout period if the conduit beneficiary is an EDB (see PART III(D) of this Outline).

But when the life beneficiary of the trust is only a "designated beneficiary" and not an EDB, and the trust qualifies as a see-through trust, the 10-year rule will apply. Under SECURE's 10-year rule, there is no requirement that the trustee withdraw distributions annually. The only requirements (as far as the Tax Code is concerned) are that (1) if the participant died after his RBD, the trustee must withdraw the balance of the RMD for the year of death (if the decedent hadn't withdrawn all of it prior to death) and (2) everything else must be withdrawn no later than December 31 of the year that contains the 10th anniversary of the date of death. To minimize taxes and maximize the value of the asset for the trust beneficiaries, when exactly (within that 10-year, or potentially 11 taxable-year period) should the trustee withdraw from the inherited plan? The trust may mandate some withdrawals unrelated to income tax planning—for example it may require the trustee to withdraw and distribute all "income" of the IRA (in the case of a marital deduction trust), or to withdraw and distribute as much as required for the beneficiary's health, education and support. But what if anything should the trustee withdraw from the plan beyond those required amounts? See PART III, Case #8 for more on this problem.

If the client and planner have an answer to that question should they include that withdrawal requirement in the instrument? Or leave it up to the trustee's discretion and judgment?

I lean towards not tying the trustee's hands. I am skeptical that anyone can predict the best withdrawal pattern on the date the trust is signed. But trustees may prefer the certainty of a dictated withdrawal rule. At the very least I presume trustees will want to see language exempting the trustee from any liability for guessing wrong about what withdrawal pattern is best.

C. The trust forms you will need

This is drawn from the case studies section (PART III). Here are the master trust forms you will need to carry out most estate plans after SECURE:

For surviving spouse:

A **combination conduit/QTIP trust** providing that the spouse will receive, for life, the "greater of" the income or the RMD, plus such other amount(s) if any as the client wants spouse to receive in addition such as amounts needed for health and support, or enough to provide minimum payout of 3% of the trust value per year, or amounts for any purpose in the trustee's discretion. As a conduit trust, ALL distributions from the retirement plan must be distributed to spouse forthwith. This trust is entitled to spousal life expectancy payout "deal." This "model" of trust (and the next one) are unchanged from pre-SECURE days.

A **plain (nonQTIP) conduit trust** providing that the spouse will receive, for life, the RMD, plus such other amount(s) if any as the client wants spouse to receive in addition (see above). As a conduit trust, ALL distributions from the retirement plan must be distributed to spouse forthwith. This trust is entitled to spousal life expectancy payout "deal."

A **trusteed IRA** can be used for either of the above instead of a separate trust.

An **income-only type marital trust** for spouse's sole life benefit. Spouse gets all income for life, plus such other amount(s) if any as the client wants spouse to receive in addition. After spouse's death the trust passes only to identifiable individual beneficiaries. As a STAT, this trust would qualify for the 10-year rule.

A **"spray" trust for the benefit of client's surviving spouse and issue**. Trustee uses income and/or principal as the instrument directs for benefit of this group. Benefits not distributed eventually pass to these or other individuals. As a STAT, this trust would qualify for the 10-year rule.

For disabled/chronically ill beneficiary:

A supplemental needs trust for sole life benefit of the D/CI beneficiary. Trust can NOT provide for any distributions to anyone other than the D/CI beneficiary during his/her life. Trust can NOT provide for a "self-destruct" clause if the trust causes D/CI beneficiary to cease to qualify for government benefits. On death of D/CI individual, the trust passes to only individual beneficiaries. As an AMBT, this trust would qualify for life expectancy payout.

Any trust for the sole life benefit of the D/CI beneficiary, even if it provides for "all" needs not just supplemental needs....for example, "income to D/CI beneficiary plus principal as needed for health and support." On death of D/CI individual, the trust passes to only individual beneficiaries. As an AMBT, this trust would qualify for life expectancy payout.

For NMTTYY ("Nimitty") [not more than 10 years younger] beneficiary:

A **conduit trust** providing that the Nimitty will receive, for life, the RMD, plus such other amount(s) if any as the client wants him/her to receive in addition (such as amounts needed for health and support, or enough to provide minimum payout of 3% of the trust value per year, or amounts for any purpose in the trustee's discretion). As a conduit trust, ALL distributions from the retirement plan must be distributed to Nimitty forthwith. This trust is entitled to life expectancy payout. As always, a trusteed IRA could be used instead of a separate stand-alone conduit trust.

If the Nimitty is an older individual, also consider a charitable remainder trust if the client has charitable intent.

If the client does not like either of the foregoing, see "Plain old STAT" below.

For client's minor child(ren):

For one minor child, if client is willing to have child receive outright control/distribution of the entire account no later than age 28 [that COULD turn into a later age depending on IRS regulations eventual definition of "reaches majority], a **conduit trust** providing that the trustee shall withdraw each year from the retirement plan, and pay to or for the benefit of the minor, the RMD for such year (if any), plus whatever other amounts the client wishes to specify such as: such amounts as the trustee deems advisable for the health, education, support, of the minor and/or such amounts as the trustee deems advisable for any reason. As a conduit trust, this trust qualifies for the modified (fake?) life expectancy payout allowed for a minor child of the deceased participant. As always, a trusteed IRA could be used instead of a separate stand-alone conduit trust.

For one or all minor children: **A see-through spray "family pot" trust** providing such amounts to be paid to or for the benefit of the children as the trustee deems best for expenditures specified by client such as health, support, education, etc. and any other reason the trustee deems advisable, with outright distribution to each child at age(s) specified by client. If all child-beneficiaries die prior to termination of the trust the remaining trust property passes only to individuals. As a STAT, this trust would qualify for the 10-year rule.

For a plain old designated beneficiary (PODB):

A **conduit trust** providing that the PODB will receive each year the RMD (if any), plus such other amount(s) if any as the client wants him/her to receive in addition such as amounts needed for health and support, or enough to provide minimum payout of 3% of the trust value per year, or amounts for any purpose in the trustee's discretion. As a conduit trust, ALL distributions from the retirement plan must be distributed to PODB forthwith. This trust is entitled to the 10-year rule. The entire trust will be terminated and distributed to the PODB within 10 years after the client's death. As always, a trusteed IRA could be used instead of a separate stand-alone conduit trust.

A "**Plain old STAT**": During life, the PODB will receive such amounts as the client provides in the trust—such as income plus principal as needed for health and support, or income plus additional amounts in the trustee's discretion, or a fixed rate distribution of 5% per year—whatever the client wants to have him/her receive from the trust. Upon the PODB's death, the remaining trust property passes only to individuals. As a STAT, this trust would qualify for the 10-year rule.

A **Flex Trust**: A Flex Trust for a PODB is a Plain Old STAT with one slight difference. The trust encourages the trustee to pass all retirement plan distributions out to the PODB as received, and to retain such distributions in the trust (paying trust tax rates) only if the trustee believes that to be in the best interest of the PODB, for example if the PODB is in the middle of a divorce, bankruptcy, or some other situation that would mean that distributions to the PODB would more likely benefit someone other than the PODB.

PART II: THE 7 FIT (FIDUCIARY INCOME TAX) FACTS PLANNERS MUST KNOW

Your client dies leaving his $1 million IRA to a trust you drafted. Now what happens?

Tax disaster can ensue when these two complicated entities (trusts and retirement accounts) collide. IRA distributions are normally 100% includible in gross income when paid to either a human beneficiary or a trust. But what happens to gross income paid to a *trust* is totally different from what happens to gross income paid to a *human*. People and trusts operate in different tax universes. Using a trust as a vehicle to leave a retirement plan to human/family beneficiaries can be a costly way to benefit those individuals. If the estate planner, trust drafter, and trustee understand the differences between human income tax rules and fiduciary income tax rules, taxes can be minimized or at least planned for.

This section summarizes the 7 facts of FIT (Fiduciary Income Tax) planners and trustees must know to properly handle retirement benefits paid to a trust. For detailed explanation of each FIT Fact see the cited sections of *Life and Death Planning for Retirement Benefits*.

FIT Fact #1: Trust tax rates are higher

A trust goes into our Code's highest income tax rate (37%) with just $13,050 of taxable income (2021 rates), regardless of how poor or rich the trust beneficiaries are. A human doesn't hit that top rate until she has $523,600 of taxable income (if single) or $628,300 (if married filing jointly). The extra 3.8% tax on "net investment income" applies to humans who have over $200,000 of income ($250,000 if married filing jointly), but hits a trust after only $13,050 of income. If a client's intended beneficiaries are not in such high income tax brackets themselves, leaving the benefits to a trust may cause the family to be taxed at a much higher rate than they normally pay. There are ways to work within the trust framework to avoid having IRA distributions (gross income) taxable at high trust rates. How do you manage that?

FIT Fact #2: The DNI deduction

Trusts are taxable on their taxable income, just like humans (though with different rate structures). But trusts get a deduction humans don't get, called the "DNI deduction." The trust can get an income tax deduction for "distributable net income" (DNI) that is paid out to the human beneficiaries. The beneficiaries who receive the DNI pay tax on it at their (hopefully lower) rates. Needless to say, there are rules around the DNI deduction—for example, the distribution out to the beneficiary generally has to occur in the same year the income was received by the trust (or shortly thereafter). (For more of these rules limiting the DNI deduction, keep reading.)

By requiring or permitting the trustee to pass the retirement benefits out to the human beneficiaries, the client enables the trustee to shift income to lower-bracket beneficiaries via the DNI deduction. Income "stuck" in the trust is what gets hit with those high trust tax rates.

But don't fall for the fallacy that the trustee can always simply erase the tax on IRA distributions by paying them out to the beneficiaries. For one thing, not every distribution from a trust "carries out DNI" (see FIT Facts #4, #5, and #6). For another thing, the trustee cannot just make distributions willy nilly because he wants to—the distribution must be permitted or required by the trust instrument—see FIT Fact #3:

FIT Fact #3: "Trust accounting income" is not the same as "federal gross income"

If the trust says "pay income to my spouse for life, and on her death pay the principal to my children," that does not mean the trustee is to pass out all *taxable* income or *federal gross income* to the spouse. It means the trustee must pay all *trust accounting income* to the spouse.

The trustee may receive an item that goes into federal gross income but is not considered trust accounting income. For example, if the trust cashes out a $1 million IRA when husband dies, the trustee has received $1 million of gross income and that $1 million goes into the trust's DNI. But under most states' trust accounting laws, only a small portion (or none) of that $1 million will count as "trust accounting income." For example, under the Uniform Principal and Income Act promulgated some years ago (which was adopted by many states, but may since have been modified on a state by state basis), if the $ 1 million IRA distribution was not a "required minimum distribution" 100% of it would be treated as "principal" for trust accounting purposes and so no portion of it could be paid out to the spouse under the "pay all income to my spouse" clause of the trust!

If you want to be sure the trustee has the flexibility to pass retirement benefits out to the trust's human beneficiaries, you must build that flexibility into the trust instrument. For example, make sure the trustee has discretion (or is required) to pay out all *retirement plan distributions* regardless of whether they are considered "income" or "principal" for trust accounting purposes. See ¶ 6.5.03 of *Life and Death Planning for Retirement Benefits*.

Example: With a "conduit trust," the trustee is required to pass out to the human beneficiary all distributions the trust receives from the retirement plan. No plan distributions will be "trapped" in the trust to be taxed at trust rates.

Example: If the trustee has discretion to "pay income or principal to my spouse in any amounts for any reason the trustee deems advisable. In determining whether to make such distributions, the trustee shall take into consideration the respective income tax rates applicable to the trust and the beneficiaries with respect to any such proposed distribution." Or, if you want the trustee to have discretion to pay out "federal gross income" then say so, rather than just using the word "income" which will mean (in the context of trust language) trust accounting income.

Drafters should strongly consider including a definition of “income” with respect to retirement benefits when specifying that a particular beneficiary is to receive the trust’s “income.” With respect to IRAs, the IRS has blessed two methods of determining “trust accounting income,” namely, defining it as the retirement account’s internal income, or a “unitrust” approach based on 3%–5% of the annual value of the account. See Rev. Rul. 2006-26, 2006-1 CB 939. See ¶ 6.1.02–¶ 6.1.04 of *Life and Death Planning for Retirement Benefits*.

FIT Fact #4: The difference between “pecuniary” and “residuary” bequests

John’s trust says “at my death pay $1 million to my spouse Jane, and hold all the rest of the money in trust for my children B and C for life.” The trustee cashes out the $1 million IRA and distributes $1 million to Jane.

Unfortunately for the trustee, that distribution does not “carry out DNI.” Generally there is no DNI deduction for paying a “pecuniary” (fixed dollar amount) bequest. § 663(a)(1), Reg. § 1.663(a)-1. Spouse Jane will receive $1 million of cash income tax-free and the trust for B and C will have to pay income tax on the IRA distribution. (Exceptions: There is a DNI deduction for pecuniary bequests that must be paid over three years or more, or where the “pecuniary amount” is determined by a formula based (for example) on the size of the taxable estate.) See ¶ 6.5.02(F) of *Life and Death Planning for Retirement Benefits*.

Moral: If the trust is to be funded with substantial retirement benefits, be aware that the trust may have to cash out (and pay tax on) retirement plan distributions and pay pecuniary bequests with what’s left after taxes. Stop and think before including substantial pecuniary bequests in a trust that will receive retirement benefits of a significant amount.

FIT Fact #5: The “separate share rules”

Here’s another sneaky exception to the “distributions-pass-out-DNI” rule that can keep the trustee from deducting a payout to the trust beneficiaries. The “separate share rule” applies to a trust that is allocated into separate shares (equivalent to separate trusts—so that a distribution to one beneficiary reduces his/her share of the trust and does not reduce other beneficiaries’ shares). (This is in contrast to a “pot” or “spray”- type trust where there is just one “share” and the trustee makes distributions among the beneficiaries based on (*e.g.*) need rather than on predefined shares.)

When a trust subject to the separate share rule receives an IRA distribution, the resulting gross income generally must be allocated proportionately among the shares—regardless of who it is actually paid out to—for DNI purposes.

Example: Fred leaves his IRA to a trust that is to be paid on his death in equal shares to his children A, B, and C. The trustee cashes out the $1 million IRA and distributes it all to A; the trustee plans to distribute other assets to B and C so all get equal amounts. He does this because A has some business losses she can use to offset the gross income from the IRA distribution. Unfortunately this plan doesn’t work. Since the trustee *could have* allocated the IRA distribution equally among all three shares, for income tax purposes the $1 million of income is allocated proportionately among the shares for DNI purposes. Therefore even if trustee pays it all out to Child A, that distribution will “carry out DNI” only to the extent of one third of the $1 million. The tax code says the rest of the $1 million of gross income is allocated to B’s and C’s shares, so those shares will be taxed on $333,333 each even though those shares are receiving different (noncash) assets. See ¶ 6.5.05 of *Life and Death Planning for Retirement Benefits*.

If foreseen, the drafter can override this rule by requiring the trustee to allocate the IRA proceeds to a particular share, for example directing that asset to low-income pottery maker Jan and directing that nonIRA assets shall be paid to high-income You-Tube star Chris. However, it would be rare for the estate planner and client to be able to foresee, at the time the trust is drafted, which beneficiary will be in the lowest tax bracket after the client's death.

There is another way around the rule—the trustee can pay off the other beneficiaries first, so the "only share that can be funded" with the IRA distribution at the time the trustee receives it is the share the trustee wants to allocate it to. See ¶ 6.5.06 (last paragraph) of *Life and Death Planning for Retirement Benefits*.

Moral: Pay attention, in planning, drafting, and administering a trust that will receive substantial retirement benefits, whether it is feasible to get gross income from IRA distributions steered to lower bracket beneficiaries.

FIT Fact #6: Charitable bequests have a whole different set of rules

A distribution to a charity does not "carry out DNI." When the trustee writes a check to a charity in payment of the charity's bequest in the trust, the trustee cannot get a DNI deduction for that check. He may be able to get a charitable deduction—but that's under a whole different code section (§ 642(c)) with its own set of even more complicated and demanding rules. For example a pecuniary bequest to charity can (if all requirements are met) qualify for a charitable deduction even though it would never qualify for a DNI deduction. For full explanation of the fiduciary income tax charitable deduction see ¶ 7.4 of *Life and Death Planning for Retirement Benefits*.

Moral: Leaving retirement benefits to charity is a very tax-favored way to dispose of those benefits. The rules for deducting a charitable gift *from a trust* are a whole separate subject of study. If the client wishes to benefit charity with her retirement plan, the trust drafter and trustee must master the fiduciary income tax charitable deduction rules.

FIT Fact #7: Difference between a distribution *"of* the IRA" vs. "*from* the IRA"

This is the secret path that sometimes enables trustees to get around some of these rules: A distribution from an IRA is gross income. However, the IRA itself is not gross income. The Code characterizes the IRA itself as "right to receive" gross income. See § 691(a)(2) and ¶ 6.5.07 of *Life and Death Planning for Retirement Benefits*.

As we've seen, the DNI rules (trust accounting income vs. taxable income; separate share rule; no DNI deduction for charitable gift) can ensnare the trustee so that IRA distributions get trapped (and taxed) in the trust at high tax rates. In some cases the trustee can avoid the snares by transferring the *IRA itself* to a residuary (not a pecuniary) beneficiary. For example, if there is a separate share trust, and the trustee transfers the IRA itself to the share of one residuary beneficiary and some other assets to the shares of the other residuary beneficiaries, the transfer of the IRA does not trigger any taxable income at the trust level. The trustee does not need to worry about allocating the gross income proportionately among the shares because there is no gross income to allocate.

See ¶ 6.1.05 and ¶ 6.5.07 of *Life and Death Planning for Retirement Benefits*.

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PART III: CASE STUDIES

Clients have the same goals for their retirement benefits after SECURE as they had before SECURE. The goal of long-term deferral of income taxes on those benefits, which was easy to achieve in most cases before SECURE, is impossible to achieve in most cases now.

How does that change affect the client's achievement of other goals? In some cases—no effect; client can still achieve deferral of income tax along with her other goals. In some cases—well the deferral game is over so we'll just drop that goal and stick with the remaining goals. In some other cases—you've got a problem to which there are no easy answers. Client must choose between his personal planning goals and lower taxes.

Unless YOU the great genius estate planner think of a way out of that box—in which case I hope you'll share it with the rest of us.

Case # 1: How to Benefit the Surviving Spouse: Ken and Karen

1. Facts

Ken Koslow is a 62-year-old executive. He has two children, ages 36 and 33. His children are competent adults. Both of them have very low incomes. No family member is disabled or chronically ill. Ken's wife, Karen, is, like Ken, a high-income executive. She is 55. Ken's assets consists of:

House (joint with spouse)	$ 2,500,000
Non-plan investments	225,000
Life Insurance	500,000
Qualified plan	2,000,000
IRA	1,000,000
Total	$6,225,000

Ken's plan is to leave his life insurance and other "non-retirement-plan investments" to his children, the house to his wife (it is already in joint ownership), and all of his retirement benefits to a QTIP marital deduction trust. The trust would pay income to Karen for life and on her death the principal of the trust would pass to his children. Ken's stated goal is that "all of my family should benefit from my retirement plans, as these are my largest asset."

The Code provides special favorable treatment for retirement benefits payable to the surviving spouse as beneficiary. If a client wants to provide for his spouse, but does not want to make his retirement benefits payable outright to her as named beneficiary, what does the family lose if the client names *a trust for the spouse's benefit,* rather than the spouse herself, as beneficiary of his retirement plan?

This case discusses that question in a particular context: where the client's reason for wanting to name a trust as beneficiary is that his spouse is not the parent of his children—the so-called "second marriage" scenario.

In a second marriage situation where a client wants to leave assets for the life benefit of his spouse, but ultimately have the funds pass to his children by a prior marriage; or any situation in which a client wants to leave assets in a life trust for the spouse's benefit rather than outright to the spouse for tax or non-tax reasons; the usual solution is a "QTIP" trust.

(This case study assumes that the spouse is a competent adult capable of handling his/her own financial affairs. Thus, the case assumes that the choice between leaving benefits "outright to spouse" versus "to a trust for spouse" is made solely on the basis of tax implications and choice of individuals to be benefitted. If the spouse's creditor problems or inability to handle financial affairs would put funds left outright to him/her at risk of loss, then it may be essential to leave benefits in trust for him/her, rather than outright to him/her, regardless of the tax consequences. This principle is not restated in every paragraph.)

2. Options for benefitting the surviving spouse

Here are the primary methods for leaving retirement benefits "to, or for the benefit of," the participant's surviving spouse:

A. **Spouse is beneficiary; spousal rollover.** Name the spouse outright as designated beneficiary of the retirement plan; spouse rolls over to her own IRA. This has tremendous income tax advantages. The surviving spouse can "roll over" the inherited benefits to the surviving spouse's own IRA (or other eligible retirement plan). By doing so, she eliminates the need to take any "required minimum distributions" until she reaches age 72. Once she reaches age 72, RMDs to her will be based on the Uniform Lifetime Table, which produces much smaller RMDs (and longer deferral) than the single life expectancy table applicable to beneficiaries holding an inherited IRA. The "drawback" from Ken's perspective is that his children receive no benefit at all from the IRA.

B. **Spouse is beneficiary but does not roll over.** If the surviving spouse is named outright as designated beneficiary, but chooses not to roll the benefits over to her own IRA, the substantial tax advantages of the rollover are lost. There are still some advantages compared with benefits left to other individuals. The surviving spouse, as an Eligible Designated Beneficiary (EDB), is entitled to take out the benefits in annual instalments over her life expectancy—she is not subject to the 10-year rule applicable to most other designated beneficiaries (however, the 10-year rule will kick in upon her death). Furthermore, she does not have to start taking RMDs until the later of the year after the participant's death or the year the participant would have reached age 72 (other EDBs must start no later than the year after the year of the participant's death). Finally, her life expectancy would be recalculated annually (the life expectancy of any other EDB is a fixed term). Why would the surviving spouse hold inherited benefits as beneficiary rather than rolling them over to her own IRA? Usually it's a matter of age: If the spouse is under age 59½ she may prefer to hold the IRA as an inherited benefit (distributions from which are not subject to the 10% tax under § 72(t)) as opposed to rolling them to her own IRA (distributions from which are subject to the 10% tax unless another exception applies). Such a spouse would normally complete the rollover after attaining age 59.5. Or, the surviving spouse may be younger than the deceased spouse. In this case the surviving spouse can defer the start of RMDs longer by waiting to complete the rollover until the year before the decedent would have reached age 72, vs. rolling them over to her own IRA from which she would have to start RMDs when she reaches age 72. Since there is no deadline for a spousal rollover to occur, the surviving spouse can leave the benefits in the decedent's plan for one of these age -related reasons then later roll it over to her own IRA once the age-related reason disappears (e.g. when she attains age 59½).

C. **Conduit trust for surviving spouse:** The benefits are left to a trust under which the trustee is required to distribute outright to the surviving spouse, as received, all distributions the trustee receives from the inherited retirement plan. Because Treasury regulations specify that under a "conduit trust" such as this the spouse is considered the sole beneficiary of the trust and of the plan, the conduit trust receives the same RMD treatment as under #B above—RMDs don't start until the later of year after year of death or year decedent would have attained age 72, and spouse's life expectancy is recalculated annually. However, unlike with "B," no rollover is possible. A trust cannot exercise the rollover/spousal election option even if the spouse is the sole beneficiary of the trust. Reg. § 1.408-8, A-5(a).

D. **Combination conduit/QTIP Trust.** This is a conduit trust (see "C") under which the trustee is required to take out of the IRA and distribute to the surviving spouse not just the RMD but the income of the IRA if greater; as a conduit trust, whatever the trustee does take out of the IRA must be passed out to the surviving spouse. The purpose is to qualify for both the federal estate tax marital deduction AND "EDB" treatment for RMD purposes. This trust receives the same RMD treatment as the "plain" conduit trust discussed at C.

E. **Any trust that is not a conduit trust.** If the trust for the benefit of the surviving spouse is not a "conduit trust" [i.e., a trust under which ALL distributions from the retirement plan must be forthwith distributed to or for the benefit of the spouse], then under present regulations it does not qualify for EDB treatment even if the surviving spouse is the sole life beneficiary. This would apply to a "plain" QTIP trust under which the surviving spouse is entitled to all income for life (so it qualifies for the marital deduction),even if additional rights such as "principal if needed for health or support" or "principal in the discretion of the trustee" are granted to the spouse, because she is not entitled to receive *all distributions* the trustee receives from the IRA. If this trust qualifies as a see-through trust [see Chapter 6 of *Life and Death Planning for Retirement Benefits*] it will be subject to the 10-year rule. If it is not a see-through trust it will be subject to the applicable "no-DB rule" [see Chapter 1 of *Life and Death Planning for Retirement Benefits*].

Ken does not like Options A and B because those give Karen total outright control of the $3 million of retirement benefits. Ken wants her to have "life only" use of these benefits "so there will be something left for the kids."

He has the same objection to the conduit trust idea—Options C and D. Under those scenarios, if Karen lives to her life expectancy, almost all the retirement benefits will have been paid out to her, with almost nothing left for Ken's children.

He likes the idea of a plain old garden variety income only QTIP trust (Option E) under which Karen would receive all income, plus principal for health and support and/or in the discretion of the trustee, but whatever "principal" she does not need is "saved" for the children to inherit after her death. What's wrong with that idea?

2. <u>Drawbacks of leaving benefits to a QTIP trust rather than outright to spouse</u>

Here are the tax drawbacks of leaving benefits to a QTIP trust for the spouse, compared with leaving the benefits outright to the spouse or to who then rolls them over to her own IRA:

A. **Distributions are subject to the 10-year rule.** Under the plain old QTIP trust, which is subject to the 10-year rule, all the retirement benefits will be distributed out of the plans within 10 years after Ken's death and will be entirely taxed to the trust at trust tax rates (except to the extent that some distributions are passed out to Karen as "trust accounting income" and/or principal needed for health or support). There will be no deferral until Karen reaches age 72 (achievable only through outright inheritance plus spousal rollover), and no life expectancy payout (achievable only with a conduit trust).

B. **High trust tax rates**. Distributions paid to the trust and held in the trust for later distribution to the children will be taxed at high trust rates even though Ken's children are in low tax brackets. So what exactly is "preserved for the children?" The after tax value of the retirement plans ($3 million X 63% = $1,890,000), and...

C. **Children probably have a long wait for a little money.** Karen is only 19 years older than Ken's oldest child. Thus it is quite likely that Ken's children themselves will be "old" before they see anything from the marital trust. Karen's life expectancy is currently about 30 years, according to the IRS tables.

3. Solutions offered for this problem

So we now know that leaving retirement benefits to a QTIP trust for Karen's life benefit would involve substantial income tax drawbacks, compared with leaving the benefits outright to Karen or even outright to the children. We review with Ken other possible ways to achieve his goal:

A. **Leave the benefits outright to Spouse rather than to a QTIP trust (and buy life insurance as a "replacement asset" for the children).** Some clients, upon learning all the drawbacks of leaving benefits to a QTIP trust, would decide to forget the trust idea and simply leave the benefits to the spouse outright. The decision depends on whether the advantages the client is trying to achieve by using a QTIP trust outweigh the tax drawbacks. For example, if the client's reason for desiring a QTIP trust was a concern about a potential future disability of his currently healthy spouse, he might decide to take that risk and leave the benefits outright to the spouse rather than incur the definite drawbacks of naming a QTIP trust. On the other hand, if the spouse is a drug addict or compulsive gambler, it is worth incurring the tax drawbacks of a QTIP trust in order to prevent the funds' being dissipated by the spouse. In Ken Koslow's case, he does not want to leave all the benefits outright to Karen because he wants his children have some rights to the benefits. Thus, "Solution A" is suitable for him only if he wants to take an extra step and buy life insurance to benefit the children, so they would receive the insurance in lieu of any interest in the retirement benefits.

B. **Name Spouse as outright beneficiary, but on the condition that she will name Participant's children as beneficiaries of her rollover IRA.** Ken hears this idea from his golfing buddy and asks what you think. It sounds like a neat solution, because it enables the surviving spouse to roll over the inherited benefits (thus obtaining the deferral benefits of the spousal rollover), while still protecting the children of the prior marriage, right? Wrong. This idea is a non-starter. First, the children are not at all protected by the spouse's assurance that she will name them as beneficiary of her rollover IRA. Unless they force the spouse into some kind of court proceedings, how will they know if she complied? But even if she complied, she has agreed to basically nothing, since she can withdraw all funds from the rollover IRA without anyone's consent or knowledge. Once the funds have been withdrawn from the IRA she can spend them (or leave them to anyone she chooses if she does not spend them) and the children will get nothing. If Ken leaves the benefits to Karen on the conditions that (A) she will *not* spend them, and that (B) she must leave either the benefits themselves or the proceeds thereof to Ken's children, then he has created a terminable interest that will not qualify for the marital deduction. He has also probably eliminated the possibility of a spousal rollover (thus defeating the point of the exercise): Reg. § 1.408-8, A-5(a), provides that a spouse can elect to treat an inherited IRA as her own only if she is the sole beneficiary of the IRA *and* has an unlimited right to withdraw amounts from the IRA. Ken decides not to use this "solution," and agrees not to seek tax advice on the golf course.

C. Leave some benefits outright to spouse and some outright to the children. This is the solution Ken adopts. It is a sensible compromise between leaving all the benefits to a QTIP trust or all to the spouse outright. It gives each of the beneficiaries (spouse and children) a substantial financial benefit. The substantial tax savings (compared with leaving benefits to a QTIP trust) allows all the beneficiaries (spouse *and* children) to receive more money than they would receive as beneficiaries of a QTIP trust.

If adopting this solution, how do you decide how much of the retirement benefits, and which specific plans, should be left to which beneficiary?

One approach to the "how much" question is to determine the value of what would have been the beneficiaries' respective interests in a QTIP trust. With a QTIP trust, the spouse has a life interest and the children have a remainder interest. The total value of their respective interests equals 100 percent of the value of the trust. These relative values can be determined using the IRS's tables for valuing life estates and remainder interests (or some other set of actuarial tables). See https://www.irs.gov/pub/irs-pdf/p1457.pdf and IRS Publications 1457, 1458, and 1459.

For example, if the relative value of the spouse's life interest is 65 percent of the total value of the trust assets, and the children's remainder interest, at the outset, is worth 35 percent of the total trust value, the participant might consider leaving 65 percent of the benefits outright to the spouse and 35 percent outright to the children (or to a trust for their exclusive benefit). (As the years go by, the relative value of the spouse's life estate declines as she gets older, and the value of the remainder interest increases to the same extent.) If the spouse takes full advantage of the spousal rollover for her share, and the children take full advantage of the 10-year payout option for their shares, both spouse and children may end up with more dollars in their pockets than they would if they received theoretically the same relative amounts as life and remainder beneficiaries of a QTIP trust.

The relative amounts left to the respective beneficiaries need not be exactly what their relative interests would have been in a QTIP trust; it can be whatever percentage the client wishes. Regarding which plan to leave to whom, consider such factors as spousal rights under REA (the spouse has a right, under federal law, to all or part of the death benefit under any qualified plan; see second to last paragraph of section #4 below) and any state law rights (the spouse may have a community property right to an IRA).

Sometimes when this solution is offered the client's response is "But if I leave some of my plans directly to my children, my spouse won't have enough to live on." If that is true, and the client's primary goal is to assure the spouse's financial security, then the client should not leave any of the benefits to the children—and the client should certainly not leave benefits to a QTIP trust! The QTIP trust will *dramatically* erode the value of the benefits during the spouse's lifetime. The only way to assure her financial security is to leave the retirement benefits to her outright.

4. <u>How Ken implements his chosen solution</u>

Note: The numbers and tax brackets in this case study solution were based on an older version of the tax code. However, the structure of income taxes as applied to inherited IRAs still has the same result—benefits left to a trust for the spouse are potentially taxed *much higher* than benefits left outright to the spouse and rolled over and/or left to individual beneficiaries who are not in the highest income tier. There is no reason to believe subsequent income tax law changes would change the overall result in this case though the actual numbers would change.

Here is how Ken Koslow implements Solution E.

Using software, his planner projects the eventual value of the benefits to the family under "Scenario 1," which is leaving all benefits to a QTIP trust. The planner assumes that all income of the retirement plans is distributed annually to the QTIP trust and thence to Karen, where it is taxed at 39.6 percent. To the extent the RMD exceeds the income each year, the excess is retained in the trust and also taxed at 39.6 percent. Assuming Karen dies at the end of her 30-year life expectancy, there would be nothing left in the retirement plans at her death. At that time, the marital trust would contain essentially the date-of-death balance of the plans, as increased by capital gains (if any) and reduced by the income taxes the trust had to pay on the plan distributions. This net amount would pass to Ken's children. Karen's estate (which she could leave to her own beneficiaries) would consist of the after-tax accumulations of income from the marital trust.

This proposed scenario was compared with another alternative, "Scenario 2." Under Scenario 2 there would be no marital trust. The $2 million of qualified plan benefits would be made payable to Karen personally, and the $1,000,000 IRA would be payable directly to Ken's children. Ken would make sure his life insurance and investments outside the plan were sufficient to pay any estate taxes on the benefits passing to the children.

This scenario has many advantages over the QTIP scenario. Each beneficiary would have total control of his or her own share of the benefits, without having to compete for the attention of the trustee of the marital trust. Karen would take the plans payable to her out as a lump sum and roll them over to her own IRA. She would then defer all distributions until she reached 70½, at which time she would start withdrawing benefits using the Uniform Lifetime Table. She would name her nieces as her designated beneficiaries on the rollover IRA.

No benefits would be subject to the high income tax bracket of a trust.

Ken's children are in low income brackets. With a $1 million IRA payable to them over no more than 11 taxable years after Ken's death, each child would receive roughly 10% of $1 million, or $100,000, each year. This size distribution would put them into higher brackets, probably, but due to their minimal income levels currently it would still be a lower rate than the 37% applicable to a trust.

The children would have their inheritance immediately at Ken's death, and would not have to sit around for 30 (or more?) years waiting for Karen to die. Karen would not have to feel the children are looking over her shoulder with regard to the investments of the marital trust.

Another advantage of this approach has to do with the practicalities of plan distribution options. Qualified retirement plans (QRPs) often do not permit an installment payout to any beneficiary. Thus, if QRP benefits are made payable to a marital trust, the plan may not permit the trust to draw those benefits out gradually over the life expectancy of the oldest trust beneficiary. The trust can avoid taking a taxable lump sum by using the nonspouse beneficiary rollover to an "inherited IRA," if the trust qualifies as a see-through trust; see ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits*. If these benefits are made payable to Karen personally, by contrast, even if the plan forces her to take a lump sum distribution, she can roll the benefits over to an IRA in her own name which has whatever payout options she wants, without the worry over whether a trust qualifies as a "see-through."

Furthermore, most qualified retirement plans are subject to the Retirement Equity Act of 1984 (REA), meaning that the benefits cannot be distributed to someone other than Karen (the surviving spouse) without her consent. By making the qualified plan benefits payable to Karen personally, you avoid the need for obtaining her consent, which would be required to make the benefits payable to a marital trust or some other beneficiary. Since REA does not apply to IRAs, Ken can make the IRA payable to his children without Karen's consent (subject to any requirements of state law or prenuptial agreements they may have signed).

Last but definitely not least, it is probable that through the combination of substantially increased deferral and somewhat lower income tax rates *both* Karen *and* the children would end up with *more dollars*. On Karen's death, she would still have a substantial portion of the plan she inherited still *inside* her rollover IRA; she could leave to her family her rollover IRA plus the after-tax fund of accumulated RMDs she took from the rollover IRA. The children, at Karen's death, would own their own after-tax fund of distributions they took from their inherited IRA. Based on the tax rates and estimated interest rates and other estimated factors at the time this case study was run, Karen would end up with twice as much money at the end of her 30-year life expectancy by being named outright beneficiary of 2/3 of Ken's retirement benefits as she would have had by being named sole life beneficiary of an income only QTIP trust....and the children would end up with three times as much money by being named outright beneficiaries of the $1 million IRA than they would have received as remainder beneficiaries of a QTIP trust that received 100% of his benefits!

5. <u>Where to read more</u>

Matters mentioned in this case study are discussed in full detail in the following sections of *Life and Death Planning for Retirement Benefits* (8^{th} ed., 2019):

Qualifying for the estate tax marital deduction: ¶ 3.3

Special income-deferral rights granted to a surviving spouse named as beneficiary of a retirement plan, including spousal rollover: ¶ 1.6 and ¶ 3.2

Income tax and trust accounting and "see-through trust" aspects of naming a trust as beneficiary of a retirement plan: Chapter 6

Explanation of conduit trusts: ¶ 6.3.05

Comparison of RMD rules applicable to surviving spouse as beneficiary, with those applicable to trust for the benefit of spouse: ¶ 3.3.02

Uniform Lifetime Table and Single life expectancy tables: ¶ 1.2.03 (see Chart #1 and Chart #2 at end of this Outline for charts applicable after 2020)

Recalculation of life expectancy annually versus fixed-term method: ¶ 1.2.04

Federal spousal rights to inherit benefits under qualified plans: ¶ 3.4

Case # 2: Planning for Beneficiary who is not Spouse, Minor Child, or D/CI

When the person the client wishes to benefit with his/her retirement plan death benefits ("proposed beneficiary") is not his/her spouse or minor child, and is neither disabled or chronically ill, what planning options are available?

The life expectancy payout option has been taken off the table for this proposed beneficiary unless he or she is "not more than 10 years younger than" the participant. Planning considerations for the retirement benefits are therefore as follows:

A. Not more than 10 years younger ("Nimitty")

If the individual is "not more than 10 years younger," than the participant he/she qualifies as an "eligible designated beneficiary" and therefore qualifies for the life expectancy payout even post-SECURE. This situation will arise if the client is leaving benefits to his parents or other older-generation relatives, siblings, or a not-too-much-younger "significant other" or friend. Thus this situation will be encountered uncommonly but not rarely. It would be desirable if possible to leave the benefits to this beneficiary in a way that preserves the option of the life expectancy payout—in other words, name him/her as outright beneficiary or leave the benefits to a conduit trust for him/her.

What are the rules/limitations on the life expectancy payout option here? At this writing there is as yet no guidance other than pre-SECURE regulations (which answer some but not all questions), so here is the landscape:

1. **How is the "10 years younger" measured?** No word yet from Treasury on how this will be calculated. The author's expectation is that it will be calculated based on birth year (not on actual birth DATE), as is already the case when determining whether the participant's spouse is more than 10 years younger for purposes of determining the participant's Applicable Distribution Period.

2. **Will a trust for the sole life benefit of the individual qualify for the life expectancy payout, even if it is not a conduit trust?** "No" is the answer under pre-SECURE regulations so this would require a modification by the Treasury. At this time there is no authority for allowing Eligible Designated Beneficiary status to a trust for the benefit of an Eligible Designated Beneficiary unless it is a conduit trust.

3. **What if it is a nonconduit trust for the sole life benefit of the individual, if all the remainder beneficiaries of the trust are also EDBs?** See answer to #2.

If the proposed beneficiary is of an older generation, also consider whether a charitable remainder trust would fit with the client's planning goals. See "Trio of Problems" Case Study.

B. More than 10 years younger

SECURE has one word for this proposed beneficiary: Gotcha!

The nondisabled non-chronically ill individual who is more than 10 years younger than the client and who is not the client's spouse or minor child is the direct target of SECURE's revenue raising intent. SECURE dictates that any retirement benefits payable to this individual must be distributed by the end of the year that contains the 10^{th} anniversary of the client's death. If the benefits are in a "traditional" retirement plan, they will be distributed and taxed no later than that date. If the benefits are in a Roth plan, they will be distributed (and tax-free accumulations will cease) no later than that date. The massive income tax increase created by SECURE's changes to the minimum distribution rules falls primarily though not exclusively on this beneficiary.

Planning options:

1. **Name the individual as outright beneficiary of the plan.** This way the beneficiary will decide when, during the 10- or 11- taxable year period after the client's death, to withdraw the benefits and all distributions will be taxed at the beneficiary's personal rate.

2. **Name a conduit trust for this individual as beneficiary of the plan.** The advantages are, the trust is guaranteed to qualify for the "10-year rule" payout, all traditional-plan distributions will be taxed at the individual beneficiary's rate (since all such distributions are paid out to such beneficiary upon receipt), but the trustee (rather than the individual beneficiary) controls the investments and controls when the plan distributions are taken. Thus, for example, if the client's goal with a Roth IRA is to force the beneficiary to delay distributions until the end of the 10-year period, a conduit trust can accomplish that goal. The disadvantage is that there is no ability to keep the funds in trust beyond the end of the 10-year period.

3. **Name a nonconduit see-through trust for this individual as beneficiary of the plan.** A trust does not have to be a conduit trust to qualify for the 10-year payout—it only has to be a "see-through trust." The advantages of using a nonconduit see-through trust are that (i) the retirement plan qualifies for the 10-year payout but (ii) the plan distributions do not have to be paid out to the individual beneficiary at any particular point during his life. The client, through the trustee and trust terms, can control when and why money is distributed from the trust to the individual beneficiary. The drawback? All distributions from the plan that are NOT passed out to the individual beneficiaries will be taxed at trust rates. Gotcha!

4. **Name a non-see-through trust as beneficiary.** If the trust doesn't qualify as a see-through, it will be subject to the "no Designated Beneficiary" (no-DB) payout rules—all benefits from plans as to which the client died before his/her Required Beginning Date must be distributed by the end of the year that contains the fifth anniversary of the client's death, all benefits from other plans must be distributed in annual instalments over what is left of the client's life expectancy. See ¶ 1.5.06 and ¶ 1.5.08 of *Life and Death Planning for Retirement Benefits* (8^{th} ed. 2019) for explanation of how benefits are distributable under the no-DB rules. The advantage for the client is that the trust can say whatever the client wants it to say, without regard to the restrictions of the see-through trust rules. Planners need to learn from the "numbers guys": How much of a financial difference is there to the beneficiary between a 5-year payout and a 10-year payout? Or between the 10-year payout and a payout over the deceased participant's life expectancy? Maybe the dollar value of

the 10-year payout is not that must greater than the alternatives....there is not as big a contrast between the 10-year vs. 5-year payout as there was between (in the old days) the life expectancy payout vs. the 5-year payout (in the case of a young beneficiary).

5. **....Or find the holy grail "fifth option?"** Sophisticated estate planners are competing to find creative ways to "beat" SECURE.....some way to carry out the client's estate planning goals without subjecting all the death benefits to rapid distribution and/or high tax rates. Charitable remainder trusts? Beneficiary grantor trusts? "Teapot" trusts? When this holy grail is discovered, it will be reported upon in this Outline. As of now....we're still waiting.

Case # 3: Providing for Minor Children

Facts: Stan and Stacey Steinmetz are in their 30s. They have four children ages 2 to 12. They have combined net assets of $1.5 million, including Stan's $100,000 401(k) plan, Stacey's $250,000 IRA, their $1,200,000 home with a $500,000 mortgage, life insurance (through Stan's job), and various liquid investments acquired through savings and inheritance.

They are leaving all of their assets outright to each other. On the death of the surviving spouse, they would like to have all assets of both spouses pour into a "family pot" trust for the benefit of the children. The trustee would be instructed to use the principal and/or income of the trust as the trustee deems advisable for the care, support, and education of all four children until there is no child living who is under the age of 25 years, at which time the trust would terminate and be distributed outright to Stan's and Stacey's issue then living by right of representation. In the highly unlikely event that at any time there are no issue of Stan and Stacey living, while there are still assets remaining in this trust, the remaining trust assets would pass equally to Stan's brother Fran (now age 38) and Stacey's sister Lacy (now age 36).

Where do the retirement benefits fit into this?

The first step is to determine whether the "life expectancy payout" is even attainable for benefits left to the Steinmetz children post-SECURE. We find that it is—theoretically. As minor children of the plan owner they are "eligible designated beneficiaries"—but only up to a point. Specifically, as each child "attains majority," he or she ceases to be an EDB and the 10 year rule kicks in. The Steinmetzes face several obstacles and unknowns in trying to capture the benefit of a life expectancy payout for benefits payable to their minor children:

- In their home state, a child attains majority at age 18. The Treasury can (and to some extent probably already has and undoubtedly further will) define "majority" as some later point, such as "age 26" or "completion of a course of education." However until there is some word from the Treasury, in order to put an estate plan into effect NOW, the Steinmetzes have to assume that outright distribution of their retirement benefits after both spouses die would occur no later than age 28 (10 years after age 18) for each child.

- Barring future expansion of options by fiat from the Treasury, the only now-known way to achieve EDB status for a trust for the benefit of an EDB is if the trust is a conduit trust (except in the case of a disabled or chronically ill beneficiary). Therefore the pot trust would have to be a conduit trust requiring the trustee to pass out all distributions to the children or for their benefit as received. Since we still don't know exactly how a conduit trust for multiple minor children will work we presumably need to assume that the trust will "flip" to the 10-year rule when the oldest child reaches age 18 (the youngest will still be only 8 at that point). Thus all benefits would be distributed when the youngest reaches age 8, which is not a problem for the Steinmetzes since they want the pot trust to be paid out to the children when the youngest reaches 25 anyway.

- Though all the children are minors now, they will attain majority in different years. When will the trust "flip" to the 10 year rule? Conservatively we would assume it is when the oldest child attains majority. The Treasury will need to issue regulations indicating how the "minor child" EDB exception applies to a trust for multiple minor children. To achieve a more certain result some parents might choose to leave the benefits to multiple separate conduit trusts, one for each minor child, so each child's RMD is based on his/her own life expectancy and each child's flip to the 10-year rule will occur based on such child's attaining majority not on the majority age of the oldest child.

These points indicate the uncertainties and/or drawbacks of planning for minors under SECURE.

Stanley and Stacey should evaluate the desirability of the "fake" life expectancy payout allowed for minor children and determine whether it is worth shaping their estate plan to fit the requirements of this fake life expectancy payout. For example, the family pot trust strongly appeals to them—is it worth giving that up so each child can have his/her own life expectancy and majority-age apply to his/her separate share of the benefits?

If it is not, then Stan and Stacey could simply name each other as primary beneficiary of their respective plans, and name the family pot trust as contingent beneficiary, without worrying about whether the trust qualifies for "EDB" status or even as a "see-through" trust, acquiring life insurance (if required to compensate for taxes on the retirement benefits).

<u>Stan's 401(k) plan</u>: Stan and Stacey and their attorney decide qualification as a see-through trust could indeed matter with respect to Stan's 401(k) plan. Although the only form of death benefit permitted under that plan is a lump sum distribution in cash, the trustee of a <u>see-through trust</u> named as beneficiary of the plan would be allowed to direct the plan to transfer the lump sum, by direct trustee-to-trustee transfer (also called direct rollover) to an "inherited IRA" in Stan's name, thus preserving the possibility of either the sort-of-life expectancy payout allowed for minor children of the participant or at least the 10-year rule. See ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits* regarding this "nonspouse beneficiary rollover" option.

<u>Stacey's IRA</u>: If the trust that is named as contingent beneficiary of Stacey's IRA qualifies as a see-through trust, the trustee will be subject to the 10-year rule, not the "no-DB rules," and could even have the option of using the sort-of-life- expectancy payout applicable to minor children of the participant if the trust for the children is a conduit trust. It would be nice for the trustee to have the option of deferring distributions from the IRA as long as possible. One "blessing" of SECURE is, if the trust qualifies as a see-through, the life expectancy of the oldest contingent remainder beneficiaries (the parents' siblings) does not adversely affect the payout period.

Here are four options Stan and Stacey have regarding how to name their family pot trust as contingent remainder beneficiary of Stacey's IRA and Stan's 401(k) plan ("plans" or "benefits"):

Approach #1: Make the trust a Conduit Trust as to the benefits. Under this approach, the trustee would be required to distribute any distribution the trustee received from the IRA to (or apply it for the benefit of) such one or more of Stan's and Stacey's children as the trustee would select in its discretion. The RMDs could be distributed to any one or more of the children outright, or to a custodian or legal guardian for them, or used for the children's benefit. Many practitioners routinely adopt this approach for minors' trusts on the theory that the RMDs will be very small (because the oldest child has such a long life expectancy), and the trustee could presumably always find a use for such RMDs that would justify distributing them to or for the benefit of one or more of the children. A conduit trust would qualify for EDB treatment, but it is not clear when EDB status would terminate causing the payout period to "flip" to the 10-year rule—presumably when the oldest child attains majority (whatever that means!).

Approach #2: Ignore see-through trust status. Stan and Stacey might decide that the complexities, uncertainties, and compromises involved in trying to qualify for see-through trust/EDB status are not worth the prize. Once upon a time the potential prize was a life expectancy payout over the long life expectancy of a minor child....but after SECURE, there is no more "long life expectancy payout"—the best deal for minor children is a 10-year payout commencing upon attaining majority, AND it appears the trust must be a conduit trust to achieve that goal. Rather than pay lawyers and trustees to draft and administer multiple trusts, or revise their trust to say things they don't want it to say, Stan and Stacey could assume the plans will *not* qualify for the "fake life expectancy" treatment available to minor children, and purchase term life insurance to assure adequate funds for payment of any extra income taxes. This maj reduce legal fees while allowing Stan and Stacey to have the trust say exactly what they want it to say for the benefit of their children.

Case # 4: Trio of Problems with One Solution: a Charitable Remainder Trust (CRT)

For use of a CRT to benefit a disabled child, see the "Dingle" case.

A. Keeping substantial retirement distribution out of children's direct control

Felicia Fallon is 66. She has $8 million in total assets: $3 million in the qualified retirement plan (QRP) of her employer, and another $5 million of liquid investments and residential real estate. She has two children, ages 48 and 45, and several grandchildren. The children are well provided for financially. While her children are to be the principal beneficiaries of her estate, Felicia has some interest in charitable giving. She does not want her children to cash out the retirement plan on her death, but she is afraid they will do just that. She reviews several options.

1. <u>Annuity option under the plan</u>.

One is to force the children to take an annuity distribution from the retirement plan, if the plan offers her the option of restricting her beneficiaries to an annuity payout. However, though "defined benefit plans" are exempt from SECURE's ban on life expectancy payouts, it is not yet clear whether this exemption applies to annuities purchased within a defined contribution plan, so it is not clear this option is actually available. Even if it is available, Felicia considers fixed annuity payouts too vulnerable to inflation.

2. Leave benefits to see-through trust, rely on beneficiary rollover

Another possibility is to leave the benefits to a see-through trust for the benefit of her children. If the plan offers a lump sum distribution form of benefit, the trustee could direct the plan to transfer the lump sum to an "inherited IRA" payable to the trust as beneficiary. See ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits* for details on such nonspouse beneficiary rollovers.

There are two drawbacks to relying on the nonspouse beneficiary rollover.

First, drafting a see-through trust is a complicated and perilous undertaking, in view of the IRS's problematic regulations. See ¶ 6.2–¶ 6.3 of *Life and Death Planning for Retirement Benefits*. If the trust for some reason does not qualify as a see-through (for example, because the trustee forgets to send required documentation to the plan administrator by October 31 of the year after the year of the participant's death) the nonspouse beneficiary rollover to an inherited IRA is not available (it's available only to "designated beneficiaries"). IRS Notice 2007-7, A-16.

Second, there is the risk that the lump sum benefits, instead of being transferred by direct rollover to an inherited IRA as instructed by the trustee-beneficiary after the participant's death, will by mistake (either of the plan trustee or the IRA provider) be transferred to a taxable account, causing immediate income taxation of the entire lump sum. Transferring intended rollover distributions into a taxable account is one of the most common mistakes made in the retirement benefits area. See, *e.g.*, PLRs 2007-03036, 2007-04038, 2007-27027, 2007-09068, 2007-17027, 2007-22030, 2007-27022, 2007-27025, and 2007-32025. When this mistake happens after the participant's death it is generally not correctable (unless the beneficiary happens to be the participant's surviving spouse).

3. Roll benefits to an IRA while living

Another approach is to roll the benefits over to an individual retirement trust (IRT, or "trusteed IRA") while Felicia is still living; the IRT can then provide for a restricted payout to her children after her death. But since they are neither disabled nor chronically ill, this would put the entire retirement plan into their hands and outright control within about 10 years after her death. She does not want them to have outright control of the entire sum at any time. See ¶ 6.1.07 of *Life and Death Planning for Retirement Benefits* for more explanation of IRTs.

4. Leave benefits to a charitable remainder trust

Finally, Felicia considers leaving the benefits to a charitable remainder trust (CRT). The CRT that would pay a six percent unitrust payout to the children for their joint lifetime and for the life of the survivor. The advantage of this scenario is that the CRT pays no income tax on the $3 million lump sum distribution it receives. The children would then receive, for life, the 6 percent income stream from the entire $3 million fund. Their income distributions would fluctuate depending on whether the CRT's investments grew at more or less than 6 percent per annum. The children would have to pay income taxes on these distributions. On the death of the surviving child all funds remaining in the CRT would go to the charity(ies) designated by Felicia.

In addition to eliminating income taxes on the lump sum distribution, this approach produces an estate tax charitable deduction to Felicia's estate for the value of the remainder interest. The value the children receive (in the form of a lifelong stream of income from the CRT, plus decreased estate taxes) would presumably be less than the net value they would receive if they were outright beneficiaries of a lump sum distribution of the entire plan balance on Felicia's death. But since the trust is fulfilling both Felicia's charitable goals and her goal of not giving the children control of a lump sum, that price may be worth paying..

Also, if both children die prematurely (before the end of their "life expectancy" as predicted by the IRS's actuarial tables for valuing CRTs), the entire trust moves to the charity sooner than predicted. Thus, in case of premature death, the value to the family of the CRT scenario would be much lower. The children can overcome this risk by buying decreasing term insurance on their lives; or, Felicia could decide that this risk is not of concern to her since her goal for this particular asset was to provide the children a life income, not an inheritance they could pass on at their deaths.

B. Multiple beneficiaries.

Ogden is single, age 45. He has worked for several companies and as a result he has money in several different qualified plans, 403(b)s, and IRAs. His estate planning goals are: to provide for his parents' needs, if either or both of them survive him and need additional funds; to provide something for his siblings; and to benefit charity. He creates a CRT which will pay a five percent unitrust payout in equal shares to the living members of the group consisting of his parents (who are in their 70s) and two siblings (ages 42 and 48). His estate has other assets to pay the estate taxes applicable to his other assets and to the noncharitable interests under the CRT.

The CRT achieves all his goals: It provides income to his family beneficiaries as long as any of them is/are living; the ones who live longest get some "inflation protection" from the fact that their incomes will increase as other members of the group die off; it takes care of his charitable goals; it is much simpler than trying to draft or administer a "see through trust" for all the beneficiaries; and it is tax-favored (because there will be no income tax on the retirement benefits themselves as they are paid to the CRT). Of course the income payments made to the family beneficiaries from the CRT will be income taxable.

C. Older beneficiary.

Hilda, age 68, has a $3 million IRA. Her goal is to provide a life income to her sister Justine (age 71) and remainder to a charitable foundation. Leaving the benefits to a typical family trust that provided life income to Justine and remainder to charity would require a rapid fully income-taxable distribution of the account after Hilda's death. Such a trust would not qualify as a see-through (because of its nonindividual remainder beneficiary, the charity), so the IRA would have to be entirely distributed within five years after Hilda's death. Even if the trust were a conduit trust (so it qualified as a see-through despite the charitable remainder beneficiary), the benefits would have to be entirely distributed (and taxed) over Justine's relatively short life expectancy (a conduit trust for Justine would qualify for the life expectancy payout because Justine is an EDB, being "not more than 10 years younger than" Hilda).

Assuming the income stream from a CRT would provide sufficient funds for Justine, Hilda should leave her IRA to a CRT for Justine's life benefit. Then there would be no income tax on distribution of the benefits from the IRA to the CRT, and Hilda's estate would get an estate tax charitable deduction for the value of the charitable remainder. Justine would receive a reasonably predictable income stream that would last for her entire life, not just her life expectancy.

This solution assumes there are other assets available to pay any applicable estate expenses and taxes. This example illustrates that even when the "life expectancy payout" is still available (because the sisters are close in age) it is not always the best option.

Where to read more

Regarding charitable giving with retirement benefits, see Chapter 7 of *Life and Death Planning for Retirement Benefits* (or the downloadable *Special Report: Charitable Giving with Retirement Benefits*, www.ataxplan.com). See ¶ 7.5.04–¶ 7.5.07 regarding making retirement benefits payable to a charitable remainder trust.

Case # 5: A Tale of Two Families: Disabled Beneficiaries

Mr. and Mrs. Dingle have three children, ages 23, 18, and 16, one of whom, Daisy (the 18-year-old), is severely disabled and will need lifelong care. Mr. and Mrs. Ringle also have three children, ages 35, 25, and 23, one of whom, Ronnie (age 25), is severely disabled. Both the Dingles and the Ringles have $1 million in IRA funds among their other assets, and both seek to use the IRA asset to help their respective disabled children. However, there the similarity ends.

A. Supplemental needs trust for family of modest means

The Dingles have no other substantial assets they will be able to leave for Daisy's benefit. Daisy Dingle qualifies for government-provided medical care and other need-based welfare-type benefits. Thus, the Dingles want the IRA to be held in a trust to provide for Daisy's needs that are not covered by the benefits programs she qualifies for, and they want to be sure that after their deaths the trust and the IRA it holds are not considered "countable assets" that would disqualify Daisy for the benefits she now receives. They similarly do not want trust distributions for Daisy's benefit to disqualify her for need-based assistance. The type of trust they need is called a "supplemental needs trust" (SNT).

Mr. and Mrs. Dingle will name each other as outright beneficiary of their IRAs, with a supplemental needs trust for Daisy's benefit as contingent beneficiary. They hire a Medicaid specialist-attorney to draft the trust.

The Dingles cannot name a "conduit trust" for Daisy as beneficiary of their IRAs. Because a conduit trust mandates that all distributions from the IRA to the trust be paid out forthwith to or for the benefit of the individual trust beneficiary, such a trust would disqualify Daisy from the various need-based benefits programs. The required minimum distributions from the IRA would be treated as "countable income" of Daisy for purposes of her qualification for the various benefit programs. Thus the trust must be an accumulation trust, not a conduit trust.

Due to her disability, Daisy is an "Eligible Designated Beneficiary" (EDB) under SECURE, entitled to a life expectancy payout for benefits that are payable to her outright. As we have seen, benefits left to a conduit trust for her would be entitled to the same EDB treatment she individually is entitled to—a life expectancy payout. But it is not possible to name either Daisy individually or a conduit trust for her as beneficiary without sacrificing her eligibility for government benefit programs. Fortunately for the Dingells...

Under SECURE, a see-through accumulation trust (STAT) for the benefit of a disabled (or chronically ill) EDB *is* entitled to the EDB treatment/life expectancy payout—even though see-through accumulation trusts for other categories of EDB are not so entitled. SECURE calls this an "Applicable multi-beneficiary trust" (AMBT).

It would be desirable for Daisy's supplemental needs trust to qualify for the life expectancy payout so that distributions from the IRA to the trust could be spread out over her long life expectancy as long as she is living (it would have to switch to a 10-year payout beginning upon her death). Under SECURE, in order to qualify for the life expectancy payout, the trust for Daisy must provide that no one other than the disabled beneficiary (Daisy) can receive any distributions during Daisy's lifetime. Oddly, SECURE does not seem to require that the trust actually make any distributions at all to Daisy—as long as no one else receives any distributions during her life.

So, at first, it appears that all is well—the Dingells can leave their IRA to a STAT SNT AMBT for Daisy that will qualify for the life expectancy payout, just as they could have done before SECURE. However there is an important difference between their pre- and post-SECURE options:

- Under pre-SECURE law, the Dingells might have provided that, in any particular year, if the RMD taken from the IRA exceeded Daisy's "supplemental needs" expenses for such year, the excess could be paid to (for example) Daisy's siblings. That would have enabled the trustee to pass out such "excess" income to the siblings who are probably in lower income tax brackets than the trust itself is. That clause cannot be included post-SECURE without losing the life expectancy payout...so RMDs that come in to the trust and exceed the amount that can be spent that year on Daisy's supplemental needs will be taxed at trust tax rates.

- Under pre-SECURE law, some practitioners would have recommended including a "poison pill" clause in the trust that would cause the trust to terminate and be distributable outright to other beneficiaries (such as Daisy's siblings) if at any time its continued existence would cause Daisy to lose her eligibility for government benefits. Post-SECURE this clause cannot be included due to the requirement that no beneficiary other than Daisy can receive any benefits from the trust during her lifetime.

- Finally, under pre-SECURE law, if Daisy were to die before the end of her "life expectancy" payout period, the IRA could continue to be held by the trust (or by the trust's remainder beneficiaries) with distributions continuing to be paid out gradually over what was left of Daisy's original life expectancy. Post-SECURE, all benefits must be distributed within 10 years after Daisy's death regardless of whether her "remaining life expectancy" was more or less than 10 years.

Thus, SECURE has accommodated the need for nonwealthy disabled beneficiaries to use the life expectancy payout, with its potential long-term deferral and spreading-out of taxable distribution, without sacrificing qualification for need-based government benefits. However this exemption for AMBT is carefully structured to prevent other family members from "piggy-backing" on the disabled individual's EDB status to achieve income tax deferral and income-spreading.

Note: If the trust for Daisy is also a "qualified disability trust," the trust would get an annual exemption of $2,000 for federal income tax purposes (compared with the $100/$300 exemption applicable to other trusts), although this exemption is subject to a phaseout in case of income over

$100,000. See § 642(b)(2)(C) for the special exemption rule and the definition of qualified disability trust.

Because the trust is payable to one life beneficiary and on her death it terminates and passes immediately outright to two other named individual beneficiaries, the trust qualifies as a see-through trust; see ¶ 6.3.08 of *Life and Death Planning for Retirement Benefits* for discussion of this type of "see-through accumulation trust." The applicable distribution period (ADP) for required minimum distributions (RMDs) to the trust under pre-SECURE law would be the life expectancy of the oldest of the three siblings. Under SECURE, it appears that the drafters' intent was that the ADP for this type of trust would be the life expectancy of the EDB-life beneficiary of the trust, but the statute does not actually so state; it states only that the life expectancy payout will apply but it does not say whose life expectancy.

Another approach the Dingles could consider would be to name a charitable remainder trust (CRT) as beneficiary of the IRA; see "Trio of Problems" Case study. The annual unitrust or annuity payments from the CRT could be paid to a SNT for Daisy so as not to disqualify her from her government benefit programs. Rev. Rul. 2002-20, 2002-1 I.R.B. 794. While this approach might be suitable for some families, it is not suitable for the Dingles because this approach would cause the bulk of their IRA to pass to charity. Their intent is to have the IRA pass exclusively to family members. Note: Rev. Rul. 2002-20 appears to require that the SNT be includible in Daisy's estate on her death; see the Ruling for details.

Another approach that some planners might consider is, using a conduit trust for Daisy as beneficiary of the benefits, then having Daisy (through her guardian) transfer the conduit distributions, as she receives them, into a "(d)(iv)(A)" (self-settled) SNT, if that approach is permitted under applicable state law without causing Daisy to lose her qualification for need-based benefit programs. A (d)(iv)(A) trust is an SNT created by the disabled individual him or herself with his or her own assets. While permitted by applicable federal need-based benefit programs, this kind of trust does require that any trust assets remaining at the beneficiary's death must be transferred to the state that paid Daisy the welfare benefits, up to the amount of such benefits Daisy received after contributing those assets to the trust.

B. Conduit trust for disabled beneficiary: Wealthy family

In contrast to the Dingles, the Ringles have substantial wealth, and intend to provide for Ronnie's needs from their wealth without attempting to qualify him for any need-based government benefit programs. They expect that their other children will always have very high incomes, while Ronnie will have no income other than what he receives from trusts they provide for him. Also, Ronnie will always have very high medical expenses. Thus, it makes sense to leave the IRA to a trust for Ronnie's benefit. IRA distributions to Ronnie through the trust will be includible in his gross income, but the income tax impact will be low due to his low income tax bracket and high medical expenses. If the IRA is paid to the other children, the income tax impact on the IRA distributions would be much higher.

Ideally, because of Ronnie's youth, it would be desirable for the trust to qualify as a see-through trust with an ADP equal to Ronnie's life expectancy.

Ronnie's parents want to provide that the trust (including the IRA it holds) would pass at Ronnie's death to a charity that does research into the medical condition Ronnie suffers from. Because the charity is a nonindividual beneficiary, the trust cannot qualify as a see-through it is a Conduit Trust. Under a Conduit Trust, only the "conduit" beneficiary is considered a beneficiary of the trust and of the retirement plan for purposes of the IRS's RMD trust rules, and the remainder beneficiary is ignored. Accordingly, the Ringles' trust provides that, so long as Ronnie is living, the annual RMD, and any other amounts the trustee withdraws from the IRA, must be passed out immediately to Ronnie or applied for Ronnie's benefit. Thus, the trust is a Conduit Trust, Ronnie is deemed the sole beneficiary, and the trust qualifies as a see-through trust for purposes of the RMD trust rules.

Case # 6: Sol's Roth IRA Conduit Trust for his Grandchildren

Sol had a $1 million IRA. A few years ago, realizing that he didn't need this asset for his living expenses (he had ample other assets and income for his modest lifestyle in retirement), he read about the "stretch IRA" and decided this would be a great way to leave an inheritance for his five grandchildren, now in their teens. Using a stash of about $400,000 of cash to pay the taxes he converted the $1 million traditional IRA to a trusteed Roth IRA. The trusteed Roth IRA terms provided that, upon Sol's death, the designated beneficiaries would be his five grandchildren. Each grandchild's share would be paid out to him or her in annual instalments, tax-free, over the grandchild's life expectancy. The prospect of leaving each of his beloved grandchildren a 60-year tax-free payout from this Roth IRA pleased Sol greatly.

Then along came SECURE. There can be no more 60-year payout to the grandchildren. Under the terms of the trusteed Roth IRA (similar to a "conduit trust") each grandchild will receive full outright (nontaxable) distribution of his or her share of the Roth IRA within 10 years after Sol's death. Sol's great plan is now in shambles. He paid $400,000 of income taxes for his plan, and is not going to get what he paid for.

What can he do? If he is concerned about the grandchildren getting too much money at too young an age (however old they will be 10 years after his death), he could leave the Roth IRA, instead, to a "see through trust" that would hold the benefits for the benefit of the grandchildren until they reach more mature ages. Though the entire Roth IRA would be distributed to the trust within 10 years after Sol's death, there would not be the problem of high trust income tax rates, because distribution of the Roth IRA to the trust is tax-free. After the trust has cashed out the Roth IRA, it can invest the money for the benefit of the grandchildren, and pass the investment income out to them, thereby in some way approximating the long-term payout that Sol originally designed.

Case # 7: Duncan: Estate Planning with Roth Accounts

"Roth" retirement plans are encountered with increasing frequency among estate planning clients, especially since (beginning in 2010) the availability of Roth "conversions" was extended to high-income individuals.

Naming the "right" beneficiary for a client's retirement plans is always a very important step in creating an estate plan. Failing to name the right beneficiary for a traditional retirement plan can cause loss of the "stretch" life expectancy payout or of the 10-year rule payout for the benefits, and the resulting acceleration of income taxes (loss of deferral) can be financially detrimental.

Some planners mistakenly conclude that naming the right beneficiary is less important for a Roth plan than for other plans, because the Roth distributions are income tax-free. Therefore (they think) if the benefits are "dumped" out of the Roth plan shortly after the client's death due to a faulty estate plan there is no great harm, because there is no acceleration of income tax.

This idea is mistaken. The stakes are actually even higher with a Roth plan *because* distributions from the Roth plan are tax-free. Thus the longer the assets can accumulate inside the Roth plan, the more tax-free income the beneficiaries will receive. If the benefits are "dumped" out of the Roth plan shortly after the client's death due to a faulty estate plan, then the potential of future tax-free investment growth is gone forever.

When a traditional retirement plan gets distributed immediately after the client's death due to a faulty estate plan, the financial damages are a little speculative. It's true the income tax has been accelerated when it could have been deferred, but the beneficiaries would have had to pay that tax sooner or later anyway. But when an account that was supposed to generate tax-free distributions over the beneficiary's lifetime or over 10 years gets distributed prematurely, the damage is severe. Just compare the value of that tax-free life-long stream of payments with the present value of an investment fund that will generate taxable income forever and see the difference.

The moral is: Proper estate planning is even more important for Roth accounts than for traditional plans.

A. Duncan's problem

Duncan wants to leave some of his assets to charity, some to his wife, and some to his children. He has some assets in a traditional retirement plan, some in a Roth plan, and some in nonretirement-plan investments. Which asset should he leave to which beneficiary?

Charity is not a tax-favored choice of beneficiary for a Roth plan. Because distributions from a Roth plan are generally income tax-free, there is no advantage to leaving this asset to an income tax-exempt entity. So right away we know the Roth should go to either the children or the surviving spouse, not the charity.

If federal estate taxes are a concern, there is a strong argument against making the traditional IRA payable to the children. By inheriting the traditional IRA, they would be inheriting an asset that has a built-in income tax "debt." Duncan does not get a marital or charitable deduction for leaving assets to his children; the only estate tax "shelter" available for bequests to his children is the federal estate tax exemption. Part of that exemption is "wasted" if the children inherit an asset that they then have to pay income tax on. Part of the "exempt" amount goes to the IRS! So the children should inherit either the Roth plan or the nonretirement assets; either way, they will owe no income tax on their inheritance and no part of the federal estate tax exemption is wasted on paying income tax.

As for who should inherit the traditional IRA, the surviving spouse gets better treatment on that asset than the children would. It could pass to her estate tax free under the marital deduction, and income taxes could be deferred quite a while through the spousal rollover. But sooner or later she would have to pay income taxes as the traditional IRA is paid out to her. The charity, in contrast, can inherit the traditional IRA income tax- and estate tax-free, so it's settled: The charity gets the traditional IRA.

We have figured out that the charity should inherit the traditional retirement, and the children should not inherit it; that leaves the Roth plan and the nonretirement assets to be divided somehow between the spouse and the children. The next question is, what is the best income tax scenario for the Roth plan?

If a Roth IRA is left to the children, they would have to withdraw it within 10 years after Duncan's death. Withdrawals would be tax-free, but that tax-free accumulation can last for only 10-11 years (assuming no child is disabled, chronically ill, or a minor). But if the Roth plan is left to the surviving spouse she gets a much better scenario: She can roll the inherited Roth plan over to her own Roth IRA (only the surviving spouse has this right). Then she will be able to stretch out the tax-free distributions much longer than the children possibly could: She does not have to take *any RMDs at all* from the rollover Roth IRA during her lifetime. After her death it can be left to the children for tax-free distribution within 10 years after her death.

Duncan's choice is made: Leave the traditional retirement plan to the income tax-exempt charity, the Roth plan to the wife for her to roll over and keep accumulating tax-free, and the nonretirement assets to the children.

C. Practical problems

Duncan has one problem. His "traditional retirement plan" is an account in a 401(k) plan, and his "Roth retirement plan" is a designated Roth account (DRAC) in the very same plan. It is not clear whether plan administrators will sometimes, always, or never allow an employee to make a split beneficiary designation (traditional account to one beneficiary, DRAC to a different beneficiary). If the plan administrator of Duncan's plan balks at allowing his proposed split beneficiary designation, Duncan may have to roll his plan benefits over to individual retirement accounts (a traditional IRA and a Roth IRA respectively) to carry out the proposed estate plan.

Here is another practical problem we are bound to see with Roth beneficiary designations: As discussed above, the tax-favored choice of beneficiary is not the same for a Roth plan as for a traditional plan. Unfortunately, with many individuals doing Roth conversions these days, it is to be expected that many clients will neglect to inform their estate planners about the conversion, and either neglect to prepare a beneficiary designation for the new Roth IRA or just carry over the beneficiary designation from the former traditional plan. This could have negative effects; for example, if a client who named charity as beneficiary of his traditional IRA converts the account to a Roth and keeps the same beneficiary designation. WE NEED TO IMPRESS ON CLIENTS THAT THEY MUST CONSULT WITH THE ESTATE PLANNER IF A ROTH CONVERSION IS DONE.

Case # 8: Oliver's Family Trust: What's a Poor Trustee to Do?

Oliver died in 2020, leaving his $1 million traditional IRA, $400,000 Roth IRA, and $3 million of other assets to a trust for the benefit of his three adult children, Junior (age 30), Melissa (age 27), and Lucas (age 25). All three children are legally competent adults, working at the start of their promising business or other careers. None of them is "disabled or chronically ill" or has any particular concerns about creditors. The older two are married, one has a child. The trust provides that the trustee will pay each child the (trust accounting) income of his or her share, plus principal in the trustee's discretion for any reason, with each child becoming entitled to withdraw the principal of his or share in instalments, 1/3 at each of ages 35, 40, and 45. If a child dies before attaining 45, the nonwithdrawn portion of his or her share passes to his or her issue if any otherwise to Oliver's then-living issue *per stirpes*, outright.

This trust qualifies as a "designated beneficiary" or "see-through" trust. Under pre-SECURE law, the retirement benefits would have been payable to the trust over the life expectancy of Junior as the oldest beneficiary. The expectation of Oliver and of the trustee, when this trust was established, was that the trustee would manage and invest the retirement assets (inside their respective plans) and the nonretirement assets for the family's benefit in accordance with usual trust management principles; and withdraw from the retirement benefits only the minimum annual "required minimum distribution" (RMD)**.** The expectation was that the trustee would withdraw more than the RMD only if unusual circumstances (such as a tax increase foreseen in the future, or severe financial need of a child with other assets not available or suitable to use for such need). It was expected that the trustee would pass out to the children, annually, the RMD from the traditional IRA if that would result in a lower income tax rate, but retain in the trust the tax-free distributions from the Roth IRA. In other words, the distribution schedule for the retirement plans was a "no-brainer" under pre-SECURE law. Just take the RMD each year....pass it out if that seems like a good idea...and NEVER take more than the RMD unless some (currently-unforeseen) situation makes such extra distribution desirable.

But now....?

Under SECURE, the trustee faces an entirely different scenario and set of choices. The only "RMD" for Oliver's IRA is now, "Withdraw 100% of both accounts no later than 12/31/2030." The trustee has a new job he never had before----THINK about and DECIDE, WHEN it would be advisable to withdraw HOW MUCH from each IRA (and then WHETHER to pass such distribution out to the individual beneficiaries).

Actually, this is still a "no brainer" for the Roth IRA: Since the investment income inside the Roth IRA is tax-free as long as the money stays inside the Roth IRA, the plan should be: Don't take ANY withdrawals from the Roth IRA until near the end of 2030, and cash out the entire account that year tax-free." Maybe the estate plan (and the trustee's investment/distribution strategies for the rest of the trust) should be designed to make it possible for the trustee to keep accumulating the Roth money until 2030. If the trust terms or beneficiary circumstances require the trustee to withdraw from the Roth earlier, that would be a "waste" of the tax-free compounding potential of the Roth.

But the traditional IRA....? Administering the traditional IRA in this trust requires the trustee to be a math whiz who can predict the future of tax rates and investment returns, while compassionately protecting the beneficiaries and their wealth. Should the trustee hire an actuary to predict based on assumed investment return rates and assumed applicable tax brackets what distribution schedule will produce the most money for the children? There are other alternatives...

The trustee COULD conclude, "the kids need a lot of money now to start families, buy houses, pay off student loans, start businesses etc. and they are in low brackets relative to their likely future career trajectories, and the government is probably just going to raise tax rates in the future due to the substantial deficits being incurred, so we should cash out big chunks of the traditional IRA each year starting now and pass that income out to the children because the income tax situation is not going to get any better."

Or the trustee COULD conclude, "Oliver wanted these children protected from themselves until they reached more mature ages, even though taxes might be higher then, and who knows what the future holds, so let's keep that IRA as a reserve fund and think about draining it down when we get closer to the end of the 10 years." Of course the trustee could cash out the IRA and NOT pass out the IRA distributions to the children, but that would mean socking each distribution with the highest income tax rate (37%).

Or the trustee COULD decide, as each child reaches a distribution-age-stage, I'll give him/her his/her appropriate distribution amount in the form of a transfer of a chunk of the IRA, and let the child worry about when to take the distributions.

Or the trustee COULD decide, since I can't predict the future, I'll just close my eyes and spread the risk by taking out the IRA in annual instalments of 1/11th in 2020, 1/10th in 2021, 1/9th in 2022, and so on, until taking out the final 1/1th (100%) in 2030, and pass out of much of the resulting income as seems likely to be taxed at a lower rate in each beneficiary's hands.

This process would be even more complex if the children have very different circumstances from each other. Melissa is an investment banker earning $12 million a year while baby Lucas wants to be a sheepherder and weaver while living "off the grid." Tax science would tell us Lucas should get the IRA distributions while Melissa gets her share in other less tax sensitive assets. How is the trustee supposed to figure that out—can the trustee give compensating extra distributions to a beneficiary who receives income-taxable assets while another beneficiary receives nontaxable stepped-up-basis assets?

The when-to-take distributions issue is a problem with every trust that qualifies for the 10-year rule (or even the 5-year rule). And, don't forget, it is also a problem for a trustee administering the trust of a pre-2020 decedent (where it is too late to draft the "best" clauses for dealing with the problem), because his expectation was that there would be a life expectancy payout to the trust over the oldest trust beneficiary's life expectancy even if the oldest trust beneficiary died before the end of his/her IRS-determined life expectancy. Thanks to SECURE, the trustee must now keep in mind the possibility that such oldest trust beneficiary could die at any time and cause the payout period to flip to the 10-year rule. If the life beneficiary is only 50 years old, but is suffering from a possibly-terminal medical condition, should the trustee start planning for a flip from "We've got over 30 years remaining on this annual life expectancy payout" to "We have to take out everything sometime in the next 10/11 years?"

Message to trustees: Good luck with all that! Trustees may wish to raise their fees and/or try to get either no-discretion language into the trust or exculpatory language regarding the exercise of discretion.

What should a drafter do?

Some drafters wish to dictate in the instrument how and when the trustee shall withdraw from the retirement plans....for example, by requiring annual distributions over the 10/11-year payout period. This may make the trustee's life easier, and hedge the bets; it makes no attempt to figure out how to get the lowest tax bite.

Other drafters may insert exculpatory language protecting the trustee against claims on this point if he acted in good faith.

Should the drafter consider the impact of retirement benefits on the trustee's compensation and on the trustee's decision-focus regarding when to cash out the retirement plan? Suppose the trustee's fee is computed as a flat 1% of investable assets. If the $1 million IRA counts as $1 million of investable assets (as it should, since the trustee has to invest it), the trustee is getting $10,000 a year for that asset. If the trustee cashes it out and pays 37% tax at the trust level, the principal is reduced to $630,000 and the fee is reduced to $6,300.

PART IV: WHAT SECURE ACTUALLY SAYS AND HOW IT FITS IN WITH PRIOR LAW

I. INTRODUCTION TO SECURE

A. Meet SECURE

This section of the Outline will examine the SECURE regime, how it works, who it applies to, which beneficiaries are exempt, what we still don't know, and what estate planners need to do about all this.

B. Where to Find the Law

The massive budget bill enacted by Congress and signed into law by President Trump on December 20, 2019, calls for over $1.7 trillion of spending. Some of this is apparently to be paid for by accelerating the distribution of our clients' tax-deferred retirement plans.

Where to find the law: See § 401, in TITLE V—REVENUE PROVISIONS of "DIVISION O" ("SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT") of the "Further Consolidated Appropriations Act, 2020." § 401(a) of this TITLE V [confusingly numbered, since the existing minimum distribution rules are in § 401(a) of the Tax Code] adds new subparagraph (H) to § 401(a)(9) of the Code and adds new definitions in § 401(a)(9)(E).

§ 401(b) of TITLE V provides the effective date of the new provisions—and contains some more minimum distribution rules. These effective date provisions are not contained in the Code.

One website that purports to keep track of the various versions of the law that circulated prior to its final passage is https://www.govtrack.us/congress/bills/116/hr1994/text.

This Outline also refers to the "Committee Report," which is the only "legislative history" the author has discovered: the "DESCRIPTION OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 1994, THE "SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT (SECURE) ACT OF 2019," Scheduled for Markup by the HOUSE COMMITTEE ON WAYS AND MEANS on April 2, 2019, Prepared by the Staff of the JOINT COMMITTEE ON TAXATION, April 1." This document may be found at https://www.jct.gov/publications.html?func=fileinfo&id=5180.

The provisions of SECURE refer to the "employee" because SECURE amends § 401(a)(9), which governs qualified retirement plans maintained by employers for the benefit of their employees. As a reminder, these rules also apply to IRA owners, and when applied to IRAs the word "employee" is to mean "IRA owner." Reg. § 1.408-8A-1(b). In this Outline "participant" is used to mean the employee in a qualified plan or 403(b) plan or the owner of an IRA.

C. What this Outline Does Not Cover

The following aspects of SECURE's changes to the minimum distribution rules are not covered in this Outline:

✓ Certain retirement benefits where the participant had made irrevocable elections prior to 2020, are not subject to SECURE's changes to the post-death rules. This exception is not covered in this Outline.

✓ There is a delayed effective date for some collectively bargained plans and government plans. This topic is not covered in this Outline.

II. WHAT TO TELL CLIENTS

A. First Post-SECURE Meeting with New Client

Your new client is a mature competent adult who owns, among other assets, a $3 million IRA. His general intent is to leave all his assets to his two (competent, nondisabled, adult) children. What will you tell him are his options regarding the IRA?

Point out that the IRA is a big bag of taxable income. The $3 million asset is not "really" worth $3 million, because the account contains deferred income. If he cashed it out right now the net true worth would be about $1.8 million after payment of federal and state income taxes. If he dies right now leaving that account to the children, they would have to withdraw the money over the following 10 years (maximum of 11 taxable years).

At this point consider the income tax effect on the children: If they are already in the highest brackets, the hit will be the same on them as on client. If they are in lower brackets, this much income would probably put them into higher brackets If he intends to leave the money in trust for the children rather than outright to them, due to fear of their potential divorces or other mishaps, the income taxes will be even more likely to be at the highest rate.

Is there any way to reduce this tax hit, now that the life expectancy payout is no longer available? Here are ideas practitioners are working with now. If none of these is going to appeal to or work for this client, prepare the client to accept the tax hit.

✓ Investigate whether any of the people the client wants to benefit with his estate are in one of the categories that still qualifies for (some version of) a life expectancy payout (EDB: surviving spouse, minor child of participant, disabled/chronically ill, or less-than-10-years-younger). For example, if the client has a disabled grandchild some of the benefits could be left to a lifetime payout trust for that beneficiary.

✓ Leaving traditional retirement benefits to a charitable remainder trust can essentially eliminate the income tax on the IRA itself and provide a lifetime payout to the human beneficiaries that can replace the lost "life expectancy payout." If the client has no charitable intent whatsoever, this approach will not appeal because a substantial amount must go to the charity and the after-tax dollars left for the human beneficiaries may not be greater than what they would have received by inheriting the IRA directly. The lifetime CRT payout idea does not work for very young beneficiaries (under 30 maybe?) due to the statutory requirements of CRTs. See Leimberg Information Services newsletters by such authors as Bruce Steiner, Esq., explaining the requirements, benefits, and limitations of this idea.

✓ If the IRA owner is in a lower tax bracket than his expected beneficiaries (which is especially likely to be the case if the "beneficiary" is going to be a trust that accumulates the IRA distributions), the IRA owner could consider doing Roth conversions during his lifetime, since he can thus absorb the tax hit at a lower rate than will apply to his future beneficiaries. The risks and nonappeal of this strategy are obvious—who wants to pay taxes today that can be put off until tomorrow? Especially when there is no guarantee what anybody's tax bracket will be "tomorrow"—or what the Roth IRA rules will be tomorrow? But in some cases it would make sense.

✓ If the tax cannot be reduced or avoided, identify how the taxes will be paid....out of the benefit distributions themselves? Buy some life insurance?

These topics are not further explored in this Outline. Leimberg Information Services Inc. (LISI) newsletters by Bruce Steiner, Esq., Bob Keebler, CPA, Mike Jones, CPA and others are strongly recommended for further studies, analysis and ideas on these subjects.

B. How SECURE Affects Existing Estate Plans

The good news is, most clients' estate plans will still "work" in the sense that their designated beneficiary is still the designated beneficiary and the see-through trust is still a see-through trust. The bad news is, most plans will not work the way they were expected to work. And with SECURE, there is not one universal fix to update all clients' situations. SECURE affects different clients in very different ways. There is no one-size-fits-all change that will "fix" existing plans to accommodate SECURE.

Here are examples of what the SECURE changes mean to some client estate plan situations:

<u>Some clients' plans will not be affected at all</u>:

- The client who does not own any retirement benefits.
- The client who leaves all of her retirement benefits to charity.

<u>Some clients' plans will be Significantly affected; their estate plans must be reviewed and updated as soon as possible</u>:

- The client whose entire estate plan for his/her retirement benefits is centered on providing a long-term stretch payout for, *e.g.*, his/her grandchildren must scrap the plan and start over.
- Any client whose pre-SECURE estate plan leaves retirement benefits to a "conduit trust" should review his plan immediately. The conduit trust MIGHT still work as originally expected—*e.g.*, a conduit trust for the spouse or for a less-than-10-years-younger beneficiary. However, in many cases the conduit trust provisions will force the trustee to distribute the entire retirement plan to the conduit beneficiary within 10 years after the client's death which is probably a radically different scenario from what the client thought he was signing up for.

<u>Some clients will be able to salvage their estate plan with a few changes, or no changes; but all must be reviewed to figure out what changes are needed if any</u>:

- Carol's current estate plan leaves her IRA to a life trust for her spouse, Chuck. During Chuck's life, he is to receive, each year, all income from the retirement benefits, or the RMD if greater ("combination QTIP-conduit trust"), plus additional distributions if needed for his health or support. All distributions from the plan must be distributed forthwith to Chuck. Since as her surviving spouse he is an EDB, this conduit trust will still work as she intended, despite SECURE, during Chuck's life. But Carol needs to review the disposition of the IRA on the death of the surviving spouse; the full distribution of the IRA to the trust within 10 years after death of the surviving spouse may not be what she planned for.

- Marcia's estate plan, written some years ago, left her IRAs to her children (who were at that time just out of school, starting to climb the career ladder, and struggling to afford a first home), and also set aside money (from other assets) to provide for Marcia's own siblings who were of limited means. With the children no longer entitled to a life expectancy payout on any IRA inherited from Marcia, and also now approaching their own peak earning years so in very high tax brackets, Marcia might switch things around and leave after-tax assets to her children and leave her IRA to her siblings (or trusts for them) because the siblings (unlike the children) still qualify for a life expectancy payout, being close to Marcia in age.

- A client whose IRA is left to a "supplemental needs trust" in the form of a see-through accumulation trust for the benefit of a disabled individual can review the trust and update as necessary to make sure it qualifies as an EDB. For example, if the existing trust allows the trustee to make distributions to the disabled individual's siblings during the disabled individual's life, the trust could be amended to remove that provision so the disabled individual will be the sole life beneficiary and the trust will qualify for the life expectancy payout.

- Trusteed IRAs are "winners" and "losers" as a result of SECURE. The loss: One major selling point of the trusteed IRA ("You can stretch payouts to your grandchildren over their lifetimes, so they will enjoy tax deferral, professional management, and creditor protections without the complications of writing a separate trust instrument!") has vanished. Any client who wants long-term creditor protection for his beneficiaries now must draft a separate trust to be named as beneficiary of his retirement benefits. The gain: For clients willing to have their beneficiaries receive outright control of the retirement benefit proceeds within the shorter SECURE timetable (10 years in most cases), the trusteed IRA still has appeal. Estate planning lawyers may decide to give up the struggle to create valid "see-through trusts" when such a trust will last only 10 years instead of several decades. A trusteed IRA is guaranteed to provide the longest payout period the law allows (because it's an IRS-approved prototype IRA), whether that period is the 10-year rule or a life expectancy payout, and the expert IRA trustee should have the knowledge, will, and skill to manage payouts over the applicable distribution period in a way to maximize the benefit to the beneficiaries and minimize taxes.

III. THE NEW POST-DEATH RMD RULES (AND HOW THEY COMPARE WITH THE OLD RULES)

A. The Old Rules, Still Partially in Effect

To see how the SECURE changes fit into the Internal Revenue Code ("Code"), you have to first be familiar with the "old rules." The minimum distribution rules for retirement plan death benefits, until now, were entirely contained in Code section 401(a)(9)(B). As substantially enhanced and embroidered by Treasury Regulations, these pre-2020 rules were:

1. If the participant died before his/her required beginning date [RBD; the date on which he/she was required to commence taking lifetime required minimum distributions or "RMDs"], his/her retirement account had to be distributed in annual instalments over the life expectancy of his/her Designated Beneficiary, or, if the retirement plan permitted such an election and the beneficiary so elected, by the end of the year that contained the fifth anniversary of the participant's death.

2. If the participant died before his/her RBD, and the benefits passed to a Non-DB rather than to a DB, the retirement account had to be distributed by the end of the year that contained the fifth anniversary of the participant's death (the "5-year rule").

3. If the participant died on or after his/her RBD, the benefits had to be distributed "at least as rapidly" as the benefits were being distributed prior to death ("at least as rapidly rule") according to the Code. The Treasury regulations interpreted this to mean that the balance of the participant's retirement account had to be distributed no more slowly than in annual instalments:

    (a) Over what would have been the participant's remaining life expectancy if he/she hadn't died, if there was no DB, or

    (b) If there was a DB, over the longer of the DB's life expectancy or the period described in (a).

Whew! Pretty complicated.

Note that all methods required annual distributions except the 5-year rule. SECURE's new 10-year rule is explicitly modeled on the 5-year rule, ergo, it also does not require annual payouts, only that all amounts are distributed by the end of the applicable period.

A "designated beneficiary" was (and still is) defined as an individual named as beneficiary by the participant or by the plan, or a trust so named as beneficiary if the trust met the IRS's requirements to be considered a see-through trust, in which case the life expectancy of the oldest trust beneficiary was the applicable distribution period. If a designated beneficiary died before the end of his life expectancy payout period, the next beneficiary in line (whether or not qualifying as a "designated beneficiary") stepped into the decedent's shoes and could withdraw over the remaining life expectancy of the original designated beneficiary.

There were various rules about how to calculate "life expectancy," special rules for the surviving spouse (who alone had the option to "roll over" the inherited benefits to his/her own retirement plan—that option is not part of the minimum distribution rules), and limited options for rearranging or removing beneficiaries for a short period of time after the participant's death to lock in a more favorable required minimum distribution (RMD) situation. This RMD death benefit regime remained unchanged from 2001 through 2019.

B. SECURE Nestles into the Old Rule Regime

SECURE does not amend or replace § 401(a)(9)(B) or (with two exceptions) any of the existing regulations. It does not change the definition of designated beneficiary. Instead, SECURE adds a new section to 401(a)(9), § 401(a)(9)(H). "(H)" layers, on top of the existing rules, new payout periods that will apply to all designated beneficiaries: A 10-year payout replaces the life expectancy payout method for all but five categories of designated beneficiaries. Those five categories ("eligible designated beneficiaries") are entitled to a modified version of the life expectancy payout.

This "layering" is for the most part carefully done and appears to show intent to preserve as much as possible of applicable current law except for the payout period and for other matters specifically legislated in § 401(a)(9)(H).

Please note: THE DEFINITION OF DESIGNATED BENEFICIARY IS NOT CHANGED BY SECURE. IT IS WORD FOR WORD THE SAME AS BEFORE. NOTHING IN SECURE "OVERRULES" THE IRS'S EXISTING "RMD TRUST RULES." A CONDUIT TRUST IS STILL A CONDUIT TRUST AND ITS CONDUIT BENEFICIARY STILL QUALIFIES AS A DESIGNATED BENEFICIARY. A SEE-THROUGH ACCUMULATION TRUST IS STILL A SEE-THROUGH ACCUMULATION TRUST AND ITS COUNTABLE BENEFICIARIES ARE STILL THE PARTICIPANT'S DESIGNATED BENEFICIARIES.

Do all of SECURE's provisions fit perfectly and neatly into the existing Code and regulatory RMD rules? No. There are some rough edges the IRS will have to sand down with regulations, and a few questions that are truly up in the air (see Appendix A).

Note that SECURE applies only to "certain defined contribution plans." Defined benefit plans, including certain annuity payouts in an IRA or other defined contribution plan that were already locked in prior to enactment of SECURE, are not affected. TITLE IV, § 401(b)(4). That subject is discussed in section IV(B) of Appendix A of this Outline.

C. Old Vs. New Categories of Designated (and Non-) Beneficiaries

Pre-SECURE, there were three categories of beneficiaries:

- **Beneficiary who is not a designated beneficiary** (the participant's estate, a charity, or a trust that does not qualify as a see-through trust) ("non-DB"). The 5-year rule applied to this category for benefits of participant who died before his RBD, or the participant's remaining life expectancy if participant died on or after RBD). The definition of "NonDB" did not change and the rules applicable to the NonDB did not change.

- **Designated beneficiary** (individual(s) or see-through trust): Entitled to life expectancy payout (with life expectancy not recalculated annually), with annual distributions beginning the year after the year of the participant's death. In case of participant's death prior to the RBD, the DB had the option to choose the 5-year rule instead of the life expectancy payout, or in case of participant's death on or after the RBD the DB's payout period was the "longer of" the participant's life expectancy ("ghost life expectancy") or the beneficiary's life expectancy.

- **Surviving spouse-designated beneficiary** (the participant's surviving spouse or a conduit trust for the participant's surviving spouse): If the participant's sole designated beneficiary was his/her surviving spouse (or a conduit trust for the surviving spouse), the beneficiary was entitled to the withdraw over the surviving spouse's life expectancy payout (with life expectancy recalculated annually), with annual distributions beginning the later of the year after the year of the participant's death or the year the participant would have reached age 70½. In case of participant's death prior to the RBD, the spouse/DB had the option to choose the 5-year rule instead of the life expectancy payout, or in case of participant's death on or after the RBD the spouse/DB's payout period was the "longer of" the participant's life expectancy ("ghost life expectancy") or the beneficiary's life expectancy. Reg. § 1.401(a)(9)-2, A-5, § 1.401(a)(9)-5, A-5(a), (c)(2), A-6; § 1.401(a)(9)-5, A-7(c)(3), Example 2.

With SECURE, there are still three categories of beneficiaries, but one category now has five subcategories, with (among them) four sets of RMD rules:

- **Beneficiary who is not a designated beneficiary** (the participant's estate, a charity, or a trust that does not qualify as a see-through trust) ("non-DB"): See III(F) below regarding the post-SECURE rules for this group. The minimum distribution rules have not changed for this group.

- **Plain old designated beneficiary** (individual(s) or see-through trust): Unless "eligible" (see next category), must withdraw benefits by the end of the year that contains the 10^{th} anniversary of the participant's death. See "The 10-year Rule" below. The general distribution rule for such a "plain old designated beneficiary" is now the 10-year rule, regardless of whether the participant died before, on, or after his RBD. According to IRS Publication 590-B (2020), the PODB will not have the option to elect to use the "ghost life expectancy" even if the participant died after his/her RBD and the ghost life expectancy is longer than 10 years.

- **Eligible designated beneficiary (EDB)**: This subgroup of designated beneficiaries are still entitled to (a modified version of) the life expectancy payout method. Note in all cases that, according to IRS Publication 590-B (2020), if the participant died before his RBD, the EDB can elect to use the 10-year rule instead of the life expectancy payout, but will NOT have that option if the participant died on or after his RBD; if the participant died after his RBD the EDB's distribution period will be the "longer of" the EDB's life expectancy or the decedent's ("ghost life expectancy").

  ✓ **The surviving spouse of the participant.** § 401(a)(9)(E)(ii)(I). The participant's surviving spouse can still use the life expectancy payout with the same special rules as before (life expectancy recalculated annually, with annual distributions beginning the later of the year after the year of the participant's death or the year the participant would have reached age 72). On spouse's death the life expectancy payout (if then in effect) ends and a 10-year payout applies. See "Planning for the Surviving Spouse," below.

✓ **Minor child of the participant.** § 401(a)(9)(E)(ii)(II). The life expectancy payout applies to a "child of the employee who has not reached majority (within the meaning of subparagraph (F)." However, upon reaching majority, the 10-year rule kicks in. See "Planning for Minor Children" below.

✓ **Disabled beneficiary.** The life expectancy payout applies to a designated beneficiary who is disabled (within the meaning of § 72(m)(7)). § 401(a)(9)(E)(ii)(III). Upon his/her death the 10-year payout rule kicks in. See "Planning for Disabled and Chronically Ill Beneficiaries" below.

✓ **Chronically ill individual.** The life expectancy payout applies to a designated beneficiary who is chronically ill (within the meaning of § 7702B(c)(2)). § 401(a)(9)(E)(ii)(IV). Upon his/her death the 10-year payout rule kicks in. See "Planning for Disabled and Chronically Ill Beneficiaries" below.

✓ **Not more than 10 years younger beneficiary**. The life expectancy payout applies to an individual who is not any of the foregoing (i.e., he/she is not the spouse, not disabled, etc.) and who is not more than 10 years younger than the participant; upon his or her death, the 10 payout rule kicks in. § 401(a)(9)(E)(ii)(V). See "Planning for Not-more-than-10-years-younger (NMTTTYY, pronounced "Nimitty") Beneficiary," below.

D. Effect on Conduit and Accumulation Trusts

The conclusions in this Outline are based on my reading of the statute before and after SECURE. The (brief) minimum distribution rules contained in the Code changed little or perhaps not at all from 1986 through 2019. The Treasury regulations attempting to apply this sparse statute underwent some trial and error (1987 proposed regulations; 2001 proposed regulations) before final regulations were adopted governing all defined contribution plan participants and beneficiaries for calendar years beginning after 2002. See Reg. § 1.401(a)(9)-0 through § 1.401(a)(9)-9; § 1.403(b)-6(e); § 1.408-8; § 1.408A-6, A-14, A-15; § 54.4974-1 and § 54.4974-2; § 1.402(c)-2, answers A-3(b)(2), A-7, and A-8. **These regulations have changed not at all (other than nuances developed through private letter rulings) since issuance.**

The SECURE statute itself shows awareness of these regulations; see discussion of "Planning for Disabled Beneficiary" below. See also the Committee Report, Note 230. The intent appears to be to fit SECURE's changes within the existing regulatory rules, not replace them wholesale.

Under pre-SECURE rules, two types of trusts could qualify as see-through trusts, "conduit trusts" (which automatically qualify) and "accumulation trusts" (which could be either see-through or nonqualifying). **The exact same types of trusts defined in exactly the same way still qualify**

as see-through trusts under the new RMD regime created by SECURE. This conclusion is based on the fact that SECURE did not change the definition of designated beneficiary, and therefore the IRS's minimum distribution trust rules are still applicable exactly as they were pre-SECURE, except to the extent explicitly modified by SECURE.

So understanding the tests and definitions discussed here is still critically important to estate planning post-SECURE. For full detail and more citations on these types of trusts see Chapter 6 of the author's book *Life and Death Planning for Retirement Benefits* (8th ed. 2019):

Under a **conduit trust**, all distributions made from the retirement plan to the trust during the lifetime of the "conduit" beneficiary of the trust must be passed out (after deduction of applicable expenses) more or less immediately to the individual life beneficiary. The conduit beneficiary is considered the *sole beneficiary of that trust and of the plan* for RMD purposes, regardless of who will inherit the trust and remaining plan benefits if the conduit beneficiary dies prior to complete distribution of the retirement plan. Accordingly, a conduit trust "automatically" qualifies as a see-through trust. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2.

Post-SECURE, leaving benefits to a conduit trust for a single individual beneficiary will still be treated, for minimum distribution purposes, the same as leaving the benefits outright to that individual. Accordingly, the individual will be deemed the participant's sole designated beneficiary and the trust will be entitled to the "10-year payout rule"; or, if the individual "conduit beneficiary" is an EDB, the trust will be entitled to the "life expectancy payout" exactly as such individual (as an EDB) would be entitled if named directly as beneficiary.

If the beneficiary of a conduit trust is not an EDB, then the 10-year rule will apply to the retirement benefits that are payable to that trust and the conduit beneficiary will receive outright distribution of 100% of the retirement benefits within 10 years after the participant's death (because the conduit provision requires the trustee to pass all retirement plan distributions out to the conduit beneficiary more or less immediately upon receipt).

Please note: Conduit trust status requires that *all distributions* from the retirement plan to the trust *during the lifetime* of the individual "conduit beneficiary" must be distributed forthwith to or for the benefit of that individual. There is no option to flip the trust to "accumulation" status at some later date (such as when a minor child reaches majority) or "decant" the trust to one with a different payout schedule—to include such a provision would eliminate conduit trust status.

With an **accumulation trust**, the trustee can "accumulate" retirement plan distributions in the trust during the lifetime of the initial beneficiary(ies) for possible later distribution to another beneficiary. All beneficiaries who might ever be entitled to receive such accumulations are considered beneficiaries of the retirement plan for purposes of applying the minimum distribution rules, except that a beneficiary who is a "mere potential successor" to another beneficiary is disregarded. An accumulation trust qualifies as a see-through trust only if all of the countable beneficiaries are identifiable individuals. Reg. § 1.401(a)(9)-5, A-7(c)(1). Unfortunately, it is not always clear which beneficiaries can be disregarded as "mere potential successor"; see PART V of this Outline and lengthy discussion at ¶ 6.3 of *Life and Death Planning for Retirement Benefits* (8th ed. 2019).

Accumulation trusts are more complicated than conduit trusts, because an accumulation trust may or may not qualify as a see-through trust. If any "countable" beneficiary of an accumulation trust is not an individual, the trust does not qualify as a see-through.

Here is what happens to these trusts under SECURE, in my opinion:

- ♦ Generally, without issuance of new regulations, an accumulation trust cannot qualify for EDB treatment (with one exception—see "AMBTs," PART IV(C) of this Outline), even if the primary or life beneficiary of the trust is an EDB, because if the EDB is not the sole designated beneficiary of the retirement plan we have no authority discernible under SECURE or otherwise to conclude that EDB status applies. There is nothing in the statute that authorizes the life expectancy payout where an EDB is just one of multiple beneficiaries (with the sole exception of the "AMBT" for a disabled or chronically ill beneficiary). Under pre-SECURE regulations, which are still in effect except to the extent specifically "overruled" by SECURE, the life beneficiary of a "conduit trust" (and only a conduit trust) is considered the sole beneficiary of such trust and of the retirement plan payable to such trust, and accordingly if such conduit beneficiary is an EDB he/she is therefore entitled to the life expectancy payout. The life beneficiary of an accumulation trust is not deemed to be the sole beneficiary of such trust (see Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 1) and therefore there is no authority for affording such trust a life expectancy payout even if the sole life beneficiary is an EDB (except in the case of an AMBT).

- ♦ With the exception of certain trusts (AMBT; see PART IV(C) of this Outline) for the sole life benefit of disabled or chronically ill beneficiaries, an accumulation trust that is a see-through trust (STAT; see-through accumulation trust) must take distribution of the entire plan balance within 10 years after the participant's death.

- ♦ **Good news for drafters:** Since the life expectancy payout is no longer an option for accumulation trusts for beneficiaries who are not disabled or chronically ill, it no longer matters who is the "oldest beneficiary" of the trust. For example, parent could leave an IRA to a see-through accumulation trust for the benefit of her nondisabled, non-chronically ill, adult child, with the provision that (say) the trust will be distributed outright to child at age 40, but if child dies before age 40, the trust will be distributed to parent's sister Matilda. Even though the adult child and Matilda are both considered beneficiaries of the trust, and Matilda is older than the child, it makes no difference because the 10-year rule applies regardless of the respective ages of the "countable" trust beneficiaries.

- ♦ **Bad news for drafters:** HOWEVER: it is still required that the oldest trust beneficiary be "identifiable" because this is one of the requirements a trust must meet in order for the trust beneficiaries to be considered "designated beneficiaries." See ¶ 6.2.03 of *Life and Death Planning for Retirement Benefits* (8th ed. 2019). If the trust does not qualify as a see-through trust there is no "designated beneficiary" and the 10-year rule is not available.

- ♦ An accumulation trust that does *not* qualify as a see-through trust must, as before SECURE, take distributions under the rules applicable to Non-DBs (5-year rule or ghost life expectancy). **Example:** Todd leaves his IRA to a trust for his son Herbie. The trustee is to pay Herbie all income for life, plus principal if needed for health or support. On Herbie's death the trust is to terminate and be distributed to Charity X. Since this is not a conduit trust, both beneficiaries "count," and since one of the countable beneficiaries is not an individual the trust does not qualify as a see-through trust, therefore the no-DB rules apply.

E. The 10-year Rule and Who it Applies to

Since SECURE operates by borrowing the "5-year rule" of § 401(a)(9)(B)(ii) to create the 10-year rule, the 10-year rule operates in the same manner as the longstanding (and still extant) 5-year rule: All amounts must be distributed by December 31 of the year that contains the 10th anniversary of the date of death; and in the interim, no distributions are required, as long as funds are out of the plan by that deadline. See Reg. 1.401(a)(9)-3, A-2. Although the statute says the deadline is the "10th anniversary of the" participant's date of death, by referencing the 5-year rule it appears the intent was to use the same approach as the regulations' interpretation of the 5-year rule, namely, that the deadline is the end of the year that contains the fifth anniversary of the date of death. The Committee Report affirms that conclusion.

Note: The IRS issued its latest annual edition of "*Publication 590-B* (*Distributions from Individual Retirement Arrangements*)" in late March 2021. Although the Publication correctly described the 10-year rule as it is described above in four places, the Publication also contained an example on page 12 which seemed to imply that a PODB would have to take annual "life expectancy-type" payments even under the 10-year rule. This example caused great consternation among the IRA provider and planning communities, in view of the universal understanding that the 10-year rule did not require annual payments. A careful reading of 590-B led to the conclusion that this example was just a mistake, representing language carried over from prior editions without being properly updated to reflect SECURE. The IRS subsequently confirmed on its website that the example was a mistake and would be corrected. With that confirmation, there is nothing in Publication 590-B that would contradict the interpretation of the 10-year rule stated in this Outline.

The 10-year rule is imposed by SECURE in a very odd way.

Pre-SECURE, § 401(a)(9)(B)(ii) provided as follows: "(ii) 5-year rule for other cases. A trust [in the statute "trust" refers to an employer retirement plan, such as for example a 401(k) plan] shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee."

New § 401(a)(9)(H) states that "Except in the case of a beneficiary who is not a designated beneficiary, subparagraph (B)(ii) shall be applied by substituting '10 years' for '5 years," and (II) shall apply whether or not distributions of the employee's interests have begun in accordance with" the lifetime RMD rules.

Parsing this out, we find that for a beneficiary who is not a designated beneficiary, the rules don't change, but for every *designated* beneficiary the NEW rule is: "[The retirement plan must provide]...that, if an employee dies before the distribution of the employee's interest is completed (regardless of whether distribution had begun prior to death), the entire interest of the employee will be distributed within 10 years after the death of such employee."

Note that:

✓ The actual payout period could extend over 11 taxable years of the beneficiary. Example: Rita dies in 2021, leaving her IRA to her adult daughter Julie. Julie must withdraw the entire IRA by December 31, 2031 Assuming Rita died early enough in 2021 to allow this, Julie's distributions could be spread over 11 taxable years, 2021–2031. If Rita dies on 12/31/21, Julie realistically has only 10 taxable years over which to spread the distributions.

✓ Unlike with the life expectancy payout, there is no requirement of annual distributions. The distributions can be made at any time or times during the 10-year period as long as the plan is totally distributed by the end of the period.

§ 401(a)(9)(B)(iii) itself hasn't changed. Where the general rule was that, in case of death before the lifetime distributions had begun, benefits had to be paid out within 5 years after the employee's death, 401(a)(9)(B)(iii) provided and still provides that there is an exception to the general rule: Benefits payable to a designated beneficiary can be paid in annual instalments over such beneficiary's life expectancy in accordance with regulations. However, the new § 401(a)(9)(H) now overrides § 401(a)(9)(B)(iii) and in effect says, yeah, but this "(B)(iii) exception" allowing the life expectancy payout shall apply ONLY in the case of an "*eligible* designated beneficiary." A PODB is entitled only to the 10-year rule regardless of whether death was before or after the RBD.

According to IRS Publication 590-B (2020), an EDB can elect to use the 10-year rule instead of the life expectancy payout IF the participant died before his RBD, but NOT if the participant died on or after his RBD.

F. Non-DB Payout Rules are Unchanged

Prior to SECURE, the payout rules for a Non-DB were simple: If the participant died before his RBD, the "5-year rule" applied: the Non-DB had to withdraw the entire account by the end of the year that contained the fifth anniversary of the participant's death. Reg. § 1.401(a)(9)-3, A-2, A-4(a)(2), § 1.401(a)(9)-4, A-3. (SECURE borrowed the "5-year rule" to create the "10-year rule" now applicable to the nonEDB DBS of post-2019 decedents). If the participant died on or after his RBD, the Non-DB had to withdraw the remaining benefits over what would have been left of the participant's life expectancy if the participant had not died. Reg. § 1.401(a)(9)-2, A-5. SECURE did not change these rules applicable to Non-DBS.

The new 10-year rule and its handful of life-expectancy exceptions are contained in new Code § 401(a)(9)(H), which begins with these words: "Except in the case of a beneficiary who is not a designated beneficiary..." Though the double negative makes it a bit hard to read, the meaning is not capable of any interpretation other than: The new 10-year rule and its exceptions do not apply to a Non-DB. The House Committee Report is in accord with this interpretation: "2. The proposal changes the after-death required minimum distribution rules applicable to defined contribution plans, as defined, *with respect to required minimum distributions to designated beneficiaries*. ..." Emphasis added.

Under pre-SECURE rules, IRS regulations stepped on the Code's strict and bare-bones rules by providing that, in the case of the employee's death after his required beginning date, leaving the retirement benefits to a designated beneficiary (DB), the Applicable Distribution Period would be the *longer of* the life expectancy of the DB or the life expectancy of the deceased employee. This prevented the absurd situation that would arise if the designated beneficiary was older than the deceased participant, where the DB would get a shorter payout period (DB's life expectancy) than the Non-DB (decedent's life expectancy). See, *e.g.*, Reg § 1.401(a)(9)-3, A-4(c). This sensible rule prevented DBS from being "worse off" than the Non-DB. Based on the 2020 edition of IRS Publication 590-B, this "longer of" rule will now apply to EDBs when the participant dies on or after his RBD—the EDB's ADP is the longer of the EDB's life expectancy or the ghost life expectancy. However:

- PODBs will NOT be entitled to this longer-of rule, i.e. cannot use the ghost life expectancy payout even if the ghost life expectancy is longer than 10 years.

- Nor will the EDB be entitled to elect the 10-year rule, when the participant dies on or after the RBD (though the EDB uses the "longer of" rule in that case).

Why this is important: Under new IRS actuarial tables that will take effect in 2022 (they were proposed by the IRS in November 2019), a participant's "remaining life expectancy" (the "ghost life expectancy") will be longer than 10 years if the participant dies between approximately ages 73 and 80. Thus, if Publication 590-B's provisions become law under regulations, we may have the situation of a DB (such as a see-through accumulation trust or "STAT") concluding he, she, or it is worse off than Non-DBS if the participant dies during that time period.....and the unseemly sight of practitioners scrambling to disqualify their "see-through trusts" to enable the beneficiary to take advantage of the Non-DB rule.

IV. PLANNING FOR ELIGIBLE DESIGNATED BENEFICIARIES

There are five categories of EDB. SECURE's rules are a bit different for each category. Clients whose intended beneficiaries fall into these categories will have more planning options than the client whose beneficiaries are just "plain old DBs" (PODBs) and not "EDBs."

A. Planning for the Surviving Spouse

The "surviving spouse of the" participant is an EDB.

The options for leaving benefits to the surviving spouse are little changed from the pre-SECURE menu. The surviving spouse named as (outright) beneficiary still has the option to roll over the inherited benefits to his/her own IRA or (in the case of an inherited IRA) to elect to treat it as his/her own IRA. The election/rollover rules are not minimum distribution rules and are not affected by SECURE.

Similarly, if the surviving spouse holds the account as beneficiary (without rolling it over to his/her own IRA), he/she gets a special delayed commencement date for starting RMDs from the inherited IRA and a surviving-spouse-only method of calculating life expectancy (it is recalculated annually; other EDBs, just as other DBs before SECURE, use a "fixed term" also called "reduce-by-one" method of computing life expectancy). A conduit trust for the surviving spouse (or trusteed IRA) will be entitled to all the minimum distribution benefits of the surviving spouse under the IRS's rule that the conduit beneficiary is considered the sole beneficiary of the plan. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2. Thus:

✓ The surviving spouse holding as designated beneficiary, or a conduit trust for the surviving spouse, does not have to commence taking RMDs until the end of the year in which the deceased participant would have reached age 72 (or, if later, the year after the participant's death). See § 401(a)(9)(B)(iv)(I), as amended by SECURE. IRS Publication 590-B (2020) confirms that this delayed effective date for the surviving spouse applies even if the deceased spouse died before SECURE was effective, if the deceased spouse's first distribution year (had he/she lived) would have been age 72.

✓ The spouse's life expectancy, recalculated annually, will be the Applicable Distribution Period for the surviving spouse holding as beneficiary or for a conduit trust for the surviving spouse's sole life benefit.

✓ The 10-year rule will not apply during the spouse's life.

One common type of trust-for-spouse is the combination QTIP-conduit trust under which the spouse receives the greater of the income or the RMD each year. This model will continue to work just fine under SECURE—during the spouse's life. Upon the spouse's death, the 10-year rule kicks in. See *"***What Happens on Death of the EDB?***"* below.

However, a see-through accumulation trust (STAT) for the surviving spouse will not be eligible for the life expectancy payout, even if the spouse is sole life beneficiary—for example, an "income only" marital trust. This type of trust would have to cash out all the benefits within 10 years after the participant's death. Prior to SECURE, such a " QTIP-type" trust for the spouse where the spouse would receive the income of the trust (with or without additional payouts of principal such as "for health or support") but the principal was all or mostly reserved for the remainder beneficiaries (such as children from a prior marriage) *could* qualify for the life expectancy payout if the remainder beneficiaries were individuals. As an "accumulation trust," however, this type of trust does not qualify for the life expectancy payout under SECURE (unless IRS changes its regulations). It can qualify for the 10-year payout at best. See Reg. § 1.401(a)(9)-5, A-7(c)(3), Examples 1, 2.

B. Planning for Minor Child of the Participant

Leaving retirement benefits for the benefit of minor children is difficult without either accelerating the taxation of the benefits or accelerating the children's control.

One category of EDB is "a child of the employee who has not reached majority (within the meaning of subparagraph (F))." § 401(a)(9)(E)(ii)(II). "Subject to subparagraph (F)," such child "shall cease to be an eligible designated beneficiary as of the date the individual reaches majority," at which time the 10-year rule will kick in. § 401(a)(9)(E)(iii).

Example: Agnes dies in 2020 leaving her IRA to her minor child Don. Don's guardian must withdraw benefits annually from the IRA, starting in 2021 (the year after Agnes's death) using the old pre-SECURE "life expectancy payout method," computed based on the age Don will attain on his 2021 birthday, not recalculated annually. Assume Don reaches majority on August 17, 2028. That is the final year the RMD will be based on the "life expectancy payout." Don will have to withdraw the rest of the IRA using the 10-year rule, meaning the IRA must be entirely distributed to him no later than December 31, 2038. If Don dies after attaining majority but before the end of the 10-year period, his successor beneficiary will have to withdraw over what is left of Don's 10-year period. If Don dies before attaining majority, the 10-year payout to his successor beneficiary will begin the year after Don's death (and the successor beneficiary must also withdraw the RMD for the year of Don's death, if it was not withdrawn prior to Don's death).

So the child's initial status as an EDB and continued status as such are dependent upon not having "reached majority" and we are to look at "subparagraph (F)" for what reaching majority means. § 401(a)(9)(F) is an otherwise unrelated provision that deals with payments made from a defined benefit plan to a minor child of a deceased employee, and provides that such payments will be treated as having been paid to the employee's surviving spouse for some obscure statutory purpose not otherwise relevant to estate planners. Here is (F) in its entirety:

"(F) Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations)."

This seems to mean that the Treasury has latitude to expand the definition of "reaching majority" by giving "other designated events" the same effect as reaching a specific state-law age of majority. Presumably any regulations already issued (for the original purposes of subparagraph (F)) are by extension applicable to subparagraph (E). The only existing regulation under (F) provides as follows: "... a child *may be treated* as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26. In addition, a child who is disabled within the meaning of section 72(m)(7) when the child reaches the age of majority *may be treated* as having not reached the age of majority so long as the child continues to be disabled." Reg. § 1.401(a)(9)-6, A-15; emphasis added. The author has been unable to find anyone who has any experience with what "has not completed a specified course of education" means.

Note that the wording "may be treated" appears to give the plan administrator the last word on the question of whether a child has or has not reached majority. Plans may choose to treat the child as still a minor if he/she has not completed a specified course of education—or may choose not to. This plan-by-plan state-by-state approach does not provide a nationally applicable bright line framework for determining what "attaining majority" means. Clearly that definition is too subjective and variable to serve as a guide for millions of parents, estate planners, and plan administrators. It is to be hoped that the Treasury will issue a clear bright line universally applicable definition of reaching majority such as "attainment of age 26, or, if disabled at that time, upon later termination of such disability."

In the meantime, here are the planning options:

A <u>conduit trust</u> for a minor child of the participant is entitled to the same treatment the minor child, as an EDB, would have, namely, the life expectancy payout [until "majority"], because, as conduit beneficiary, the child is considered the "sole designated beneficiary" of the retirement plan. Benefits left outright to the child would be entitled to the same treatment (see Agnes example above). Based on all we know now, this will result in the child's receiving outright control of all the money somewhere from age 28 to age 36: i.e., no later than age 28 (10 years after age 18), 31 (10 years after age 21), or possibly 36 (10 years after age 26, under the "specified course of education" rule) (unless disabled at that point).

This may or may not be what the parents would want. Some parents are content to have their children receive their inheritances outright as early as age 28, other are not. Here are other important points about this EDB category:

- The EDB exception for minor children applies only to the child of the participant—not to grandchildren or any other minor children.

- If the minor dies prior to attaining majority, the 10-year rule would kick in at that time. See "What Happens at Death of EDB?" below.

How does the exception work if there is a conduit trust for multiple minors? That is unknown. Since the IRS has rarely if ever acknowledged that there can even be a conduit trust for multiple beneficiaries it might be wise to avoid this approach if seeking to qualify for the exception.

Another unknown is whether the "minors" exception would be available if the IRA is left to a trust for multiple children of the participant only some of whom are minors. Suppose the trust is required by its terms to divide immediately upon the participant's death into separate conduit trusts, one for each child. Can the minor children's subtrusts then qualify for the exception? That is unknown. Under existing IRS regulations, post-death trust divisions are ignored for purposes of determining the applicable distribution period. Reg. § 1.401(a)(9)-4, A-5(c). The SECURE drafters were apparently aware of this regulation, since SECURE specifically allows such post-death divisions to be used to establish an exception-qualifying trust for a disabled beneficiary (see "Planning for Disabled and Chronically Ill," below); the fact that SECURE does not do the same for minors' trusts suggests a negative answer, though some optimists are interpreting § 401(a)(9)(H)(iv)(I) as statutorily overruling Reg. § 1.401(a)(9)-4, A-5(c) for all EDBs.

An <u>accumulation trust</u> for the child enables the parents, through their chosen trustee, to control the funds for a longer time, until the child reaches a more mature age—but such a trust would not be an EDB because the minor child is not considered the sole beneficiary of an accumulation trust, even if he/she is the sole lifetime beneficiary. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 1.Thus this trust would have to cash out the retirement plan within 10 years after the parent's death, causing an accelerated tax bill at high trust income tax rates. What happens to the after-tax proceeds left after this distribution occurs depends on the terms of the trust.

Many parents (and others seeking to benefit young children) will face this planning dilemma: They can't give control to a very young child, but distributions taxable to a trust will pay the highest possible income tax rate. The conduit trust (formerly a solution to this dilemma, due to its guaranteed designated beneficiary status and its small required distributions during the beneficiary's youth) is no longer available to solve this problem (except for children of the participant, if the participant is willing to accept a full payout 10 years after the child's attaining majority). Realistically in most cases those seeking to benefit very young beneficiaries will have to focus more on how to pay the taxes (buy life insurance?) rather than on how to defer them.

C. Planning for Disabled or Chronically Ill Beneficiary

A designated beneficiary who is "disabled (within the meaning of section 72(m)(7))" is an EDB. § 401(a)(9)(E)((ii)(III). § 72(m)(7) provides that "an individual shall be considered to be disabled if he is 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. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require." Entitlement to Social Security disability benefits automatically assured disabled status under § 72(m)(7).

A designated beneficiary who is "a chronically ill individual (within the meaning of section 7702(B)(c)(2)" is an EDB—"except that the requirements of subparagraph (A)(I) [of § 7702B(c)(2)] shall only be treated as met if there is a certification that as of such date, the period of inability described in such subparagraph with respect to the individual is an indefinite one which is reasonably expected to be lengthy in nature)." § 401(a)(9)(E)((ii)(IV).

The beneficiary's status as disabled or chronically ill is determined as of the date of the participant's death. Thus an able designated beneficiary who becomes disabled at some later date will not be entitled to switch over to a life expectancy payout.

For complete explanation of the requirements of the "disabled" or "chronically ill" EDB status, and the issues involved in determining eligibility, the author strongly recommends the article "Security for Disabled and Chronically Ill Beneficiaries" by Nancy H. Welber, Esq., *Trusts & Estates* magazine, April 2020, p. 40 (www.trustsandestates.com).

On the death of the disabled or chronically ill individual, as with other EDBs, the life expectancy payout period terminates and the 10-year rule kicks in. See "What Happens on Death of EDB," below.

Trusts for disabled and/or chronically ill EDBs are given two special breaks not granted to trusts for surviving spouses, minor children, and less-than-10-years-younger beneficiaries. These breaks are structured as being applicable to "applicable multi beneficiary trusts," defined in § 401(a)(9)(H)(v) as:

"Applicable multi-beneficiary trust. For purposes of this subparagraph, the term "applicable multi-beneficiary trust" means a trust—

(I) which has more than one beneficiary,

(II) all of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the distribution period pursuant to this paragraph, and

(III) at least one of the beneficiaries of which is an eligible designated beneficiary described in subclause (III) [disabled] or (IV) [chronically ill] of subparagraph (E)(ii)."

Note the requirement that "all of the beneficiaries of which are treated as designated beneficiaries..." This appears to incorporate by reference the IRS's minimum distribution trust rules as contained in Reg. § 1.401(a)(9)-4, A-5(a). In other words, before a trust can qualify for the special breaks giving to an applicable multi-beneficiary trust, the trust must qualify as a see-through trust under the pre-SECURE IRS minimum distribution trust rules.

Here are the two "breaks" given to an applicable multi-beneficiary trust:

Special break #1: If the trust is required by the terms of the trust instrument to be divided immediately upon the death of the employee into separate trusts for each beneficiary, the payout rules "shall be applied separately with respect to the portion of the employee's interest that is payable to" any disabled or chronically ill EDB. § 401(a)(9)(H)(iv)(I), (v).

This special rule "overrules" the IRS's normal rule that, when retirement benefits are left to a single trust, which then immediately divides into separate subtrusts for separate beneficiaries, such division does not create separate accounts for purposes of determining the applicable distribution period unless the separate subtrusts were each named separately as beneficiary in the beneficiary designation form. See Reg. § 1.401(a)(9)-4, A-5(c), as applied in PLRs 2003-17041, 2003-17043, 2003-17044, 2004-32027–2004-32029, 2004-44033–2004-44034, and 2015-03024. Under SECURE's special rule in § 401(a)(9)(H)(iv)(I), separate subtrusts can be treated as separate accounts even if not so separately named in the beneficiary designation form—for the sake of a disabled or chronically ill individual.

SECURE does not grant any such "grace" to other trusts to be divided immediately into separate trusts upon the participant's death, even if following such division one of the separate trusts is solely for the benefit of the participant's surviving spouse, minor child, or less-than-10-years-younger beneficiary. Could the IRS extend that grace by regulation, effectively repealing Reg. § 1.401(a)(9)-4, A-5(c)? Since that regulation was inserted into the final regulations without any notice or hearing, and since it was a 100% reversal of the IRS's prior ruling position, it's about time for that regulation to go. Also note: Apparently, the portion "payable to" the disabled/chronically ill EDB means the portion payable to either a conduit trust or a see-through accumulation trust for the sole life benefit of that EDB (see next paragraph).

Special Break #2: If under the terms of the trust [or subtrust created as provided in the preceding paragraph] "(II) no individual (other than a eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii)) [*i.e.*, a disabled or chronically ill individual] has any right to the employee's interest in the plan until the death of *all such eligible designated beneficiaries* with respect to the trust," then the life expectancy exception "shall apply to the distribution of the employee's interest and any beneficiary who is not such an [EDB] shall be treated as a beneficiary of the [EDB] upon the death of such" EDB. § 401(a)(9)(H)(iv)(II), (v). In other words, an accumulation trust can qualify for the life expectancy payout based on the disabled or chronically ill beneficiary's EDB status, provided no one other than such disabled or chronically ill individual can receive any distributions from the trust until after the death of the disabled or chronically ill beneficiary.

How is this treatment different than for other EDBs? For one thing, this special rule is saying the disabled or chronically ill EDB does not have to be the "sole" beneficiary of the trust—just the sole *life* beneficiary. Thus an accumulation trust for a disabled beneficiary, for example, could get the life expectancy payout treatment, even though (under the regulations) the disabled beneficiary is not considered the sole trust beneficiary.

In the case of the surviving spouse, minor child, or less-than-10-years-younger individual, the trust would get the EDB's life expectancy payout treatment only if it were a conduit trust, since that is the only way the EDB would be considered the sole beneficiary. Unfortunately, by spelling out a rule whereby a separated-at-death subtrust or life-income-only nonconduit trust for a disabled or chronically ill beneficiary can qualify for the life expectancy payout, this provision of SECURE could be read as confirming that no such grace can be granted to subtrusts or nonconduit life trusts for the benefit of other EDBs.

This Special Break, by its reference to "all such" EDBs, clearly contemplates a trust that benefits multiple disabled/chronically ill EDBs within a single trust or subtrust. Strangely, no other section of SECURE mentions the possibility of multiple EDBs within a single trust—see "**What we don't know**," below.

D. Planning for Less-than-10-years-younger Beneficiary

The final category of EDB is "an individual [who is not a surviving spouse, minor child, disabled or chronically ill individual and] who is not more than 10 years younger than the employee." As with other EDBs, the exception permitting a life expectancy payout ends at the death of the EDB; see "What Happens on Death of the EDB?," below.

For a small number of clients, this exception will work perfectly. For example, an individual whose chosen beneficiaries are his/her siblings:

Patty Example: Patty, age 75, wishes to leave her $3 million IRA to her three siblings, all of whom are older than age 65. Each sibling, as an EDB, will be able to withdraw his or her share of the inherited IRA over his or her life expectancy (assuming they divide the inherited IRA into separate accounts by 12/31 of the year after the year of Patty's death). This is exactly what Patty wanted to achieve in her estate plan, and it still works under the new rules. The only difference is, as each sibling dies, his or her inherited IRA will become subject to the 10-year rule. While that is not a welcome modification, the family can deal with it. For example, Sibling #1 might decide to name the surviving siblings as her successor beneficiaries, knowing that they could use and might welcome the additional money, and name a charity as contingent beneficiary, giving the surviving siblings the option to disclaim the IRA to the charity if it turns out they don't need the money.

E. What Happens on Death of the EDB?

As we have seen, EDBs are entitled to an exception from application of the 10-year rule: The EDB is entitled to a life expectancy payout, just like all designated beneficiaries used to get in the old days (though the minor child's right to the exception ends at majority). Upon the EDB's death, however, § 401(a)(9)(H)(iii) provides that "the exception under clause (ii) [granting life expectancy payout to the EDB] shall not apply *to any beneficiary of such eligible designated beneficiary* and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary." Emphasis added.

This means exactly what it appears to mean according to the Committee Report (page 94): "Further, under the proposal, the 10-year rule also applies after the death of an eligible beneficiary or after a child reaches the age of majority. Thus, for example, if a disabled child of an employee (or IRA owner) is an eligible beneficiary of a parent who dies when the child is age 20 and the child dies at age 30, even though 52.1 years remain in measurement period, the disabled child's remaining beneficiary interest must be distributed by the end of the tenth year following the death of the disabled child. If a child is an eligible beneficiary based on having not reached the age of majority before the employee's (or IRA owner's) death, the 10-year rule applies beginning with the earlier of the date of the child's death or the date that the child reaches the age of majority. The child's entire interest must be distributed by the end of the tenth year following that date."

So if (for example) a surviving spouse who is life beneficiary of a conduit trust established by the deceased participant later dies while there is still something left in the retirement plan, the RMD schedule after her death would be as follows:

- The RMD for the year of the spouse's death, calculated based on her life expectancy as usual, must be distributed by year-end if it was not distributed prior to her death.

- All remaining assets must be distributed to the trust by December 31 of the year that contains the 10^{th} anniversary of the spouse's death.

Hopefully, the term "beneficiary of such eligible designated beneficiary" merely means the "successor beneficiary" of the original EDB (whoever or whatever that may be) or (even better) "whoever becomes entitled to ownership of the benefits at that point." The term *sounds* as if it means the beneficiary who was designated by the EDB him or herself to succeed to the benefits after the EDB's death. However, if the EDB's benefits are in a trust, the EDB would never have the option to actually name or designate a beneficiary—the benefits just pass to the remainder beneficiary of the trust. In such a case the EDB never has "a beneficiary" in any normal sense of the term. This is the type of rough edge the IRS will need to sand down with regulations.

F. Practitioners' Wish List; SECURE FAQs

A number of practitioners have voiced disagreement with the above interpretation of the EDB rules, and certain questions come up again and again.

Can conduit treatment convert to accumulation at some point?

Zelda agrees that under the "old" rule, conduit payments to the life beneficiary of a conduit trust had to continue for the entire lifetime of the conduit beneficiary. But, says Zelda, for a (non-EDB) conduit beneficiary post-SECURE the longest payout possible is 10 years...therefore, Zelda thinks, the conduit requirement (all IRA distributions must be paid out forthwith to the conduit beneficiary) should also continue for only 10 years. I cannot see an argument for this. For one thing, that interpretation would permit the trustee to take NO IRA distributions for the entire 10 years...take all money out at the end of that period...and then pay it to someone other than the conduit beneficiary? The conduit concept derives from the Code's iron-clad and still extant rule that the payout period depends on the identity of the beneficiary—i.e. WHO IS ACTUALLY GOING TO GET THE MONEY? The concept that somehow we can ignore who actually gets the money and impose an arbitrary limit on the conduit duration is a nonstarter under existing rules (so would require legislation or a new regulation to implement)....but will be a nonstarter even under SECURE because nobody other than Zelda is looking for ways to separate the payout period from the identity of the actual recipient of the benefits.

The question Zelda raises is the most FA of SECURE's FAQs (Frequently Asked Questions) in my experience: "Can we leave the IRA to a conduit trust for the minor child, that converts to an accumulation trust when the child reaches majority?" Answer: NO! The definition of a conduit trust is that all distributions from the retirement plan to the trust RECEIVED DURING THE LIFE OF THE CONDUIT BENEFICIARY must be distributed forthwith to (or for the benefit of) the conduit beneficiary. A conduit trust that "flips" (or "decants" or "converts") to an accumulation trust when the child attains majority, or at the end of the 10 years, IS NOT A CONDUIT TRUST.

Why can't an accumulation trust qualify?

Larz thinks the regulations should now be loosened up, so that the life expectancy (for EDBs) or 10-year payout (for plain old DBS) would be available for accumulation trusts that would ultimately pass to charity, or that a mere "life beneficiary" should be treated the same under SECURE as a "conduit beneficiary" was treated pre-SECURE (i.e., as the "sole beneficiary" of the retirement benefits). Possibly the IRS will take that approach through new regulations now that the stakes are not so high—*e.g.*, permitting the 10-year rule for some trusts that would not have qualified for a life expectancy payout under the old rules. On the other hand the IRS may take the view that, since Congress has most bluntly and forcefully expressed its dislike of long post-death payout periods for retirement benefits, this is not the time for it to jump in and loosen the rules to resurrect the longer payout periods SECURE has killed. We shall have to wait and see.

G. Don't Confuse the Payout Rule with the Trust Terms

There is a tendency to confuse the retirement plan-payout rule applicable to a trust with the terms of the trust itself. Whatever payout rule applies to the trust (10-year rule, 5-year rule, etc.) does not change the terms of the trust....it just dictates when the trustee must withdraw all the money from the retirement plan, not what the trustee can/must do with that distribution once received (except in the case of a conduit trust that requires all plan distributions to be forthwith transmitted to the conduit beneficiary).

Edie Example: Edie leaves her IRA to a see-through accumulation trust for the life benefit of her son Ian. The trustee is to use all income and principal as the trustee deems advisable for Ian's benefit. Upon Ian's death the trust is to terminate and be distributed outright to Ian's four children. Edie dies in 2020. The trustee must withdraw all of the IRA money no later than December 31, 2030. But that doesn't mean the trust will suddenly terminate in 2030. The trustee will continue to hold the after-tax proceeds of the IRA distribution for Ian's benefit on the same trust terms as before, until Ian's death.

PART V: THE MINIMUM DISTRIBUTION "TRUST RULES" IN A NUTSHELL

This Part summarizes how a trust named as beneficiary of a retirement plan can qualify for "designated beneficiary" (DB) or even "eligible designated beneficiary" (EDB) treatment under the post-death minimum distribution rules of § 401(a)(9). This summary condenses long sections of Chapters 1 and 6 of the author's book *Life and Death Planning for Retirement Benefits* (Ataxplan Publications; 2018) to which the reader should refer for more in-depth explanation.

Introduction/overview

§ 401(a)(9) of the Code dictates how rapidly retirement benefits must be distributed ("pursuant to regulations") following the death of the participant (the "employee" in a qualified employer retirement plan, or the owner of an IRA). It prescribes one set of rules for the beneficiary of a participant who died before his "required beginning date" (RBD; the date for commencing lifetime required minimum distributions or RMDs) and different rules for the beneficiary of a participant who dies after that date...and in each of those cases, one set of rules for a "designated beneficiary" (DB) and different rules for a beneficiary who, even though he, she, or it lawfully inherited the retirement benefits, does not qualify as a *designated* beneficiary... a Non-DB.

Generally the rules for a DB are more favorable (allow longer tax deferral) (although as explained elsewhere in this Outline under certain circumstances the Non-DB rules can be more favorable in a particular case). For that reason, assuring "designated beneficiary status" for the beneficiaries of the client's retirement plan is usually the desired goal in planning for such benefits.

Generally the definition of a DB is an individual named as beneficiary by the participant or by the plan document. § 401(a)(9)(E); Reg. § 1.401(a)(9)-4, A-1, A-2.

The participant's "estate" can never be a DB. Reg. § 1.401(a)(9)-4, A-3; § 1.401(a)(9)-8, A-11; PLR 2001-26041. So if the participant names his estate as beneficiary of his retirement plan, or if he does not successfully name any beneficiary and (under the plan document) the benefits pass to his estate by default, there is no DB and there is no way to fix that and achieve DB status.

If the plan beneficiary is a trust, a trust (like an estate) is obviously not "an individual." However, the Treasury issued regulations under which the individual trust beneficiary(ies) will be treated as the designated beneficiaries if the trust passes the following five tests:

1. The trust must be valid under state law.

2. "The trust is irrevocable or will, by its terms, become irrevocable upon the death of the" participant.

3. "The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit" must be "identifiable...from the trust instrument." This means that it must be possible to identify the (countable; see below) trust beneficiary with the shortest life expectancy, i.e., the oldest trust beneficiary.

4. Certain documentation must be provided to the plan administrator.

5. All (countable; see below) trust beneficiaries must be individuals.

A trust that meets these tests is nicknamed a "look-through" or "see-through" trust because under the regulations we "look through" the trust and treat the trust beneficiaries as the designated beneficiaries of the inherited retirement plan. These are not official terms.

Which trust beneficiaries "count" for purposes of these tests?

The hard part of testing a trust under the RMD trust rules is determining whether all trust beneficiaries are individuals (Rule 5), and which trust beneficiary is the oldest (Rule 3). The difficulty is in determining which trust beneficiaries "count" for purposes of these two rules, and which beneficiaries may be disregarded. Obviously the life beneficiary is a countable beneficiary. Which if any remainder beneficiary(ies) are disregarded in applying the tests of whether all beneficiaries are individuals and who is the oldest one? *Note: Many questions and special cases are not covered in this summary; this summary discusses only the simplest situations.*

Reg. § 1.401(a)(9)-5, A-7(c), the "**mere potential successor rule**," tells us which beneficiaries are disregarded in applying the trust rules. Reg. § 1.401(a)(9)-4, A-5(c):

"(c). Successor beneficiary–(1) A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy...or whether a person who is not an individual is a beneficiary, *merely because the person could become the successor* to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a *mere potential successor* to the interest of one of the employee's beneficiaries upon that beneficiary's death." Emphasis added.

How does the "mere potential successor" rule apply to a trust? For purposes of testing trust beneficiaries for "mere potential successor" status, the world can be divided into two types of trusts: "**conduit trusts**" and "**accumulation trusts**." This division is based on Reg. § 1.401(a)(9)-5, A-7(c)(3), Examples 1 and 2, and the IRS's rulings interpreting and applying that regulation (although the regulation does not use the terms conduit trust and accumulation trust).

Conduit trust: Guaranteed safe harbor; conduit beneficiary is deemed sole beneficiary

Under a conduit trust, all amounts distributed from the retirement plan to the trust during the lifetime of the conduit beneficiary must be distributed, forthwith, to or for the benefit of the conduit beneficiary. As the regulation describes it, "*all amounts* distributed from A's account in Plan X to the trustee while B is alive will be paid *directly* to B upon receipt by the trustee of Trust P… *No amounts* distributed from A's account in Plan X to Trust P are accumulated in Trust P during B's lifetime for the benefit of any other beneficiary." Emphasis added.

With a conduit trust for one individual, the retirement benefits are deemed paid "to" that individual for purposes of the minimum distribution rules, and accordingly the "all beneficiaries must be individuals" test is met. As the IRS explains in Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2, under a trust with these terms, "…B [the conduit beneficiary] is the sole designated beneficiary of A's account in Plan X for purposes of determining the designated beneficiary under section 401(a)(9)(B)(iii) and (iv)….Therefore, the residuary beneficiaries of Trust P are mere potential successors to B's interest in Plan X."

A conduit trust for the benefit of an EDB will be entitled to the life expectancy payout because the conduit beneficiary/EDB is deemed to be the sole beneficiary of the trust and of the retirement plan. That is the "holding" of Example 2 of the regulation, even though the regulation was pre-SECURE: In that regulation example, with a conduit trust for the surviving spouse, the trust was entitled to the "special minimum distribution deals" of the surviving spouse (namely recalculation of life expectancy and delayed required commencement date) because she was deemed to be the sole beneficiary of the trust and of the plan payable to that trust.

All potential remainder beneficiaries (the persons who would take the remaining benefits if the conduit beneficiary died before the benefits had been entirely distributed) are disregarded because the IRS regards them as mere potential successors to the conduit beneficiary's interest.

The conduit trust for one individual beneficiary is a safe harbor. It is guaranteed to qualify as a see-through trust, and it is guaranteed that all remainder beneficiaries (even if they are charities, an estate, older individuals, or non-DBs/EDBs) are disregarded under the RMD trust rules.

Accumulation trust: May or may not qualify as a see-through trust

Any trust that is not a conduit trust is called in this Outline an **accumulation trust**, meaning that the trustee has the power to accumulate plan distributions in the trust during the life of the life beneficiary. Under an accumulation trust some or all of the potential remainder beneficiaries *do* "count" (i.e., they are not disregarded) for purposes of the RMD trust rules. This is in sharp contrast to a "conduit" trust, under which all beneficiaries other than the conduit/life beneficiary are disregarded as mere potential successors.

From Reg. § 1.401(a)(9)-5, A-7(c)(1): "Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), *both beneficiaries must be taken into account* in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries." Emphasis added.

Since both the life and remainder beneficiaries must be counted, the accumulation trust will qualify as a see-through trust only if no countable remainder beneficiary is not an individual and it is possible to identify the oldest remainder beneficiary.

How far "down the chain" of beneficiaries do you have to keep counting? Which remainder beneficiaries can be ignored as "mere potential successors?" The boundaries of that question have not been determined. IF you can find an individual who will inherit the trust immediately and outright upon the death of the prior beneficiary you can stop counting; you have a see-through trust and you can ignore potential beneficiaries who come after that individual as "mere potential successors."

For example, if the trust says "income to A for life, remainder to B on A's death," and both A and B survive the participant, then you count A (the life beneficiary) and B (first remainder beneficiary) and ignore what might happen if B doesn't actually survive A. In more complex cases more detailed analysis must be applied and the rule is not clear in every situation.

APPENDIX A
WHAT THE IRS MUST, PROBABLY SHOULD, AND MIGHT DO ABOUT SECURE

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EXECUTIVE SUMMARY

SECURE's radical changes to the post-death minimum distribution rules (replacing the "life expectancy payout" with a "10–year rule" for most beneficiaries) require response from the Treasury in the form of regulations or other guidance clarifying, filling the gaps, and fixing the glitches in the newly amended portions of Code section 401(a)(9).

DETAILED ANALYSIS

I. BACKGROUND

SECURE was enacted in December 2019 effective primarily with respect to deaths after 2019. SECURE's radical changes to the post-death minimum distribution rules (replacing the "life expectancy payout" with a "10–year rule" for most beneficiaries) require response from the Treasury in the form of regulations or other guidance clarifying, filling the gaps, and fixing the glitches in the newly amended portions of Code section 401(a)(9). For some provisions, Congress assumed existing approaches would apply (for example, that the new 10-year rule will work the same as the old 5-year rule), or invited the Treasury to create a new rule (for example, defining "reaches majority"). But for some situations the Treasury will have to simply invent a new rule and hope it catches Congress's intent correctly—for example the treatment of multiple designated beneficiaries all of whom are EDBs and the treatment of an "annuitized" IRA. Finally, the tectonic shift created by SECURE suggests that some provisions of the IRS's "minimum distribution trust rules" could be revisited at this time.

II. THINGS CONGRESS ASSUMED TREASURY WOULD, OR DIRECTED TREASURY TO, TAKE CARE OF

With respect to certain details of SECURE, Congress (apparently) either intended that the IRS would confirm a treatment assumed by the new law or explicitly delegated definition to the IRS.

A. Confirm 10-year rule works the same as the 5-year rule

What we call the "5-year rule" is stated as follows in the Code and has been so stated since the section was enacted:

> "(ii) 5-year rule for other cases. A [retirement plan]...shall not constitute a qualified [retirement plan]... under this section unless [it]...provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii) [i.e., before his "required beginning date" (RBD)], the entire interest of the employee will be distributed within 5 years after the death of such employee." § 401(a)(9)(B)(ii).

Though this literally would mean "will be distributed by the fifth anniversary of the employee's date of death," Treasury regulations interpreted this as "by the end of the year that contains the fifth anniversary of the date of death." Reg. § 1.401(a)(9)-3, A-2. This interpretation was quoted without comment by Congress in the Committee Report, indicating Congressional adoption of the Treasury interpretation. SECURE built on the "5-year rule" by adding, in new § 401(a)(9)(H), the new general "10-year rule" for designated beneficiaries: "...In the case of a defined contribution plan, if an employee dies before the distribution of the employee's entire interest—In general. Except in the case of a beneficiary who is not a designated beneficiary, subparagraph (B)(ii)—shall be applied by substituting '10 years' for '5 years'..."

Thus, the statute now presumably means that the general payout rule for a designated beneficiary is that all benefits must be distributed by the "end of the year that contains the 10th anniversary of the date of death," not literally by the 10th anniversary of the date of death. Treasury needs to confirm this in regulations.

B. Define "not more than 10 years younger"

Unlike mere "designated beneficiaries" (DBs), who are now subject to the new 10-year rule, "eligible designated beneficiaries" (EDBs; a new status created by SECURE) are still entitled to a (modified version of the) life expectancy payout. SECURE created five categories of eligible designated beneficiaries, one of which is "an individual [who is not a surviving spouse, minor child, disabled or chronically ill individual and]...who is not more than 10 years younger than the employee." § 401(a)(9)(E)(ii)(V). Read literally, this category would exclude any beneficiary born more than 10 years before the deceased participant's date of birth. The Treasury needs to clarify whether this literal reading will apply or whether the age difference will be determined simply by reference to the parties' birth years, as is done already with the lifetime distribution rule applicable to a participant whose spouse is more than 10 years younger than the participant. See Reg. § 1.401(a)(9)-5, A-4(b)(1) which uses "the employee's and spouse's attained ages as of the employee's and the spouse's birthdays in the distribution calendar year" rather than actual birth dates to determine "more than 10 years younger" status.

C. Define "reaches majority"

Another category of EDB is "(II) Subject to clause (iii), a child of the employee who has not reached majority (within the meaning of subparagraph (F))." § 401(a)(9)(E)(ii)(II).

Unlike other EDBs, this beneficiary can lose his or her EDB status during life: "(iii) Special rule for children. Subject to subparagraph (F), an individual described in clause (ii)(II) shall cease to be an eligible designated beneficiary as of the date the individual reaches majority and any remainder of the portion of the individual's interest to which subparagraph (H)(ii) applies shall be distributed within 10 years after such date." § 401(a)(9)(E)(iii).

Obviously, the definition of what constitutes reaching majority is extremely important in applying this EDB rule. But the cross-referenced "subparagraph (F)" (here quoted in full) adds no enlightenment in this regard. "(F) Treatment of payments to children. Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations)." Huh???

Presumably the cross reference to (F) merely indicates that the Treasury is to define "reaching majority." To date the IRS's only pronouncement under (F), contained in the minimum distribution regulation (issued in 2004) applicable to defined benefit plans, permits (but does not require) a plan administrator to deem a child still a minor (a) for the duration of such child's disability, if the child is disabled at the time of reaching the age of majority or (b) until completion of a specified course of education (though not later than age 26 in this case). Reg. § 1.401(a)(9)-6, A-15. "Specified course of education" has never been defined in any source the author has located. In any case, this existing regulation which *permits* the plan administrator to recognize a delayed "reaching majority" date for a particular narrow purpose, is not appropriate for computing *required* minimum distributions.

For minimum distribution purposes, a particular status or age must either constitute reaching majority (with concurrent loss of EDB status) or not. "Reaching majority" for this vital purpose cannot be up to the election of each individual plan administrator or IRA provider.

Hopefully the Treasury will adopt a bright line universal standard based on age, such as "age 26," which is not dependant on the laws of the 50 different states or on subjective criteria such as educational status, along with continuing its wise extension of "minority" status in the case of a minor who is disabled at the time of reaching the applicable age. Plan administrators and IRA providers must compute and pay RMDs and their job becomes impossible if the RMD payable to a particular beneficiary must constantly be reevaluated to determine what state the child is living in at the moment, what that state's age of majority is this year, and/or whether the child is still enrolled in a school that meets some vague requirement as a specified course of education.

If "reaches majority" varies by state or depends on subjective shifting criteria such as "completion of a course of education" it is not workable as a minimum distribution rule. Plan administrators will simply enforce an "age 18 for everybody" rule, causing parents and guardians to have to shop for an IRA provider willing to adopt more nuanced interpretations of reaching majority.

Based on the current minimum distribution trust rules, the only type of trust that would qualify to use a minor child's EDB status would be a conduit trust for such minor. See Reg. § 1.401(a)(9)-5, A-7(c)(3), Examples 1 and 2. Since a conduit trust must pay out to the conduit beneficiary all distributions the trust receives from the IRA, if minority status ends at age 18 and the trust then flips to the 10-year rule, the conduit trust must withdraw all the IRA benefits and distribute them outright to the former minor no later than age 28. That age is younger than most parents tend to pick for turning over outright control to their children.

If the IRS picks an age which is a bit later than the usual 18-or-21 state-law age-of-majority, such as 26 (which has been used in the one regulation issued under the cross-referenced subparagraph (F), possibly suggesting Congressional approval of that age), it becomes much more likely that parents of young children will accept it as an age for the "10 year rule" to kick in: It would allow parents to retain control of the funds (via a conduit trust) until the child's age 36 which may be more palatable than age 28 or 31 (10 years after the usual state law majority ages), minimize headaches for plan administrators, and avoid plan-administrator-shopping based on age of majority policy.

III. SECURE'S GAPS TREASURY NEEDS TO CLOSE

There are places where SECURE was unclear, or may have made a mistake, or simply didn't go far enough in defining what was intended. Treasury needs to fill these gaps and fix these glitches.

A. Clarify meaning of beneficiary's beneficiary

Under SECURE, when an EDB dies, the life expectancy payout to which such EDB was entitled ends and the payout period "flips" to the 10-year rule. Specifically, § 401(a)(9)(H)(iii) provides that "the exception under clause (ii) [granting life expectancy payout to the EDB] shall not apply *to any beneficiary of such eligible designated beneficiary* and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary." Emphasis added.

Hopefully, the term "beneficiary of such eligible designated beneficiary" merely means the "successor beneficiary" of the original EDB (whoever or whatever that may be) or (even better) "whoever becomes entitled to ownership of the benefits at that point." The term *sounds* as if it means the beneficiary who was designated by the EDB him or herself to succeed to the benefits after the EDB's death. However, if the EDB's benefits are in a trust, the EDB would never have the option to actually name or designate a beneficiary—the benefits just pass to the remainder beneficiary of the trust. In such a case the EDB never has "a beneficiary" in any normal sense of the term. This is the type of rough edge the IRS will need to sand down with regulations.

B. Specify treatment of a trust all of whose beneficiaries are EDBs

If a parent leaves his IRA to a conduit trust for the sole benefit of his minor son, we know the son's life expectancy is the ADP until he reaches majority. Under a conduit trust, the conduit beneficiary is considered the sole beneficiary of the trust and of the retirement plan payable to such trust, and accordingly EDB status applies. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2.

What if the trust is a conduit trust for the benefit of the deceased parent's two or three children, all of whom are minors? The trust presumably qualifies for the life expectancy payout—but until when? Until all of the children attain majority? Until the oldest one does?

What about an accumulation trust all countable beneficiaries of which are EDBs? For example, a trust that provides life income to the decedent's surviving spouse, with remainder outright to the decedent's siblings all of who are not more than 10 years younger than the participant? The trust for the spouse is not a conduit trust for her, so she is not considered the "sole beneficiary" of the trust...ok, that's true...but the other "countable beneficiaries" are *also* EDBs. Since every countable beneficiary is an EDB, shouldn't this trust be entitled to the life expectancy payout?

Pre-SECURE regulations are no help on this because there was no situation prior to SECURE where more than one beneficiary could qualify for a special minimum distribution treatment. The only analogous situation was the special minimum distribution rules for the surviving spouse, but since there could be only one surviving spouse the pre-SECURE regulations did not need to cover the situation of multiple "special" designated beneficiaries. See Reg. § 1.401(a)(9)-5, A-7(c)(3).

C. Fix the "whose life expectancy?"glitch for AMBT

SECURE allows an Applicable Multi-Beneficiary Trust (AMBT) to use the life expectancy payout if the sole life beneficiary of the trust is a disabled or chronically ill (D/CI) beneficiary. § 401(a)(9)(H)(iv). The problem: As written by SECURE, this clause does not say WHOSE life expectancy is the ADP for such an AMBT. Presumably Congress intended that the life expectancy of the D/CI sole-life-beneficiary of the AMBT would be the ADP, but the Code as amended by SECURE doesn't actually say that. All the Code now says is that "subparagraph (B)(iii)" (the life expectancy of the designated beneficiary payout method) shall apply to such trust, and the other beneficiaries of the trust shall be considered beneficiaries of the D/CI beneficiary.

This is apparently intended to mean that the D/CI beneficiary's life expectancy is the ADP for the trust. However, under existing regulations, the ADP for a nonconduit see-through trust is the life expectancy of the *oldest countable trust beneficiary*. Reg. § 1.409(a)(9)-4, A-5(c); § 1.401(a)(9)-5, A-7. The D/CI sole life beneficiary of the AMBT may or may not be the oldest countable trust beneficiary. Thus drafters are stymied until regulations correct this ambiguity—restricted, out of caution, to naming only remainder beneficiaries who are close in age to or younger than the D/CI life beneficiary of the AMBT.

D. Clarify application of SECURE to trusts created by pre-2020 decedent

Another gap or mistake in SECURE has to do with the treatment of successor beneficiaries of decedents who died prior to 2020.

Though generally, SECURE's amendments to the post-death minimum distribution rules apply only to beneficiaries of post-2019 decedents, the following language in Section 403(b) of the Act (part of SECURE's effective date provisions) makes a grab for benefits of pre-2020 decedents also:

"(A) If an employee dies before the effective date [*i.e.*, before 2020] then, in applying the amendments made by this section to *such employee's designated beneficiary* who dies after such date—

> (i) such amendments shall apply to *any beneficiary of such designated beneficiary*; and
> (ii) the designated beneficiary [*i.e.*, the dying-post-2019 designated beneficiary of the died-before-2020 participant] shall be treated as an eligible designated beneficiary for purposes of applying section 401(a)(9)(H)(ii) of the Internal Revenue Code of 1986 (as in effect after such amendments)."

The referenced section of 401(a)(9)(H) provides that, upon the death of an Eligible Designated Beneficiary who was enjoying the life expectancy payout, the 10-year rule kicks in.

This rule for beneficiaries of pre-2020 decedents is not clear. One interpretation is that, where the decedent died prior to 2020 leaving benefits to a single designated beneficiary, who then died after 2019, the 10-year-rule kicks in just as if (under the post-2020-deaths rules) such original designated beneficiary had been an EDB. However, subparagraph (i) seems to suggest the opposite, namely, that when the original designated beneficiary dies post-2020, we will start looking at HIS (or her) beneficiary to see if such (successor) beneficiary is a designated beneficiary, EDB, or non-designated beneficiary, then we'll apply the appropriate "new rule" distribution period based on the result of that examination. However, it seems unlikely that interpretation was intended.

Under the other possible (and more likely) interpretation, we treat the death of the designated beneficiary of a pre-2020 decedent the same as the death of an EDB of a post-2019 decedent, and apply the 10-year rule based on the year of such beneficiary's death. This interpretation works clearly if a pre-2020 decedent left his/her retirement benefits to one designated beneficiary who then died after 2019:

Single Designated Beneficiary Example (Outright): Gloria died in 2012, leaving her IRA to her son Alfred as sole designated beneficiary. Since then, Alfred has been taking annual minimum required distributions from the inherited IRA computed based on his 34.2-year life expectancy. Alfred names his son Carl as successor beneficiary to the account in case Alfred dies in less than 34.2 years. Alfred dies in 2020, when there are still over 20 years left in his original "life expectancy" Applicable Distribution Period. [Note: new IRS life expectancy tables are effective beginning in 2022, which will extend all "life expectancies" somewhat.] Under the old rules, grandson Carl would simply step into the shoes of the deceased designated beneficiary Alfred and take distributions over the remaining 26 or so years of Alfred's life expectancy. Thanks to SECURE, grandson Carl is subject, instead, to the 10-year rule. He will have to withdraw the entire remaining balance of this inherited IRA by December 31, 2030.

But: Suppose Gloria's son Alfred, having survived Gloria, then ALSO died prior to 2020. Alfred was unquestionably the "sole designated beneficiary" of Gloria. On his death in, say, 2018, his interest passed to grandson Carl, who continued taking the RMDs Alfred would have been required to take had Alfred not died prior to the end of his life expectancy. SECURE's pre-2020-deaths rule apparently does not apply and can never apply to this inherited IRA since BOTH the participant AND her designated beneficiary died prior to the 2020 effective date. Presumably Treasury regulations will confirm this interpretation.

Now suppose the pre-2020 decedent left his benefits to multiple designated beneficiaries or to a see-through accumulation trust. With an accumulation trust, all beneficiaries of the trust are "countable" (except beneficiaries who are "mere potential successors" of other beneficiaries) and all such countable beneficiaries must be individuals for the trust to qualify as a see-through trust. The life expectancy of the oldest such countable beneficiary then becomes the Applicable Distribution Period for the trust. See ¶ 6.3.07 of *Life and Death Planning for Retirement Benefits* (8th ed. 2019).

So under such a trust, who is the participant's "designated beneficiary" upon whose death SECURE requires that the life expectancy payout ends and is replaced with the 10-year rule? Are all countable beneficiaries considered "designated beneficiaries" of the pre-2020-decedent? Or is only the oldest beneficiary, whose life expectancy dictated the ADP, considered "the" designated beneficiary of that pre-2020 decedent? Or is there to be some new subset category such as "principal" designated beneficiary?

If the legislation is to be interpreted strictly in favor of the taxpayers whose estate plans SECURE sought to upend, the 10-year rule will not apply to the accumulation trust of a pre-2020 decedent until *all* of the trust's countable beneficiaries have died.

[Some commenters consider this unworkable since, under an accumulation trust, new beneficiaries (such as later-born issue) can be added after the participant's death, creating a potentially infinite number of "designated beneficiaries" who would have to die to trigger the new SECURE rule. I do not support that objection. A participant's designated beneficiaries do not include individuals not in being at the time of his death. Their potential existence does not impair DB status for those living at the participant's death but the regulations are clear that beneficiaries not in existence at the participant's death are not countable beneficiaries. For example, if the trust says "pay income to my daughter for life and on her death pay the principal to her then living issue or if none exist to my son," if at the time of the participant's death the daughter has no issue, you cannot assume that she will have issue and count these assumed future issue as designated beneficiaries.]

Another interpretation would be that the life expectancy payout will end at the death of the oldest trust beneficiary, the individual whose life expectancy is the ADP. I do not support this interpretation for the following reason.

It is clear under the regulations that a participant can have multiple designated beneficiaries. See, *e.g.,* Reg. § 1.401(a)(9)-5, A-4 (meaning of spouse is "sole designated beneficiary"), and A-7(a): "General rule. (1) Except as otherwise provided in paragraph (c) of this A-7, *if more than one individual is designated as a beneficiary* with respect to an employee as of the applicable date for determining the designated beneficiary under A-4 of §1.401(a)(9)-4, *the designated beneficiary with the shortest life expectancy* will be the designated beneficiary for purposes of determining the applicable distribution period." Emphasis added.

From that language it is clear: There can be multiple designated beneficiaries. The oldest one of them will be considered "the" designated beneficiary *for one specific purpose*—determining which life expectancy will be the ADP. But all of them are the participant's "designated beneficiaries."

Unfortunately that distinction is sometimes elided in various writings including private letter rulings, so that instead of saying "All of these individual countable trust beneficiaries are the decedent's designated beneficiaries, and the oldest one is 'the' designated beneficiary for purposes of determining the ADP, i.e., his or her life expectancy will be the ADP," the writer will say "X is the oldest beneficiary so X is the designated beneficiary," as if the definition of designated beneficiary meant ONLY the oldest beneficiary.

The Treasury must promulgate a workable way to apply SECURE's pre-2020-deaths rule to accumulation trusts. In this author's opinion, if the trust qualifies as a see-through, all the countable individuals are regarded as designated beneficiaries of the deceased participant: From Reg. § 1.401(a)(9)-5, A-7(c)(1): "Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), *both beneficiaries must be taken into account* in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries." Emphasis added.

PLR 2008-43042 perfectly illustrates the dilemma of trying to apply SECURE's pre-2020-deaths rule to a typical see-through trust. In this PLR, the decedent's IRA was left to an accumulation trust for the benefit of his child, C, with the trustee directed to pay the income to C, plus principal if needed for health, education, maintenance and support. The trust would terminate and be distributed outright to C in stages at various ages, with the final distribution to occur when C attained age 40. If C died before that age, the trust would terminate and be distributed outright to C's mother, B. The IRS ruled that the trust qualified as a "see-through trust" and that "Individuals B and C are the only individuals who need to be considered for purposes of determining who is the designated beneficiary of IRA X." Since B was the older, her life expectancy was the ADP for the IRA.

In the above PLR 2008-43042 situation, upon whose death does the 10-year rule kick in? There are three possibilities:

Mother's death? Mother B's life expectancy is the ADP—if she dies must the IRA be totally distributed within 10 years after her death, even if C is only two years old when she dies? Clearly that would make no sense. Mother was not only not the "primary" beneficiary of the trust, she was actuarially extremely unlikely to ever receive a dollar from the decedent's IRA...she would have been entitled to benefits only if her child died before age 40. Note: This difficulty arises directly from the IRS's strict past regulatory approach of considering remainder beneficiaries of an accumulation trust as countable designated beneficiaries regardless of how minimal the actuarial value of their interest.

Child's death? Does the 10-year rule kick in if child C dies before age 40? That would seem to make sense since the trust is clearly for his primary (and most likely sole) benefit....*but there is no category or definition under present law by which C's death would have any significance for purposes of the minimum distribution rules*. He is just one of multiple countable trust beneficiaries as far as the minimum distribution rules are concerned, with no special status at all. Thus, though it would make the most sense to treat C's death as the trigger for the 10-year rule to apply, this simply cannot be done without new legislation or regulations.

Deaths of both beneficiaries? In my opinion, the 10-year rule should not apply to this IRA until BOTH B and C are deceased. Both of them are the deceased participant's designated beneficiaries under the definition in Reg. § 1.401(a)(9)-5, A-7(c)(1). Since the statute is unclear (it applies when "such employee's designated beneficiary" dies after 2019, without specifying what happens if such employee's benefits were left to multiple designated beneficiaries), it should be interpreted most favorably to the taxpayer.

E. Create structure for certification of beneficiary's D/CI status

As noted, "disabled" and "chronically ill" designated beneficiaries are EDBs under SECURE. § 401(a)(9)(E)(ii)(III), (IV). Both conditions are defined by reference to other Code sections—"disabled" by reference to § 72(m)(7) and "chronically ill" by reference to § 7702(B)(c)(2). § 72(m) determines disability based on inability to work due to physical or mental impairment that is likely to last indefinitely or result in death; this section has long been used as the standard for disability benefits in connection with retirement plans. The "chronically ill" Code definition is related to the inability to perform certain functions of daily living, and therefore requiring assistance or supervision in daily living, and is used in connection with categorizing "qualified long term care insurance" as health insurance.

For both of these conditions, the law requires some external certification or proof that the individual meets the requirements in order to be considered an EDB:

- § 72(m)'s definition of disability includes this statement: "An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof [stet] in such form and manner as the Secretary may require."

- To be entitled to "chronically ill" status, SECURE states that "...the requirements of subparagraph (A)(I) [of § 7702B(c)(2)] shall only be treated as met if there is a certification that as of such date, the period of inability described in such subparagraph with respect to the individual is an indefinite one which is reasonably expected to be lengthy in nature." § 401(a)(9)(E)((ii)(IV).

The Treasury will need to establish exactly what these certifications must provide, what categories of professionals can provide them, and to whom they must be provided and when. For an excellent discussion of these issues, see the article by Nancy H. Welber, Esq., of Bloomfield Hills, Michigan, who practices extensively in both estate planning for retirement benefits and estate planning for the disabled and chronically ill and their families, "Security for Disabled and Chronically Ill Beneficiaries," *Trusts & Estates* magazine, April 2020, p. 40 (www.trustsandestates.com).

F. Beneficiary double-qualifies as EDB

SECURE doesn't deal with this point except in the case of a not-more-than-10-years-younger designated beneficiary (a person can be an EDB under that category only if he/she is not the surviving spouse, minor child, or disabled/chronically ill). What if a beneficiary qualifies as an EDB under two categories? This could happen if the participant's minor child or surviving spouse is disabled, or if a disabled beneficiary is also chronically ill. For the minor child, D/CI status creates a lifelong life expectancy payout that does not end upon reaching majority, so D/CI status is automatically better. For the a client who is planning to leave benefits to a disabled spouse, D/CI status would permit a standard "QTIP" income-only trust to qualify for the life expectancy payout whereas surviving spouse status gets a life expectancy payout only if there is a conduit trust. But surviving spouse status allows recalculation of the surviving spouse's life expectancy whereas D/CI status as such does not. Can spouse get both of those benefits? The IRS needs to resolve these questions.

IV. PLACES WHERE SECURE DEPARTS FROM THE EXISTING REGULATIONS AND TREASURY MUST GET REGS BACK IN SYNC

Overall, the Committee Report makes it clear that Congress wanted to accept, preserve, and commend the existing minimum distribution scheme created by the Treasury in its 2002 final regulations, except to the extent SECURE specifically overrode those regulations. And clearly SECURE overrode the old regulations' generous allowance of the life expectancy payout method to all designated beneficiaries regardless of the decedent's age and continuing even after the death of the original designated beneficiary. But when it replaced that general "life expectancy of the designated beneficiary rule" with the 10-year rule SECURE inevitably stomped on some of the existing regulations that only worked in the context of a life expectancy payout for all designated beneficiaries.

Here are pre-SECURE regulations that need to be scrapped or repaired or fixed up somehow to accommodate the SECURE changes:

A. Fix: When non-DB gets a better deal than DB—or EDB!

SECURE preserves the special status of the "designated beneficiary" (DB)—an individual (or see-through trust) named as beneficiary by the participant (or under the terms of the plan)—though this supposedly exalted status now entitles the DB only to the 10-year rule not the life expectancy payout, unless the DB is also an EDB. And SECURE grants special elevated status to the EDB—the life expectancy payout still applies! But what if....there are situations where a DB would rather have non-DB treatment, or an exalted EDB wishes she could get the same treatment as a humble DB?

DB would prefer non-DB treatment

If the participant dies after his Required Beginning Date (RBD; ¶ 1.4.01), leaving his IRA to a DB who is not an EDB, under the literal words of the post-SECURE Code the 10-year rule applies. However, if the participant died between (roughly) ages 72 and 80 the payout period that would be applicable to a non-DB (i.e., what would have been the participant's remaining life expectancy) will be longer than 10 years. See the "Single Life Table" in Reg. 1.401(a)(9)-9, as in effect for 2022 and later years [Appendix B in this Outline]. In other words the non-DB would get a longer payout period than the DB.

The same would happen if the participant died after his RBD leaving the IRA to an EDB who was older than the participant—the beneficiary's life expectancy would be a shorter payout than the remaining life expectancy of the participant.

The same situation could arise under pre-SECURE law: If a participant died before SECURE and after his RBD leaving his IRA to a DB who was older than the participant, the ADP for the DB (DB's life expectancy) would be shorter than the ADP that would have applied to a non-DB (the participant's remaining life expectancy). The IRS cured this anomaly prior to SECURE by adopting the "longer of" rule: The ADP in that situation would be the "longer of" the participant's life expectancy or the DB's life expectancy. *For an EDB who is older than the deceased participant who died after his RBD, the "longer of" rule of Reg. § 1.401(a)(9)-5, A-5(a)(1) still works and should still apply.*

For a DB who is not an EDB, however, the application of the "longer of" rule does not quite work, because it is not a matter merely of comparing which is the longer payout period. A life expectancy payout, requiring annual distributions, is not precisely comparable to a 10-year payout period where all distributions can be deferred until the 10^{th} year. For example, for an inherited Roth IRA, the DB would probably be better off financially by taking no distributions until the end of the 10^{th} year than taking annual RMDs over a "longer life expectancy" such as 14 years (life expectancy of 76-year-old decedent), because the 10-year rule permits more tax-free accumulations in the account.

Thus, presumably, the IRS would use the same approach it used pre-SECURE for the 5-year rule applicable to participants who die before their RBD: The designated beneficiary of a pre-2020 decedent who died before his RBD could elect to use either the life expectancy payout or the 5-year rule (if such election was permitted by the plan), no later than the end of the year after the year of the participant's death. Reg. § 1.401(a)(9)-3, A-4. Hopefully, regulations will permit the DB of a post-2019 decedent who dies after his RBD to elect to use the payout period applicable to a non-DB; otherwise we will have the anomalous result of non-DBs being "better off" than DBs in some cases.

EDB would prefer DB treatment

Thorfinn, age 92, leaves his $1 million IRA to a conduit trust for his surviving spouse Ingibiorg, also age 92. As a conduit trust, this trust qualifies to use Ingibiorg's special EDB status and therefore the Applicable Distribution Period is, annual instalments over Ingibiorg's life expectancy of 4.9 years [post-2021 tables; see Appendix B]. Can the trust elect, instead, to use the 10-year rule? Ingibiorg would prefer that, even though it might result in a shorter overall distribution period. If the ADP is Ingibiorg's life expectancy, annual payouts will continue for her actual life, flipping to the 10-year payout upon her death. Thus if she lives longer than two years the actual payout period would be about 12 years. But she does not expect to live 10 more years and thus since she doesn't need the income and would like to push the income taxes over to the next beneficiary in line, she would prefer to have the trust use the 10-year rule. If the trust can elect that, fine—but as of now such an election option is not provided for in the statute or any regulation.

B. Does the exemption for DB plans apply to annuitized IRAs?

SECURE's elimination of the life expectancy payout, and its replacement with the 10-year rule, for all designated beneficiaries other than "eligible designated beneficiaries," states that it applies only "in the case of a defined contribution plan." § 401(a)(9)(H). What does that mean for retirement plans that are not defined contribution plans?

The Code makes a strict distinction between "defined benefit plans" (which promise the employee a certain pension based on the employee's compensation and years of service, but the employee does not have an "account" in the plan) and "defined contribution plans" (where the employee has an "account" in the plan to which the employer makes certain discretionary or mandatory contributions, and the employee will receive on retirement the value of his account including its earnings, but with no promise that it will have a guaranteed value or provide a specific income). The Code makes this distinction for purposes of setting the levels of permitted or required contributions to the plan and/or promised pensions from the plan (see § 415) and other rules that flow from these two different approaches to providing retirement benefits.

But until SECURE came along the Code did *not* provide different "minimum distribution rules" for these two types of plans. Prior to SECURE, § 401(a)(9) made no distinction between defined benefit and defined contribution plans—did not even mention there were two types of plans. Both plans were subject to the Code's pre-SECURE primitive and sketchy minimum distribution rules—the "at least as rapidly rule," the "5-year rule," etc.

When the IRS issued regulations to carry out the pre-SECURE Code's minimal directions regarding required minimum distributions (RMDs) the IRS had figured out that in fact different systems were needed for the two types of plans. Accordingly, the minimum distribution rules as they actually came to exist in the Treasury's final regulations issued in the early 2000's provided one set of minimum distribution rules for *defined contribution plans* (see Reg. § 1.401(a)(9)-1 through -5 and -7 through -9) and an entirely different set of minimum distribution rules for *defined benefit plans* (see Reg. § 1.401(a)(9)-6).

SECURE obviously respects the Treasury's conclusion that one size does not fit both types of plans when it comes to minimum distribution rules. So for openers, since SECURE does not apply to defined benefit plans, those plans can therefore continue to offer lifelong payouts to all designated beneficiaries, not just EDBs:

Dominic Example: Dominic is retiring from Foxhound Industries at age 70. The defined benefit plan in which he has participated for 40 years offers him a menu of annuities but no lump sum option. The items on the "menu" comply with the minimum distribution rules for DB plans—all of the options are among those permitted by Reg. § 1.401(a)(9)-6 (the regulation that contains the Treasury's "minimum distribution rules" for defined benefit plans). One of the options is a life income of $5,000 a month for Dominic's life, followed by a life income of $3,000 per month for life to Dominic's daughter and designated beneficiary Lily, age 43. Lily is not disabled or chronically ill. Under the minimum distribution rules applicable to defined benefit plans, an annuity can provide a life income for the employee's designated beneficiary, but if the DB is not the employee's spouse, and (like Lily) is more than 10 years younger than the employee, the maximum survivor life annuity that can be provided for the DB is reduced pursuant to a table in the regulations. See Reg. § 1.401(a)(9)-6, A-2(c)(2). Accordingly, based on their 27-year age difference, Lily's survivor annuity cannot be more than 63% of the $5,000 a month life annuity Dominic himself will be receiving. But it will continue for her entire life, even if that is longer than the 10 year maximum payout period mandated by SECURE for defined contribution plans.

So is the defined benefit plan a way to "beat" SECURE? Not really. It does offer a way to provide a lifelong payout to a designated beneficiary. But a *lifelong* payout (which terminates when the designated beneficiary dies) is not the same as a *life expectancy* payout (which allows the account's remaining balance to be distributed to a successor beneficiary if the original beneficiary dies prematurely). Also, defined contribution account owners (such as 401(k) participants) do not normally have any way to convert their plans to defined benefit plans.

So the "defined benefit plan" exclusion from SECURE is a dead end rather than a path to beating SECURE.

IRAs are defined contribution plans, not defined benefit plans. Therefore, the SECURE exception for defined benefit plans does not apply to IRAs, period. Current regulations, issued pre-SECURE, permit IRA owners to purchase "real" annuities inside their IRAs. When an IRA owner "annuitizes" his IRA by handing over the funds to an insurance company in exchange for an immediate annuity, the account shifts from the defined contribution minimum distribution rules to the defined benefit plan minimum distribution rules in the following manner: *If* the annuity purchased complies with the defined benefit RMD rules, then such purchase constitutes compliance with the RMD rules for the IRA and the IRA thereupon exits from the defined contribution RMD rules. Reg. § 1.401(a)(9)-5, A-1(e). This rule applies to "annuity contracts purchased with an employee's account balance under any defined contribution plan." T.D. 9130, 2004-1 C.B. 1082.

Is Reg. § 1.401(a)(9)-5, A-1(e), still valid? Can an IRA owner or 401(k) plan participant exit from the new SECURE minimum distribution rules by purchasing an annuity contract inside his IRA or 401(k) account, as long as the annuity complies with the (unaffected by SECURE) DB plan RMD rules? Can an IRA owner escape the 10-year rule by "annuitizing" his IRA and thereby obtain a lifelong payout for his designated beneficiary (whether or not such beneficiary is an EDB)?

If Reg. § 1.401(a)(9)-5, A-1(e), were still valid, an IRA owner could provide a lifelong payout to, for example, a grandchild-beneficiary, by purchasing an annuity inside the IRA. If the client's strongly sought goal is to provide a life income to his beneficiary(ies) this would be a way to do it. However, the SECURE Committee Report states that the new regime "applies to after-death required minimum distributions under defined contribution plans and IRAs, *including annuity contracts purchased from insurance companies under defined contribution plans or IRAs*." Emphasis added. Accordingly, this door is apparently "closed."

V. REGULATIONS THAT, THOUGH NOT DIRECTLY OVERRULED BY SECURE, MIGHT BE REVISITED IN LIGHT OF SECURE

As noted, SECURE generally adopts and commends the existing minimum distribution regulation scheme created by the Treasury's 2002 final regulations. But a couple of SECURE's changes could be read as a rejection of certain minor elements of the 2002 regulations. Perhaps Treasury should consider whether these elements should be revisited as perhaps no longer being needed or no longer making sense due to SECURE.

[Aside: Perhaps even, viewed from one perspective, Congress's decision to "dump" the life expectancy payout (for most people) could be viewed as a rejection of the regulations' expansion of the life expectancy payout beyond what the pre-SECURE Code presumably contemplated. For example, the regulations allowed the life expectancy payout to the deceased participant's designated beneficiary regardless of whether that participant died before or after commencing his own required minimum distributions (RMDs). The Code's wording (payouts for beneficiaries of a decedent who died after commencing RMDs would have to continue "at least as rapidly" as his lifetime payouts were being made) has to be manipulated and stretched quite a bit to come up with the 2002 regulations' system. Suffice it to say, Congress just changed its mind about the life expectancy payout. Whether that rejection was ultimately attributable to the IRS's overly generous interpretation of it or not, we will never know.]

A. Eliminate need to identify oldest trust beneficiary?

Under the IRS's minimum distribution trust regulations, pre-SECURE, it was vital to be able to identify the trust beneficiary with the shortest life expectancy because that beneficiary's life expectancy would be the Applicable Distribution Period (ADP) for the trust. But after SECURE, unless there are further changes to the regulations, the "oldest trust beneficiary" is almost irrelevant. Post-SECURE, the only two types of trusts that can qualify for life expectancy payout are:

- <u>A conduit trust for an EDB</u>. Since the conduit beneficiary is deemed to be the sole beneficiary of the trust, the trust is entitled to the life expectancy payout based on the EDB's entitlement. See Reg. § 1.401(a)(9)-5, A-5(c)(2), A-7(c)(3), Example 2, paragraph (ii). So for a conduit trust we don't need to identify the "oldest trust beneficiary" because there is only one countable beneficiary—the conduit beneficiary.

- An AMBT. An AMBT is the only type of "accumulation trust" that qualifies for the life expectancy payout. As previously noted, it appears that Congress PROBABLY intended to say the life expectancy of the D/CI life beneficiary of the AMBT would be the ADP. Assuming regulations confirm that apparent intent, there is no need to identify the oldest beneficiary of an AMBT either.

As things now stand, the regulations still require that, in order for a trust to have see-through status (so that trust beneficiaries will be deemed "designated beneficiaries"), it must be possible to identify the beneficiary with the shortest life expectancy. Reg. §1.401(a)(9)-4, A-5(b)(3). A trust must still qualify as a see-through trust in order to be entitled to even the 10-year rule. Since the original purpose of the "identify oldest beneficiary" rule has become irrelevant, this requirement should be deleted from the minimum distribution trust rules definition of a see-through trust.

B. Eliminate the "no separate accounts under a single trust" rule?

Under existing IRS regulations, post-death trust divisions are ignored for purposes of determining the applicable distribution period. Reg. § 1.401(a)(9)-4, A-5(c). The SECURE drafters were apparently aware of this regulation, since SECURE specifically allows such post-death divisions to be used, and given effect, to establish an exception-qualifying applicable multi-beneficiary trust (AMBT) for a D/CI beneficiary.

SECURE does not mandate a similar exception for other post-death divisions of a trust even though other EDBs could benefit from abolishing this rule. For example, suppose participant leaves his IRA to a trust that, upon his death, is required to immediately divide into separate equal "conduit" subtrusts for his children, one of whom is a minor. If that mandatory division must be disregarded (as is now required by Reg. § 1.401(a)(9)-4, A-5(c)) the minor child's subtrust will not get the benefit of the modified life expectancy payout Congress intended for the minor child of a participant.

SECURE is restrictive enough—this regulation makes even the few "EDB" exceptions permitted by SECURE harder to obtain.

Reg. § 1.401(a)(9)-4, A-5(c), coupled with SECURE's exception for AMBT, could produce absurd results. Suppose P dies leaving his IRA to a trust that immediately upon his death splits into three equal subtrusts, one of which is an AMBT for P's disabled brother, one of which is a conduit trust for P's surviving spouse, and one of which is a conduit trust for P's minor child. The AMBT will get EDB treatment but the other two subtrusts will not unless Reg. § 1.401(a)(9)-4, A-5(c) is repealed.

If Congress doesn't like Reg. § 1.401(a)(9)-4, A-5(c), it should have statutorily repealed it for all cases, not just for the D/CI beneficiary. But maybe they figured a hint is good enough, and hoped the IRS would take that hint and abolish Reg. § 1.401(a)(9)-4, A-5(c) for everyone.

C. Allow EDB Treatment for any trust of which an EDB is sole life beneficiary?

One other aspect of the AMBT that diverges markedly from the Treasury's existing see-through trust rules is SECURE's rule that a trust for the life benefit of a D/CI beneficiary shall qualify for "EDB" treatment (i.e., the life expectancy payout) if (among other requirements) no person other than such D/CI beneficiary may receive any distributions from the trust (or the retirement benefits payable to the trust) during the lifetime of such D/CI beneficiary. Under the existing minimum distribution trust regulations, an individual can be considered sole beneficiary of a trust and IRA only if all distributions such trust receives from the IRA during such individual's life are passed out forthwith to or for the benefit of such individual. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2. But the AMBT departs radically from the "conduit trust" concept and *indeed from all prior interpretations of the term "designated beneficiary"* by granting DB/EDB status to the life beneficiary of the AMBT even if the trust is not required to ever distribute ANY amounts from the trust or the IRA to him or her! As long as distributions cannot be made to anyone else, the trust will qualify for the life expectancy payout based on the "life beneficiary's" D/CI status. § 401(a)(9)(H)(iv)(II), (v).

Estate planning practitioners would dearly love to restore the life expectancy payout to a non-conduit see-through trust where the participant's surviving spouse is merely the life beneficiary (for example, entitled to "all income of the trust for life," with or without principal distributions being permitted for health, support, etc. or in the trustee's discretion, but NOT entitled to receive any and all distributions the trust receives from the IRA). Prior to SECURE, such a trust was entitled to the life expectancy payout based on the life expectancy of the oldest trust beneficiary (usually the spouse). Post-SECURE, even though the surviving spouse is the sole *life* beneficiary of such a see-through trust, and even though the spouse is an EDB, the trust is not entitled to use the spouse's life expectancy as its ADP because the spouse is not considered the sole beneficiary of the trust under existing (pre-SECURE) regulations (i.e., because the trust is not a conduit trust for the spouse).

Since above I speculated that SECURE's override of Reg. § 1.401(a)(9)-4, A-5(c) for the sake of the AMBT could be a hint that Treasury should abolish Reg. § 1.401(a)(9)-4, A-5(c) for everyone, does it follow that a life expectancy payout in the case of the "sole life beneficiary" structure of the AMBT is a hint that this privilege should also be extended to all EDBs?

Probably not. In the case of an AMBT, the rule allowing life expectancy payout for a trust from which the supposed "designated beneficiary" may never receive a dime is a radical departure from any normal concept of what a "designated beneficiary" means or ever has meant in the retirement benefits world. Extending this concept to other EDB trusts would not be a tiny technical tweak like abolishing the separate-accounts-under-a-single-trust regulation—it would be major surgery.

This rule for AMBT appears to have been adopted solely to accommodate the peculiar requirements of the "supplemental needs trust," under which a disabled individual can be the beneficiary of a trust fund and still qualify for means-tested government benefits such as Medicaid. The "supplemental needs trust" structure is well established, recognized in one or more statutes, and accepted by the various applicable government bodies as a way for benefactors to help out disabled beneficiaries without causing them to lose the medical, housing, and support benefits they receive from government programs for the poor. Since the "supplemental needs trust" cannot be spent to pay for such government-paid-for necessities as housing and medical care, but only for "supplemental needs," the trust's assets are not countable resources of the disabled beneficiary.

In the case of a D/CI beneficiary, ANY requirement in a trust that income or principal be paid out to the beneficiary would upset the supplemental-needs-only status of the trust. The distributions to which the beneficiary would be entitled under the trust would cancel out his entitlement to some or all of the government benefits he depends on. Accordingly SECURE, in order to preserve EDB status for a disabled beneficiary without forcing reduction or loss of the beneficiary's government benefits due to trust distributions, came up with the unlikely compromise of the AMBT: The D/CI is considered the "sole beneficiary" of an AMBT as long as nobody other than such D/CI can receive distributions from the trust during the lifetime of such D/CI—whether or not any IRA distributions are passed out to or for the D/CI individual himself.

There is no need for this unique special-purpose structure for any other category of EDB. Surviving spouses, minor children, and not-more-than-10-years younger individuals (if not disabled or chronically ill) have no financial necessity of, and get no financial advantage from, not receiving distributions from an IRA payable to a trust for them. Unlike abolishing Reg. § 1.401(a)(9)-4, A-5(c), which can benefit all classes of EDBs, the "as long as nobody else gets any distributions" approach of the AMBT is of use solely in the case of D/CI beneficiaries.

Treasury conceivably could decide to extend EDB status to some trusts that are not conduit trusts—for example, a trust for the benefit of the surviving spouse that qualified for the estate tax marital deduction, giving the spouse the right to all income for life but not giving her the right to receive all IRA distributions paid to the trust. The rationale for this type of relaxation of the rules could be that, Congress having indicated that these few categories of EDBs being entitled to the life expectancy payout, and the 10-year rule for everybody else having been agreed upon as a reasonable approach for the non-EDBs, the presumed abuse that Congress found in the pre-SECURE scheme has been eliminated. Very few people will now qualify for life expectancy payouts, but Congress clearly wants to protect these few categories, and therefore (the IRS could conclude) there is no harm in making it easier for these few categories to obtain their life expectancy payout within standard estate planning structures.

On the other hand Treasury could conclude, "In Congress's opinion, we clearly went too far with the life expectancy payout the last time, so this time we will stick to the straight and narrow path. We will not expand the life expectancy payout one inch beyond what SECURE's structure mandates, even to help out the favored EDBs."

Summary: I believe the IRS can and should abolish Reg. § 1.401(a)(9)-4, A-5(c), partly in recognition of its rejection by Congress (in the case of AMBT) and partly because it will absolutely not work if it only applies (per SECURE) to some subtrusts and not to others. But none of these rationales impels in the direction of extending EDB status to nonconduit trusts.

APPENDIX B
NEW RMD TABLES FOR 2022 AND LATER

For effective dates and how to use these tables, see the end of this Appendix.

1. Uniform Lifetime Table

Table for Determining Applicable Distribution Period (Divisor)			
Age	**Distribution period**	**Age**	**Distribution period**
70	n/a	95	8.9
71	n/a	96	8.4
72	27.4	97	7.8
73	26.5	98	7.3
74	25.5	99	6.8
75	24.6	100	6.4
76	23.7	101	6.0
77	22.9	102	5.6
78	22.0	103	5.2
79	21.1	104	4.9
80	20.2	105	4.6
81	19.4	106	4.3
82	18.5	107	4.1
83	17.7	108	3.9
84	16.8	109	3.7
85	16.0	110	3.5
86	15.2	111	3.4
87	14.4	112	3.3
88	13.7	113	3.1
89	12.9	114	3.0
90	12.2	115	2.9
91	11.5	116	2.8
92	10.8	117	2.7
93	10.1	118	2.5
94	9.5	119	2.3
		120+	2.0

This table must be used by all taxpayers to compute lifetime required distributions after 2021, unless the sole beneficiary is the participant's more-than-10-years-younger spouse. See ¶ 1.3.01. This table may not be used: by beneficiaries of a deceased participant (except in the year of the participant's death); or for years prior to 2022.

For each Distribution Year, determine: (A) the account balance as of the prior calendar year end (see ¶ 1.2.05–¶ 1.2.08); (B) the participant's age at the end of the Distribution Year (¶ 1.2.04); and (C) the Applicable Distribution Period (divisor) for that age from the above table. "A" divided by "C" equals the required minimum distribution (RMD) for the Distribution Year.

2. Single Life Expectancy Table. **FOR 2022 AND LATER YEARS ONLY**

For computing RMDs after the participant's death.

Ages 0 to 59

Age	Life Expectancy	Age	Life Expectancy
0	84.6	30	55.3
1	83.7	31	54.4
2	82.8	32	53.4
3	81.8	33	52.5
4	80.8	34	51.5
5	79.8	35	50.5
6	78.8	36	49.6
7	77.9	37	48.6
8	76.9	38	47.7
9	75.9	39	46.7
10	74.9	40	45.7
11	73.9	41	44.8
12	72.9	42	43.8
13	71.9	43	42.8
14	70.9	44	41.9
15	69.9	45	41.0
16	69.0	46	40.0
17	68.0	47	39.0
18	67.0	48	38.1
19	66.0	49	37.1
20	65.0	50	36.2
21	64.1	51	35.3
22	63.1	52	34.3
23	62.1	53	33.4
24	61.1	54	32.5
25	60.2	55	31.6
26	59.2	56	30.6
27	58.2	57	29.8
28	57.3	58	28.9
29	56.3	59	28.0

Single Life Table, cont. **FOR 2022 AND LATER YEARS ONLY**

Ages 60 to 120

Age	Life Expectancy	Age	Life Expectancy
60	27.1	95	4.0
61	26.2	96	3.7
62	25.4	97	3.4
63	24.5	98	3.2
64	23.7	99	3.0
65	22.9	100	2.8
66	22.0	101	2.6
67	21.2	102	2.5
68	20.4	103	2.3
69	19.6	104	2.2
70	18.8	105	2.1
71	18.0	106	2.1
72	17.2	107	2.1
73	16.4	108	2.0
74	15.6	109	2.0
75	14.8	110	2.0
76	14.1	111	2.0
77	13.3	112	2.0
78	12.6	113	1.9
79	11.9	114	1.9
80	11.2	115	1.8
81	10.5	116	1.8
82	9.9	117	1.6
83	9.3	118	1.4
84	8.7	119	1.1
85	8.1	120+	1.0
86	7.6		
87	7.1		
88	6.6		
89	6.1		
90	5.7		
91	5.3		
92	4.9		
93	4.6		
94	4.3		

Effective dates and how to use the new tables:

In November 2019, the IRS published new actuarial/life expectancy tables to be used for determining required minimum distributions for 2021 and later years. See Prop. Reg. 1.401(a)(9)-9, published in the Federal Register Vol. 84, No. 217, 11/8/19, pp. 60812-60833. The final version was adopted in November 2020, with slight changes in the tables and a new effective date: The new tables will apply for 2022 and later years, *not 2021 as previously announced*.

Thus the old tables will CONTINUE TO APPLY for 2021.

Good news! The IRS is giving us all a little more life expectancy. Apparently Americans are living longer, and the new tables reflect that fact. That means more potential deferral for your client's IRA and 401(k) distributions—for both retirees and beneficiaries.

The background: The Treasure promulgated the current actuarial tables we use for computing RMDs in 2003. Unlike the life expectancy tables used for gift and estate tax valuations (which must, by statute, be updated every 10 years), there is no required timetable for updating the retirement-related life expectancy tables. However, Congress prompted the IRS to update these tables so updates might occur more frequently/regularly in the future.

Three tables are affected: Reg. 1.401(a)(9)-9 contains the "Single Life Table" (used for determining payouts to beneficiaries from inherited retirement plans), "Uniform Lifetime Table" (used for determining lifetime RMDs to participants over age 72), and the "Joint and Last Survivor Table" (for lifetime payouts to any over-age-72 participant whose sole beneficiary is his more-than-10-years-younger spouse). Each of those has been replaced by an updated version, based on the fact that people are living, on average, almost two years longer than they did in 2003.

The new Single Life and Uniform Lifetime tables are reproduced in Appendix A of this Outline. The Joint and Survivor Life Tables are too lengthy to be reproduced here; see the regulation. The impact on retirees and beneficiaries will be a measurable though usually modest reduction in RMDs. The larger the client's retirement plan, the greater the dollar reduction in RMDs will be under the new tables. Of course, the income taxes on any amounts not distributed are still only deferred, not (for most people) eliminated, but clients like a lower immediate tax bill nevertheless.

Retiree Example: Alfred will turn 75 in 2021. The December 31, 2020, value of his IRA is $2 million. Under the current Uniform Lifetime Table, which still applies through 2021, the divisor for age 75 is 22.9, so his 2021 RMD will be $87,336. If the new tables were in effect, his divisor would be 24.6, and his RMD would be only $81,301. The $6,000 reduction could save (defer) more than $2,000 of federal income tax for this hypothetical year for a 75-year-old with a $2 million IRA.

Beneficiary Example: Betty's sister Donna dies in 2020, leaving her IRA to Betty as "designated beneficiary." The IRA is worth $1 million as of 12/31/2020. Since Betty is not more than 10 years younger than Donna, Betty's RMDs from the inherited IRA are determined using the life expectancy payout method. Betty will turn 57 in 2021, the year after the year of Donna's death. Under the current life expectancy table, which still applies in 2021, Betty's life expectancy at age 57 is 27.9 years, so her 2021 RMD will be $35,842.29. Under the new single life table effective in 2022, her life expectancy at age 57 would be 29.8 years. If the new table had applied in 2021 (which it doesn't), her life expectancy would have been 29.8 years and her RMD would have been only $33,557.05— $2,285.24 less. For how she transitions to the new table, see below.

The changeover to the new tables will be easy and painless for most people. Life expectancies that are recalculated annually (all lifetime payouts; post-death payouts to a surviving spouse who was sole beneficiary) are easy as pie: Just recalculate using the new tables starting in 2022.

For beneficiaries of pre-2021 decedents who are taking RMDs using the fixed term method over their single life expectancy, the switch in 2022 will be only slightly more complicated: There will be a one-time reset ("redetermination") of the life expectancy that year. The designated beneficiary will go back to the year after the year of the participant's death and find his (the beneficiary's) single life expectancy as of his age in that year using the new table. Then, one year will be deducted from that new life expectancy for each year elapsed since the first distribution year to arrive at the divisor for the applicable post-2021 year.

Here is the example of such "redetermination" from Treas. Reg. § 1.401(a)(9)-9(f)(2)(ii)(B):

"Example of redetermination. Assume that an employee died at age 80 in 2019 and the employee's designated beneficiary (who was not the employee's spouse) was age 75 in the year of the employee's death. For 2020, the distribution period that would have applied for the beneficiary was 12.7 years (the period applicable for a 76-year-old under the Single Life Table in formerly applicable §1.401(a)(9)-9), and for 2021, it would have been 11.7 years (the original distribution period, reduced by 1 year). For 2022, if the designated beneficiary is still alive, then the applicable distribution period would be 12.1 years (the 14.1-year life expectancy for a 76-year-old under the Single Life Table in paragraph (b) of this section, reduced by 2 years). However, see section 401(a)(9)(H)(iii) for rules regarding how to apply the required distribution rules to defined contribution plans if the eligible designated beneficiary dies prior to distribution of the employee's entire interest."

Presumably many participants and beneficiaries will get confused, use the wrong table, miscalculate the reset, etc. But any such errors are likely to result in taking too much money out of the retirement plan rather than too little, so at least there will be no penalties triggered by the mistake.

Though the new tables are pretty easy for retirees and beneficiaries to adapt to, there are classes of people for whom this change means a mountain of work, such as financial planners and plan administrators. Any financial plan done heretofore for a retirement plan owner or beneficiary will have to be re-done to reflect the new tables...projections will change for RMDs, income taxes, liquidity needs, even potentially Medicare premiums. And plan administrators will have to reprogram all their computers to recalculate RMD payouts and projections starting in 2022.

But most to be pitied are tax-book writers who will have to replace the tables, revise chapters, and rewrite every RMD example in their books. Some will probably decide to, instead, retire, leave all that work to others, and start collecting their own newly-reduced RMDs.

APPENDIX C
The ABCD System: Your Alphabetic Menu of Planning Choices

To simplify the newly complicated menu of estate planning choices for a client's retirement benefits, use the following "A-B-C-D" chart. To understand the chart you have to do some homework first—you must know the definitions of the various types of EDBs and of a conduit trust (or trusteed IRA) and of a see-through accumulation trust. All these definitions are explained elsewhere in this Outline. For now, a brief example is included at the end of the chart.

The chart/table gives an EXTREMELY BRIEF quick take on the Applicable Distribution Period (ADP) that will apply (along with a few other features) of four options for leaving retirement benefits to or for the benefit of various classes of potential beneficiaries.

There are only four ways you can leave retirement benefits to an individual: Outright; through a conduit trust or trusteed IRA: through a see-through accumulation trust (STAT); or through your estate or a trust that does not qualify as a see-through trust, i.e., a "non-DB." The first three qualify for designated beneficiary status. The fourth doesn't. The first TWO qualify for "eligible designated beneficiary" status if the individual is an EDB; the third (at least under present law) does not [unless it is an AMBT for a D/CI beneficiary] and of course the fourth does not.

A: **Outright to beneficiary.** The client names the individual as beneficiary of the retirement plan. Individual will get whatever the "best deal" available for him/her under the minimum distribution rules, whether that is the life expectancy payout (for an EDB) or the 10-year rule (for PODBs). In the case of the surviving spouse, this method also permits the spouse to roll over the account to his own IRA. All distributions from the plan will be taxed at the beneficiary's individual rate. No need to draft a trust or pay a trustee. The beneficiary has total control of the account from the moment of the participant's death and can cash it out any time. Not suitable for beneficiary who is legally incompetent (such as a minor) unless there is a suitably competent and empowered guardian in place. Not best for any beneficiary who has problems with owning wealth such as addictions, divorce/creditor concerns, inability to manage money. Will be countable asset/income for beneficiary receiving means tested government benefits.

B: **To the beneficiary through a conduit trust or trusteed IRA.** A trusteed IRA is an IRA in the legal form of a trust. Though subject to the exact same RMD rules as a "regular" (custodial-type) IRA, the IRA provider also has trustee powers and duties and thus controls the investments and (subject to the RMD rules and any additional standards imposed by the IRA owner/participant/trustor) the rate of distributions to the beneficiary. A conduit trust is a separate "regular" trust that is named as beneficiary of the IRA; trustee has investment and distribution control, but is required to immediately pass out to the beneficiary any and all retirement plan distributions the trustee receives during the beneficiary's lifetime. RMD effects: The income tax and minimum distribution rules are exactly the same as for "A" (except no spousal rollover possible). The beneficiary gets the "best deal" available for him/her under the minimum distribution rules. All distributions from the plan will be taxed at the beneficiary's individual rate. The trustee of the conduit trust or trusteed IRA (rather than the beneficiary) controls the investments and the rate of distributions from the retirement account (subject to whatever limits the participant established in the trust agreement). For example, the participant could specify that the trustee must take from the plan and pass out to the beneficiaries, in addition to any required minimum distributions, all "income" on the account, or whatever amounts are needed for the beneficiary's health or support, or whatever amounts the trustee deems advisable in its discretion...or the participant could specify that distributions subject to the 10-year rule would be taken ratably over the distribution period. *There is no RMD or income tax advantage to "B" compared to "A."* The advantage of B is it allows the participant (through the trust agreement) greater control over the flow of distributions to the beneficiary within limits imposed by the RMD rules. Beneficiary has total control of minimum distributions once they are paid; not suitable for beneficiary who is legally incompetent unless there is a suitably competent and empowered guardian in place. Distributions will be countable asset/income for beneficiary receiving means tested government benefits.

C: **To the beneficiary through a see-through accumulation trust (STAT).** Plan is payable to a trust that complies with the IRS's "minimum distribution trust rules" and so is entitled to designated beneficiary (DB) status. It has all individual beneficiaries. The life beneficiary is entitled to limited distributions (such as "income plus principal for health and support") but is not entitled to automatically receive all distributions the trustee takes out of the retirement plan. The trustee can "accumulate" plan distributions for later distribution to life beneficiary or remainder beneficiary(ies). On life beneficiary's death, the trust will pass to individual remainder beneficiaries (not charities), so "all beneficiaries are individuals" and the trust can be treated as a DB provided it complies with the other technical rules. Under existing regulations, both life and remainder beneficiary(ies) are considered "beneficiaries" of the retirement plan, so (with one exception) the trust will not qualify for EDB (life expectancy payout) treatment even if the life beneficiary is an EDB. The exception: A STAT qualifies for EDB treatment if the sole life beneficiary is a D/CI individual. "C" allows client greater control over when (if ever) the life beneficiary receives money from the retirement plan. For example, distributions could be withheld until the beneficiary reaches a certain age or could be payable only if needed for health or support. The tradeoff: Distributions to the trust that are not passed out to the human beneficiary(ies) in the same year will generally be taxed at trust income tax rates, which is often higher than the tax rates applicable to family members.

D: **To the beneficiary through a "non-designated beneficiary" entity** such as the participant's estate or a trust that does not qualify as a see-through trust. For example, a trust that says "income to my spouse for life, remainder on my spouse's death to Charity X." The "countable beneficiaries" are spouse and charity. Since charity is not an individual the trust does not qualify as a designated beneficiary "see-through" trust. Thus it cannot qualify for DB or EDB treatment—it is a "nonDB." The ADP will be the 5-year rule (if the participant died before his/her RBD) or the ghost life expectancy (otherwise). The advantage of "D" is it allows the participant total control over who gets the IRA money and when he/she/it gets it. The "price" of this control in terms of the loss of tax deferral may not be terribly large—a 5-year payout instead of a 10-year payout for example. The main "price" will be that plan distributions not promptly passed out to humans will be taxed at trust income tax rates.

The Post-SECURE Estate Planning Choices Table for Clients' Retirement Plans

For this beneficiary:	**A.** Outright	**B.** Conduit Trust or Trusteed IRA	**C.** See-through Accumulation Trust (STAT)	**D.** Non-see-through Trust
Participant's minor child	ADP: child's life expectancy until he/she "reaches majority" then 10 more years after that point. Child gets total control upon majority (age 18?)	ADP= child's life expectancy until he/she reaches majority, + 10 years. OK if client is willing to have child obtain total control at age 28 (+/-).	Allows client to delay child's control beyond age 28+/- (or give trustee power to decide that issue). ADP= 10 years (no "life expectancy" component). Trust absorbs the income taxes on IRA distributions not passed out.	ADP= 5-year rule or ghost LE. Use if client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity.
Participant's multiple minor children	ADP for each child's share =his/her life expectancy until he/she "reaches majority" then 10 more years after that point. Each child gets total control upon majority (age 18?)	Status of a conduit trust for multiple minors or other EDBs unknown until regulations issued.	ADP=10 years. Parent can put in whatever ages parent wishes for child(ren) to obtain outright control (if ever) and allow for a "pot" trust (not stuck with equal distributions to all children). Trust absorbs the income taxes on IRA distributions not passed out.	ADP= 5-year rule or ghost LE. Use if client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity.

For this beneficiary:	**A.** Outright	**B.** Conduit Trust or Trusteed IRA	**C.** See-through Accumulation Trust (STAT)	**D.** Non-see-through Trust
Other minor children (e.g., grandchildren)	ADP= 10 year rule. Child gets total control upon majority (age 18?).	ADP=10 year rule. Child will obtain total ownership and full distribution of the IRA in 10 years regardless of age, but the trustee controls the investments and distribution rate during the 10 years. All distributions taxable to child.	ADP=10 years. Client can put in whatever ages he/she wishes for child(ren) to obtain outright control (if ever) and allow for a "pot" trust (not mandatory equal distributions to all children). The tradeoff: trust will absorb the income taxes on the IRA.	ADP= 5-year rule or ghost LE. If client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity.
Spouse	Best income tax choice usually. Spouse can use rollover, or hold as beneficiary (taking distributions over his/her LE recalculated annually, starting later of year after owner's death or year would have reached age 72). Flips to 10-year rule on spouse's death.	ADP= spouse's LE recalculated annually, starting later of year after owner's death or year would have reached age 72). Rollover NOT available. Trustee controls investments and distribution rate (subject to trust terms & RMD rules). Flips to 10-year rule on spouse's death.	ADP=10 year rule. E.g., typical "QTIP" trust—income to spouse for life (with or without principal distributions for health, support, etc.), remainder to (usually) grantor's issue. The trust pays tax on the IRA distributions to the extent not distributable to spouse.	ADP= 5-year rule or ghost LE. If client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity.

For this beneficiary:	**A.** Outright	**B.** Conduit Trust or Trusteed IRA	**C.** See-through Accumulation Trust (STAT)	**D.** Non-see-through Trust
Disabled/Chronically ill (D/CI) individual	ADP=beneficiary's life expectancy. All distributions taxable to the D/CI individual. Not suitable if beneficiary is not legally competent and/or needs to qualify for gov. bens.	ADP= beneficiary's life expectancy. All distributions taxable to the D/CI individual. Not suitable if beneficiary is not legally competent and/or needs to qualify for gov. bens.	Supplemental needs trust. If qualifies as an AMBT this is the best choice if beneficiary needs to qualify for gov bens. D/CI individual is sole life beneficiary. ADP=life expectancy.	ADP= 5-year rule or ghost LE. Use if client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity.
Individual not more than 10 years younger than participant ("Nimitty")	ADP=beneficiary's life expectancy. All IRA distributions taxable to beneficiary. Beneficiary controls rate of distributions.	ADP=beneficiary's life expectancy. All IRA distributions taxable to beneficiary. Trustee/trust terms control rate of distributions, if any, in excess of RMDs.	ADP=10-year rule, so you sacrifice the "life expectancy payout." The trust will be taking the income tax hit on IRA distributions not passed out to the beneficiary in same year	Use if client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity. ADP= 5-year rule or ghost LE
PODB [plain old designated beneficiary]	ADP=10-year rule. All IRA distributions taxable to beneficiary. Beneficiary controls rate of distributions.	ADP=10-year rule. All IRA distributions taxable to beneficiary. Trustee/trust terms control rate of distributions within the 10-year rule limit.	ADP=10-year rule. Trust will be taking the income tax hit on IRA distributions not passed out to the PODB in same year. "Flex trust" is this type.	ADP= 5-year rule or ghost LE. Use if client does not want to accept any limits–e.g., client wants trustee to be able to distribute to charity.

Example: Darryl wants to leave his IRA to or for the benefit of his nondisabled adult daughter Carol. Since Carol is not his spouse or minor child, and is more than 10 years younger than Darryl, and is not disabled or chronically ill, she is a PODB (plain old designated beneficiary). Here are his options. *Note that there is no longer any deferral difference whatsoever among the first three options.* In some families there will be little income tax difference among the options.

A. **Outright to Carol. ADP = 10-year rule.** All distributions will be taxed to Carol at her income tax rate. She will have total control of how to invest the money and (subject to the limits of the 10-year rule) when to take the money out of the IRA. She can cash out the IRA the day after Darryl's funeral if she is so inclined.

B. **To a conduit trust or trusteed IRA for Carol. ADP=10-year rule.** All distributions will be taxed to Carol at her income tax rate. The trustee will have total control of how to invest the money and (subject to the limits of the 10-year rule and subject to whatever standards or requirements Darryl specifies in the trust agreement) when to take the money out of the IRA. This would "put the brakes" on Carol's control of the account, though only for 10 years.

C. **To a see-through accumulation trust (STAT) for Carol.** The trust provides (for example), that the trustee will pay Carol all income of the trust for life plus such amounts of principal as the trustee deems advisable for her health or support (or any other reasons specified by Darryl in the agreement), and on Carol's death the remaining assets will be paid to Darryl's siblings. **ADP=10-year rule.** All distributions will be taxed to the trust at trust income tax rates except to the extent they are paid out to Carol (or, in the case of distributions received after Carol's death, to Darryl's siblings) in the year received pursuant to the standards stated in the trust. The trustee will have total control of how to invest the money and (subject to the limits of the 10-year rule and subject to whatever standards or requirements Darryl specifies in the trust agreement) when to take the money out of the IRA. Note that the remainder beneficiaries (Darryl's siblings) are older than Carol—but the "age of the oldest trust beneficiary" doesn't matter when the 10-year rule applies. Pre-SECURE the "age of the oldest trust beneficiary" was extremely important because the life expectancy of that beneficiary would be the ADP for a nonconduit see-through trust.

D. **To a non-see-through trust for Carol.** The trust provides (for example), that the trustee will pay Carol all income of the trust for life plus such amounts of principal as the trustee deems advisable for her health or support, and on Carol's death the remaining assets will be paid to a charity. ADP=5-year rule or ghost life expectancy depending on whether Darryl died before or after his RBD for the plan in question. All IRA distributions will be taxed to the trust at trust income tax rates except to the extent they are (1) paid out to Carol in the year received pursuant to the standards stated in the trust or (2) (if Carol dies before the IRA has been fully paid out to the trust) paid to the charity if received after Carol's death. The trustee will have total control of how to invest the money and (subject to the limits of the 10-year rule and subject to whatever standards or requirements Darryl specifies in the trust agreement) when to take the money out of the IRA.