Estate Planning for Retirement Benefits Under SECURE and Proposed Treasury Regulations

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How to use this Outline

This Outline attempts to explain the minimum distribution rules applicable to IRAs and qualified retirement plans as altered by the SECURE Act of 2019 and the IRS's Proposed Regulations issued February 2022. Use the following detailed TABLE OF CONTENTS to find the material you are looking for. If confronted with an unfamiliar term, use the GLOSSARY to get to the definition you need.

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PRELIMINARY MATTERS

Preface: Background; SECURE

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 2020. Signed into law December 20, 2019, SECURE has radically changed the estate planning landscape for clients' retirement benefits. This was accomplished primarily by amending § 401(a)(9) of the Internal Revenue Code. 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. 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.

The Proposed Regulations

On February 23, 2022, the Treasury issued a Notice of Proposed Rulemaking regarding required distributions from IRAs and certain other retirement plans. It can be found at: https://www.federalregister.gov/documents/2022/02/24/2022-02522/required-minimum-distributions

The 275-page Notice contains proposed changes to the Treasury regulations dealing with required minimum distributions (RMDs) from defined contribution plans, primarily to deal with changes made in the Tax Code by SECURE, but also covering other retirement plan issues more or less related to RMDs such as rollovers, as well as matters primarily of interest to plan administrators. Some of the changes are in the form of a proposed amendment to an existing regulation; others would replace an existing regulation.

This Outline covers primarily the updates to the minimum distribution rules.

This Outline assumes the reader is generally familiar with the "minimum distribution rules" of the Internal Revenue Code of 1986 as amended (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* (8th ed. 2019; www.ataxplan.com; for electronic edition, visit www.retirementbenefitsplanning.us).

About the Author

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Matters not covered in this Outline

The following matters dealt with in the Proposed Regulations and/or SECURE are not covered in this outline:

- QDROs
- QLACs
- Defined benefit plans and annuities
- The delayed SECURE effective date for certain collectively bargained and government retirement plans.
- TEFRA 242(b) elections
- The applicability of SECURE to annuities purchased prior to SECURE's effective date.
- How the minimum distribution rules apply to an annuity contract purchased inside an IRA or other defined contribution plan account. See Prop. Reg. § 1.401(a)(9)-5(a)(5).
- Lifetime RMDs to a participant whose sole beneficiary is more than 10 years younger spouse.
- Treatment of nonvested amounts in the employee's account.
- Rollovers.
- Parts of the minimum distribution rules that appear not to be modified from the existing regulations, such as how to compute the account balance

The Glossary: Abbreviations, Symbols, and Terms Used in this Outline

The following symbols, terms and abbreviations are used throughout this Outline; not all are "official" terms (defined by statute or regulations).

§ Refers to a section of the Code, unless preceded by "Reg." (for Treasury regulation) or "Prop. Reg." (for proposed Treasury regulation).

¶ Refers to a section of the author's book *Life and Death Planning for Retirement Benefits* (8th ed. 2019). The book can be purchased in print form at www.ataxplan.com or in electronic format via subscription (ebook version) at www.retirementbenefitsplanning.us.

5-year rule. See PART 3, #2.
10-year rule. See PART 3, #3.

Accumulation Trust. A See-through Trust that is not a conduit trust. See PART 4, #5.

AD; Applicable Denominator. The number that is divided into the prior year-end account balance to produce the RMD for the current year. See PART 1, #2.

ADP. Applicable Distribution Period; this term has been replaced by "Applicable Denominator."

ALAR Rule. "At least as rapidly" rule. See PART 3, #3(C-E).

Applicable Denominator. This term has been replaced by "Applicable Denominator."

AMBT. Applicable multi-beneficiary trust. § 401(a)(9)(H)(v). See PART 3, #7(D-F).

Annual distributions track. Not an official term. Used in this Outline to refer to annual RMDs (if any) required after the death of the employee, in contrast to the final year in which 100% of the account must be distributed, which is called the Outer Limit Year in this Outline.

BDOT. Beneficiary deemed owner trust. Not an official term. See PART 2, Case #3(F).

BFD. Beneficiary Finalization Date. Not an official term. September 30 of year after year of participant's death. See PART 7, #2.

Code. Internal Revenue Code of 1986, as amended through August 31, 2022.

Conduit trust. See PART 4, #5.

Countable beneficiary. Not an official term. A beneficiary or potential beneficiary of a trust who is "countable" in determining whether the trust qualifies as a DBT. See PART 4, #7-13.

DAF. Donor advised fund. See PART 2, Case #7.

DB; Designated Beneficiary. See PART 3, #1(B).

Designated Beneficiary Trust or DBT. Not an official term; my term for a see-through trust whose countable beneficiaries are all DBs, so the trust is eligible for the 10-year rule or in certain cases a life expectancy payout. See PART 4, #6.

D/CI individual. A beneficiary who is an EDB by virtue of being a disabled or chronically ill individual within the meaning of § 401(a)(9)(E)(ii)(III). See PART 3, #7.

Distribution Year. Called a "Distribution Calendar Year" in the regulations, a year in which a distribution is required to be made from the retirement account under § 401(a)(9) of the Code. Prop. Reg. § 1.401(a)(9)-5(a)(2).

EDB. Eligible designated beneficiary as defined in § 401(a)(9)(E)(ii). See PART 3, #4.

EDB Treatment. In this Outline, "EDB treatment" indicates that the trust is entitled to a life expectancy payout of some type. See PART 5.

Funding trust. A trust that will receive retirement benefits upon the participant's death and then transfer such benefits to one or more individuals or subtrusts. See PART 4, #4.

Ghost life expectancy. The remaining life expectancy of a participant who died after his RBD. See PART 3, #2.

IRA. Individual retirement account or individual retirement trust under § 408.

IRS Internal Revenue Service.

Life expectancy payout. Not an official term. A way of determining annual RMDs based on the life expectancy of a beneficiary. See PART 3, #1(D).

NoMoTTYY. Not an official term. An EDB by virtue of being not more than 10-years-younger than the deceased participant. See PART 3, #8.

Non-DB. A beneficiary who is not a Designated Beneficiary. See PART 3, #2.

Outer Limit Year. Not an official term. Prop. Reg. § 1.401(a)(9)-5(e) provides what this Outline calls an "Outer Limit Year" in which the RMD is 100% of the account, regardless of what "annual distributions track" the retirement plan was subject to in the preceding years.

Participant. Not an official term. For convenience this word is used in this Outline to represent the "employee" (with reference to qualified retirement plans and other "workplace" retirement plans") and the "IRA owner" with respect to IRAs.

PODB. Plain old designated beneficiary. A beneficiary who is a "designated beneficiary" but not an "ELIGIBLE designated beneficiary." See PART 2, Case #1.

PLR. IRS private letter ruling.

Preamble. The Preamble to the Proposed Regulations.

Proposed Regulations. The IRS's proposed RMD regulations promulgated February 23, 2022. See

QRP. Qualified retirement plan under § 401(a), such as a 401(k) plan.

QTIP trust. Qualified terminal interest property trust; a type of trust for the benefit of the decedent's surviving spouse that qualifies for the federal estate tax marital deduction under § 2056(b).

Reg. Treasury Regulation.

RBD. Required beginning date. The date by which the participant must commence taking lifetime RMDs from the retirement account. See PART 1, #1(A); PART 3, #1(A).

RMD. Required minimum distribution from a retirement plan under § 401(a)(9).

SECURE. The SECURE Act of December 2019.

See-through Trust. A trust that complies with the "4 RMD trust rules." Prop. Reg. § 1.401(a)(9)-4(f)(1)(i), last sentence. See PART 4, #5.

Separate accounts. See PART 6, #1.

SNT. Supplemental Needs Trust. See PART 2, Case #4.

S/S. Surviving spouse.

Treasury. The United States Treasury Department.

Trusteed IRA. See PART 1, #2(D).

Type I AMBT, Type II AMBT. See PART 3, #7(D-F), PART 5, #2.

PART 1: INTRODUCTION TO THE RMD RULES

Tax-favored retirement accounts covered in this Outline include individual retirement accounts (IRAs) under § 408, including Roth IRAs under § 408A, defined contribution plans that are "qualified" under § 401(a) (including 401(k) plans), and to some extent "403(b)" accounts. These accounts cannot hold tax-deferred funds forever. § 401(a)(9) dictates that distributions must commence to the account owner (called the "employee" in the regulations, which are aimed at qualified employer plans, or the "IRA owner" when applied to IRAs) during his or her lifetime. § 401(a)(9) also dictates that distributions must be made from the account after the owner's/employee's death to the beneficiaries of the account.

This Outline deals only with such post-death required minimum distributions ("RMDs").

1. How SECURE changed planning for retirement benefits (or not)

Planners and their IRA-owning clients did not welcome drastic changes to the minimum distribution rules made by SECURE, eliminating the life expectancy payout for most beneficiaries that so many had counted on. It appeared at first that SECURE might have one possible silver lining: By imposing a 10-year rule for most beneficiaries (for participant deaths either before or after the "required beginning date" or RBD), maybe at last the rules would get a little....simpler? No such luck. Instead the opposite happened. The rules got much more complicated than before—while the potential rewards for complying with them shrank.

A. Death before or after RBD matters more than ever.

Though SECURE seemed to reduce the differences between the RMD rules for "death before the RBD" and "death after the RBD," the Treasury regulations continue and even increase that difference—with a vengeance. For example, the EDB of a participant who died before his RBD can elect to use the 10-year rule instead of the life expectancy payout. SECURE did not necessitate or even suggest that wrinkle. The EDB of a participant who died after his RBD? ...can't elect the 10-year rule (sorry). Another example: A designated beneficiary who is subject to the 10-year rule does not have to take any annual RMDs in years 1-9, just a 100% distribution in Year10...unless the participant died on or after the RBD, in which case such beneficiary DOES have to take annual RMDs in years 1-9.

B. Plan administrator full employment act.

For some of the changes made by the Treasury's own proposed regulations, the Treasury needed to introduce still more complications. For example, since the proposed regulations allow an EDB to opt for the 10-year rule instead of the life expectancy payout (in cases of death before the RBD), the Treasury needed to then add rules about how the EDB's election would continue to apply to any IRA to which the original account was transferred after the election had been made. For example if the EDB inherited a 401(k) plan and elected the 10-year rule, then opted to have that plan transferred into an inherited IRA, the election would automatically apply to the transferee inherited

IRA as well. This makes lots of work for plan administrators and IRA providers who need to revise all their forms. This opens the door for lots of future mistakes needing to be fixed as elections get lost, changed, or forgotten about when funds are transferred from one account to another.

2. Where to find the new minimum distribution rules

The RMD rules for the beneficiary of a participant who died on or after the RBD are in Prop. Reg. § 1.401(a)(9)-5(d)(1). If the participant died before the RBD, the rules are in two places: Prop. Regs. § 1.401(a)(9)-3(c) and § 1.401(a)(9)-5(d)(2). To see the entire Proposed Regulations including the Preamble, go to:
https://www.federalregister.gov/documents/2022/02/24/2022-02522/required-minimum-distributions

3. New definitions and terminology

The proposed regulations provide definitions for some of SECURE's important terms, including "reaches majority" and other elements of the "eligible designated beneficiary" category; see PART 3. They also define some already-widely-used terminology, including "see-through trust," "conduit trust," and "accumulation trust," for the first time; see PART 4, #5. The proposed regs would change some existing terms: For example, the terms "applicable distribution period" and "divisor" would mostly be replaced with "applicable denominator" or just "denominator." See Prop. Reg. § 1.401(a)(9)-5(d) and proposed amendments to Reg. § 1.401(a)(9)-9.

PART 2: THE CASE STUDIES

Case #1: Mr. Brady: Planning for a PODB; How to Draft an Accumulation Trust

Your client Algernon Brady, age 63, a widower, wants to leave his estate in trust for his only child, Patrick O'Donahue Brady ("PODB" for short), age 31. PODB is not disabled or chronically ill. Concerned about PODB's ability to manage finances, and PODB's likelihood of having divorce troubles if he ever marries and/or creditor problems if he goes into business, client wants to leave all assets in trust for PODB, with the trustee using income and principal as the trustee deems advisable to provide for PODB's lifelong support and health and for the care of PODB's children if he ever has any. Client's assets include a traditional IRA, a Roth IRA, and a 401(k) plan with his employer, with significant sums in each account. You write the will and trust just as requested by Client, to deal with the nonretirement assets. What special considerations apply to the retirement accounts?

Two things make the retirement accounts different:

- No "stepped up basis" at death. All distributions from the accounts (except the Roth) will be income-taxable to the recipient at ordinary income rates. Thus planning for these accounts must take into consideration the income tax rate that will apply to distributions after Algernon's death.

- The minimum distribution rules which dictate how fast the money must be distributed from these accounts after client dies. Since spreading out the plan distributions over a longer period of time rather than a shorter one may allow a lower overall income tax burden, the planner needs to know what distribution period will apply to the client's IRAs—and the extent to which such period can be extended by drafting the trust in accordance with "See-through Trust" rules.

A. What happens when q traditional retirement plan is paid to a trust

When distributed to the proposed trust, the traditional plans will be taxed at trust income tax rates except to the extent the distributions are, in the same year received, passed out to the trust beneficiary in a manner qualifying for the "DNI deduction." See FIT Facts #1 and #2 (Appendix A). If so passed out, the distributions would be taxed to PODB individually. The income taxes on the distributions will likely be much lower if they are passed out to PODB than if retained in the trust, due to the fact that a trust hits the top bracket (37% in 2022) at just $13,450 of taxable income vs. $523,600 for a single individual taxpayer. PODB's income is much lower than $523,600.

Client is still better off leaving the accounts to a trust to achieve his goals with respect to PODB: If the trustee has full discretion, when the trust receives a distribution from the retirement account, to pass such distribution out to PODB or not pass it out, the trustee can distribute (to take advantage of PODB's lower tax rate) when trustee judges that PODB will make good use of the money or not distribute (and let the benefits be taxed at the higher trust tax rate) at times when it appears PODB may not make good use of the funds. Thus the trustee will have to monitor PODB and try to control the cash flow. From this perspective it would be helpful if the trustee could spread the distributions over a period of time rather than taking a lump sum distribution. The longest possible period of time over which distributions can be spread is 10 years, due to SECURE.

The arbitrage between trust tax rates and PODB's personal income tax rate does not apply to the client's Roth account, distributions from which will be tax-free. The only advantage of "deferral" for the Roth account is, the longer the funds can be kept inside the account generating tax-free returns, the better.

B. The minimum distribution rules applicable to PODB

If the retirement accounts are left to PODB as designated beneficiary, he would be subject to the "10-year rule." Thus if client died at age 63 in 2022, PODB would have to withdraw the entire balance by 12/31/2022 (year containing the 10th anniversary of client's death). PODB could withdraw the balances anytime during the years 2022-2032, thus giving him 11 taxable years to "spread out" the distributions.

If client dies AFTER his required beginning date (April 1 of the year he turns 72—about 10 years from now in other words), the payout period for the Roth IRA wouldn't change—it would still be the 10-year rule as described above. However, according to IRS Proposed Regulations published February 2022, PODB would have to take annual distributions from the inherited traditional plans in years one through nine of the 10-year payout. See PART 3, #3. Such annual distributions would be based on PODB's life expectancy (see Appendix C). This aspect of the proposed regulations

(requiring annual distributions in cases of death after the RBD even when the 10-year rule applies) is extremely controversial and there is some possibility it will be eliminated by final regulations, but don't count on it.

Those are the payout requirements for accounts left directly to PODB as beneficiary. What if the accounts are left to the trust this client contemplates having?

C. How to get the same treatment for the trust

The 10-year rule as described above is the best possible deal available for PODB if the benefits are left to him personally under today's RMD rules. Can a trust for PODB get the same deal? PART 4 of this Outline explains the rules for getting designated beneficiary status for a trust, including the trust testing process, in detail, with citations. This case study provides an example of the process described in PART 4:

The kind of trust this client wants is called an Accumulation Trust: The trustee would not be required, every time it withdrew money from the retirement account, to immediately pass such distribution out to PODB. On the contrary, the client wants the trustee to have the power to *accumulate* plan distributions in the trust (if the trustee thinks that would be best) for future use. Therefore the trust the client wants is an accumulation trust (PART 4, #5).

The 10-year rule is available only for a "designated beneficiary." The minimum distribution rules say, an accumulation trust can qualify as a designated beneficiary only if it meets certain requirements. Here are those requirements and how you as the estate planner must deal with them:

There are four initial rules that are easy to comply with: The trust must be valid under state law; the trust must be irrevocable upon the participant's death; a copy of the trust must be given to the plan administrator by 10/31 of the year after the year of the participant's death; and it must be possible to identify the persons who will be beneficiaries of the trust. See PART 4, #3, for details.

Once you clear those hurdles you have a "See-through Trust." See PART 4 #5.

Now we "look through" the trust and see who are the beneficiaries of the trust. Since the basic definition of a "designated beneficiary" is that the beneficiary must be an individual, all of the trust beneficiaries must be individuals or you are going to "flunk" this test.

All of the trust beneficiaries must be individuals? Well not necessarily ALL....only the countable beneficiaries—beneficiaries who cannot be "disregarded" in applying the "who are the *countable* beneficiaries" test. This is the hard part of trust drafting and testing. See PART 4, #6-13.

This brings you to a decision point faced with most clients. You can just draft the trust the way he wants it, and let the chips fall where they may—meaning the trust may not qualify as a Designated Beneficiary Trust (DBT; PART 4, #6) and therefore not qualify for the 10-year rule. Or you can offer the client alternatives—ways to draft the trust that would so qualify even if that is not exactly what the client had in mind.

Step 1 in this process is to ask Algernon, who will inherit the money that's left in this trust when PODB dies? The answer to that question will tell you the RMD status of this trust—will it qualify as a DBT or not? Because the countable beneficiaries of this trust will be son Patrick [PODB] (the "first-tier" beneficiary) and whoever gets the money when he dies (the "second tier beneficiary"). See PART 4, #8. All countable beneficiaries must be individuals or the trust is not a DBT.

Client says: "On PODB's death, the remaining funds should go to PODB's children if he has any but he doesn't have any yet." Children would be fine as second tier beneficiaries but a cardinal rule of RMD trust testing is **you can't count anyone who isn't born yet**. So you ask: And who will get the money if PODB dies without issue?""

Client says: "In that case my favorite charity." A charity is not an individual. Naming a charity as remainder beneficiary of this trust would cause the trust to "flunk" the RMD trust rules and client would have "no designated beneficiary." Would that be so terrible? The payout period would be, if he names charity as remainder beneficiary:

- If he dies before his RBD, the 5-year rule instead of the 10-year rule. This rule would apply to the Roth IRA regardless of client's age at death.

- If he dies on or after his RBD, the "ghost life expectancy" payout would apply to the traditional plans—annual distributions over what was left of client's life expectancy. That period would range from about 14 years (if he dies at age 73) to 4 years or less (if he dies at age 95 or older). As many planners have noted, the ghost life expectancy would provide a LONGER payout period than the 10-year rule if the client dies between ages 73 and 80!

So: To get "PODB" treatment for the trust client must choose one or more individuals as remainder beneficiaries. Instead of naming charity as the second tier beneficiary, he could name his seven nieces and nephews to inherit whatever is left in the trust if PODB dies without issue.

Before encouraging Algernon to change his beneficiaries (and leave money to nieces and nephews that he would really rather leave to charity), consider running projections of what the estimated tax savings would be by having a DBT vs. a trust that does not qualify as a DBT.

Always a problem, now a bigger problem under SECURE

Estate planners can have a tendency to seek "tax deferral" above all other goals in the universe when writing an estate plan for a client who owns an IRA or other retirement plan. While that tendency made some sense in the pre-SECURE era (when the long-term tax deferral offered by the "life expectancy payout" was relatively easy to obtain), it can act as a blinder in the post-SECURE world, where the difference between a 5-year payout and a 10-year payout may make little difference in long term value. To be blunt, making retirement benefits payable to a trust is GENERALLY going to mean those benefits are taxed at the highest income tax rate. A payout period of 5 to about 15 years can usually be managed, but unless the client has a young spouse (who can use the spousal rollover) or a young disabled beneficiary, there is not going to be long term deferral of the income tax bite.

If the nieces and nephews are named as the second-tier beneficiaries, the charity can be named as "wipeout" beneficiary if it should happen that PODB dies without issue AND all the nieces and nephews predeceased PODB. With that structure, the charity can be ignored because it will inherit only if all the other "second tier beneficiaries" predeceased the "first tier beneficiary." Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)(1); see PART 4, #11.

D. DO: Limit distributions from the trust to the decedent's estate

In its Preamble to the Proposed Regulations, the IRS stated that a trust provision that would call for the trustee to make payments from the trust to the participant's estate would cause the estate to be deemed to be a countable beneficiary of the trust! The participant's estate is not an individual and cannot qualify as a designated beneficiary under any circumstances. See Prop. Reg. § 1.401(a)(9)-4(b). Therefore, the Preamble (p. 41) casually states, if the trust is to pay money to the estate (or pay obligations of the estate out of the trust fund), that makes the estate a beneficiary of the participant and the participant does not have a designated beneficiary—the "no-DB rules" would apply.

Accordingly for a trust that is to receive retirement benefits, if designated beneficiary treatment is desired, and the trust instrument calls for the trustee to make distributions or transfers to the decedent's estate (as most trusts do), the trust should prohibit the trustee from distributing any *retirement benefits or proceeds thereof* to the estate, either altogether or (at a minimum) after September 30 of the year after the year of the decedent's death. See PART 7, #2.

E. Planning agenda; alternatives to consider

The client's original goal was to name a charity as remainder beneficiary of the trust after his son's death. Client has to sacrifice that goal to get "designated beneficiary trust" (DBT) treatment for the trust he contemplates. Various alternatives should be considered before finalizing the plan.

- Before revising the trust (and defeating client's desire to name charity as remainder beneficiary) you (or someone you engage) should crunch the numbers to determine what the projected income tax difference will be between qualifying for the 10-year rule vs. not so qualifying. That projection is going to be complicated and expensive and may well not prove much of anything. It will have to make assumptions about the growth rate of investments, when the client will die, what PODB's spending needs will be, when PODB will die, and what PODB's tax rate will be. Without any monetary projections, however, it is hard to justify the sacrifices being made to achieve DBT status—such as giving up on the client's charitable goal, and requiring the trustee, each year, to make projections of future tax rates and beneficiary needs and guess what will be the best year to draw down the retirement accounts.

- There is one more potential cost of having a trust that does NOT qualify as a DBT: The trust will probably be stuck with a lump sum distribution from the *qualified plan* (Algernon's 401(k) plan) because most plans only permit a lump sum distribution and the trustee will not be able to transfer the lump sum to an inherited IRA unless the trust qualifies as a designated beneficiary. See ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits*.

- If the two pots of money (retirement benefits vs. other assets) are large enough to justify two separate trusts, create one trust for the benefits (with individual remainder beneficiaries) and another for other assets (with a charity as remainder beneficiary). But this approach creates

new complications for the trustee who is forced to choose each year which trust to deplete to provide for PODB's use in such year. The planner might need to draft a formula for distribution on termination of the non-retirement-benefits trust to assure that nieces, nephews, and charity each received the appropriate amount regardless of which trust is depleted first during PODB's life.

Case #2: Jean Selby: Benefitting the spouse; How to draft a conduit trust

Your client Jean Selby has a $1 million IRA among other assets. She wants to leave the IRA to her husband Simon Selby (SS) but not outright. She wants it to be held in trust for him for life. She understands that as her surviving spouse SS is entitled to a life expectancy payout if he is named as beneficiary. A gradual payout over his lifetime sound just right to her for this IRA, just as long as he does not have to inherit as outright beneficiary.

A. The client's trust goals; RMD effects

Here is what Jean wants the trust to say: "The trustee will pay SS, each year, such amounts of income and/or principal as the trustee deems needed for his health and support. Upon his death the trust will distribute the remaining trust assets to my nieces and nephews equally, or if they have all died, to charity."

A trust written as Jean describes it would qualify as a DBT....all the "countable" beneficiaries are individuals:

SS = first tier;
Nieces and nephews and charity= secondary or second tier;
BUT charity is disregarded because [1] it is not a first-tier beneficiary and [2] it inherits only if all nieces & nephews die prior to SS.

However, unless one or more of the nieces and nephews is disabled or chronically ill (see PART 5, #2), this trust will NOT qualify for a life expectancy payout. Why? Because a trust for the spouse is entitled to use the surviving spouse's EBT treatment ONLY if the spouse is the SOLE countable beneficiary of the trust—i.e., only if the trust is a "conduit trust." The trust can qualify for EDB treatment (without the special spousal deals though) if all countable beneficiaries are EDBs (for example if all of the nieces and nephews were disabled or chronically ill), but that is not the case. If written as client has described it, this trust would only qualify for the 10-year rule (PODB treatment).

The PROBABLY-best solution is to recommend a conduit trust instead. That would give SS annual distributions over his life expectancy as Jean wants. However, it would give SS more control than he would have if the trust were written exactly as Jean envisioned it; the trustee would not be able to hold back any of RMDs from the IRA (they would all have to be passed out immediately to SS) and would not be able to take IRA distributions and accumulate them in the trust's taxable account for future use.

So recommend the conduit trust—BUT FIRST check the Single Life Table in Appendix C of this Outline to make sure the life expectancy payout really would make a financial difference. If both spouses are over age 80, there is no payout in the picture longer than10 years.

Jean and SS are both in their 50s (life expectancies 30+ years). Jean agrees to the conduit trust idea. Now how do you actually draft a conduit trust?

B. How to draft a conduit trust

The usual first step is to designate a separate article or section of the trust for dealing with retirement benefits that are subject to the minimum distribution rules of § 401(a)(9) of the Code. **Describe them** by Code section or list the client's actual plans and accounts, being sure to include (if desired) subsequently acquired retirement accounts of a similar type. Have a boilerplate paragraph authorizing the trustee to take actions with these accounts such as investing them and transferring them. Ideally there should be a paragraph discussing how the trustee will account for these retirement accounts (*e.g.* determine income and principal with respect to these accounts); see Appendix A, "FIT Fact #3, "Trust accounting income is not the same as federal gross income."

Then have a paragraph **dictating what the trustee will withdraw from the account**. It is customary to start by directing the trustee to withdraw any amount required to be withdrawn in such year by the Tax Code. It is not really necessary to do this since the trustee has to withdraw the required minimum distribution whether you tell him to or not. But including this shows you are aware of the obligation and it's a good starting point.

Then list additional amounts the trustee must or may withdraw from the retirement accounts, IF the client wants such additional amounts withdrawn and paid to the spouse, such as:

- [if marital deduction is sought] If the income earned within the IRA for the year in question is greater than the RMD for such year, the trustee shall withdraw such additional amount as is required to make the withdrawal for such year at least equal to such income.

- [if desired for spouse's health and support; recommended! See comment below]: "Such additional amount or amounts, if any, needed in the opinion of the trustee to provide for my spouse's medical care, health, and support in his/her accustomed standard of living."

- [highly advisable to allow the trustee flexibility in view of potential changes in circumstances and/or tax laws] "Such additional amount or amounts, if any, as the trustee deems advisable for any reason to carry out the purposes of this trust." If using this type of provision be sure to state the purposes of the trust someplace—in fact that's a good idea anyway.

The above bullet list contains some optional (though highly recommended) clauses to include in a conduit trust. After completing the list of what the trustee must or may withdraw, the following additional clause is MANDATORY; this is what makes the trust a conduit trust:

"Any and all amounts withdrawn from the Retirement Account(s) pursuant to the above provisions or otherwise shall, upon receipt by the trustee, be paid directly to, or for the benefit of, [name of conduit beneficiary]." See Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(A).

It is probably also advisable to mention that the trustee can withdraw mounts needed, if any, to pay expenses of the trust properly attributable to this asset, such withdrawals to be used for that purpose..

Editorial comment: I would urge Jean to permit the trustee broad discretion to pay SS more than the "floor amount" of RMD (or greater of RMD and income). Unless for some reason she is trying to put SS in a very tight box, the trust will provide SS no financial security or predictability if it is strictly limited to the RMD or even to the greater of income or the RMD. Remember 2020? The RMD was zero...and interest rates were also zero...so trusts that limited the surviving spouse to the "greater of income or RMD" gave the spouse exactly nothing for the year. For the spouse's peace of mind, include such additional distributions as shall be needed for SS's health, support, etc. For maximum flexibility for the trustee to deal with changing circumstances and predicted changes, allow discretionary distributions for any reason consistent with the purposes of the trust.

C. This variation does not work: Until death "or remarriage"

Jean suddenly realizes something: SS might remarry after her death! She asks you to insert a clause that if SS remarries the trust will terminate and be distributed immediately to the nieces and nephews. That's perfectly legal—you can do it. But it will cause the trust to lose its qualification for the life expectancy payout because SS will no longer be considered the sole beneficiary.

Under a conduit trust for SS's *entire life*, SS is the sole "first tier" beneficiary, and the nieces/nephew are "secondary" beneficiaries...and because it's a *conduit trust* the secondary beneficiaries are disregarded and therefore SS is the sole countable beneficiary therefore the trust gets the same RMD treatment as SS would receive if named directly as designated beneficiary: Life expectancy payout commencing later of year Jean would have reached age 72 or year after Jean's death, and life expectancy recalculated annually.

But if the trust might terminate BEFORE SS's death, e.g. upon his remarriage, then the nieces and nephews move up to being "first tier" beneficiaries. Why? Because their interest is "neither contingent upon, nor delayed until, the death of another trust beneficiary"—they might *not* have to wait until SS dies to get the money, they can get it if he remarries. See Prop. Reg. Preamble, p. 32. If a life-expectancy-of-the-surviving-spouse is sought for the trust, it should be a conduit trust for the surviving spouse's entire life, not terminable upon remarriage or any other lifetime event.

D. A Trusteed IRA is the same as a Conduit Trust

An individual retirement account under § 408 can be either a "custodial" account with a bank as the custodian or a trust with a bank as trustee. The Tax Code is indifferent regarding these two formats—they are treated identically under the Code. From the perspective of the IRA owner, the difference is the level of service provided by the "IRA provider."

With a *custodial IRA*, the bank keeps track of the investments and the inflow and outflow of money and files required annual IRS tax reports (1099 and 5498). With a *trusteed IRA*, the bank performs additional services typically including managing the investments, determining when distributions should be made, paying the account owner's bills or other designated expenses directly from the account, and (most importantly), after the owner's death, limiting distributions to the account beneficiary(ies) to the minimum required distributions plus such other amounts (if any) as the deceased account owner has authorized. The trustee of a trusteed IRA can make distributions to or for the benefit of the account beneficiary(ies) on a similar basis to what the trustee of a conduit trust would do: For example, pay to (or apply for the benefit of) the beneficiary the RMD plus additional amounts if needed in the trustee's opinion for health or support.

With a trusteed IRA the IRA owner does not have to prepare a separate trust agreement: The IRA agreement *is* the trust agreement. However, the IRA owner's estate planning lawyer should participate in drafting that trust agreement or at the very least review it on the IRA owner's behalf.

Since a trusteed IRA and an IRA paid to a separate conduit trust are identical in tax and RMD treatment, whenever a client is going to use a conduit trust, consideration should be given to placing the IRA into a trusteed IRA account and having the IRA trustee carry out the duties that were to be specified in the conduit trust.

Case #3: Minor beneficiaries. Tradeoffs: Separate trusts or pooled (pot) trust?

A. Stan and Stacey Steinmetz: Facts and goals

Stan and Stacey Steinmetz are in their 30s. They have four children ages 2, 6, 9, and 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, $200,000 of life insurance (through Stan's job), and $250,000 in 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 "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, based on their various needs (i.e., not necessarily equally) 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 to Stan's Uncle Oscar the Potato Farmer who is age 63.

Where do the retirement benefits fit into this?

B. RMD effects of leaving benefits to or f/b/o minor child-EDBs

The first step is to determine how the "life expectancy payout" could apply to benefits left to a trust for the Steinmetz children post-SECURE. 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 a 10-year payout limit kicks in. Attaining majority

occurs on the 21st birthday under the Proposed Regulations. Under SECURE, all benefits must be distributed within 10 years after the child reaches majority, i.e., by age 31 (or within 10 years after his/her earlier death in case of death prior to age 21). So the "life expectancy payout" for a minor-child-EDB is actually a "life-to-age-31" payout.

The Proposed Regulations provide that the outer limit for distributions to a minor child-EDB is "the tenth calendar year following the calendar year in which the designated beneficiary reaches the age of majority," meaning 100% must be distributed by the end of the year the minor attains age 31 (not by the 31st birthday itself). Also note: 100% distribution is required 10 years after the minor child's death if he or she dies before attaining age 21. § 401(a)(9)(E)(iii).

Under the Proposed Regulations, the Steinmetzes have the following options for retirement benefits payable to their minor children who are not disabled or chronically ill:

- **For one child: Name child as beneficiary.** Of course a share could be left outright to each child, to be administered by the child's guardian, and this outright bequest would qualify for the life-to-age-31 payout. However, few parents would choose this approach which among other drawbacks would give the child total outright control of the asset upon attaining the applicable state law age of majority (18 in many states). Even though the *tax law* would permit the child to keep the IRA going to age 31 (taking annual RMDs in the meantime), the child might decide to cash it out at age 18 and throw a hell of a party.

- **For one child, cont: Conduit trust for child.** The parent could leave benefits to a conduit trust for a minor child-EDB. All retirement plan distributions received by the trust would have to be immediately paid out by the trustee to (or for the benefit of) the child. As a conduit trust, this would have the advantage of being guaranteed to receive the same RMD "deal" as the child would receive if named individually, i.e., the life-to-age-31 payout, without the drawback of the child's gaining control at age 18 or 21 (state law age of majority). The trustee would control the rate of distributions until the year the child reached age 31 at which point the entire account would have to be distributed to the child. The drawback obviously is the trustee's inability (under a conduit trust) to take distributions from the IRA and hold them in the trust for distribution at a later time. An advantage of the conduit trust is that the parents can name any secondary beneficiary they want (such as a charity) to take the remaining benefits if the child dies before age 31. But under the Proposed Regulations the parent can obtain BOTH of these advantages of the conduit trust (guaranteed same RMD a child would get if named as outright beneficiary plus parent's ability to name any "wipeout" beneficiary it wants to name, even a charity) by naming an accumulation trust for the minor's benefit under which the minor would achieve total outright control and ownership at age 31, see next paragraph:

- **For one child, cont: Outright-at-age-31 trust:** Under the Proposed Regulations, the good news is the parents do not have to use a conduit trust for the child in order to qualify for the life-to-age-31 payout. An accumulation trust will work as well, *provided* it is entirely distributable to the child by the end of the year in which the child reaches age 31. In effect it is an "accumulation trust" during the years from age zero to age 30, that turns into a

conduit trust in the year the child reaches age 31. So the trust could provide that for years infancy through 30, the trustee would (1) take annual RMDs from the IRA based on the child's life expectancy and (2) take such additional distributions from the IRA as the trustee deemed advisable and (3) either pass out such IRA distributions to or for the benefit of the child or hold them in the trust for distribution in a later year, provided that (4) 100% of the trust is distributed to the child no later than the year child attains age 31. Because of the outright distribution no later than the age-31 year, the child is deemed to be the sole beneficiary of the trust for purposes of computing RMDs. Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B).

- **For one child, cont.** There's even one more option allowing the life-to-age-31 payout to a trust for one child! An accumulation trust that has ANY countable beneficiary who is a minor child-EDB can use the life expectancy payout subject to the following two restrictions: The life expectancy payout will be computed based on the life expectancy of the oldest countable beneficiary of the trust (who may or may not be the minor child-EDB); and the 10-year-payout limit year will be 10 years after the oldest minor-child-EDB who is a countable beneficiary of the trust reaches age 21 (or earlier dies). Example: Parent leaves IRA to an accumulation trust for the benefit of her minor child Sophie, age 9. The trustee will use income and principal of the trust as the trustee deems best for Sophie's benefit for her entire life. Upon Sophie's death, the trust will terminate and pass to Sophie's cousin Len who is now age 24. Because the trust has a countable beneficiary who is a minor-child-EDB (Sophie), it uses the life expectancy payout based on LEN's life expectancy (because he is the oldest countable beneficiary). The entire IRA must be distributed to the trust 10 years after Sophie reaches age 21 or earlier dies. Assuming she doesn't die prematurely, the entire IRA must be distributed in 22 years (when Sophie attains age 31). **However, note that the fact that the IRA must be distributed to the TRUST does not mean it has to be distributed to SOPHIE. The trustee can retain the IRA distributions in the trust, pay tax on them, and then hold and administer the net after-tax amount for Sophie's benefit as provided in the trust.** Prop. Reg. § 1.401(a)(9)-5(e)(1), (f)(1)(i).

Wow! That's a lot of choices for the parents to sort through. But we've only just begun. Stanley and Stacey Steinmetz don't want separate trusts for each of their children, they were thinking more of a "pot" trust so the trustee would have the ability to spend more for one child than another based on relative need. The 2-year-old will need to be supported a lot more years just to reach the age the 12-year-old has already attained. And who knows which child might need special additional education or have unforeseen medical expenses? Or which child might have unique abilities that will cost extra money to develop? It does not make sense to this couple to create rigid predetermined shares for such young children.

What are their options for a trust for multiple children?

Here the Proposed Regulations have left a few gaps in our knowledge, as will be shown in this summary:

A pot trust written just as the clients want it would say: Trustee pays income and principal as the trustee deems best to or for the benefit of the children for their health, education, support, etc. until the youngest is age 25, at which point any remaining funds are paid out to the children equally.

Of course we have to ask the client, if all four children die before that termination point is reached, where does the money go? Of course that scenario is actuarially extremely unlikely but the trust is incomplete if it does not dispose of the trust funds based on any eventuality. The clients say "That is extremely unlikely, fortunately, but if it did occur the remaining funds should pass to Uncle Oscar the potato farmer who is now age 63."

Under the Proposed Regulations, the distribution period for this trust would be determined as follows:

Because there is at least one minor child-EDB [there are four], the life expectancy payout will apply. The life expectancy used will be that of the oldest countable beneficiary. And who would that be? Hopefully it is not Uncle Oscar....but it's not clear he can be disregarded, unfortunately.

The Proposed Regulations tell us Uncle Oscar can be disregarded if he can only inherit the trust if his inheritance is conditioned on the death of a prior beneficiary who will inherit the benefits fully by age 31. Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B). In other words, if there is ONE child-beneficiary, and he/she will receive the benefits outright by age 31, but Uncle Oscar would inherit the benefits if such individual dies before age 31, Uncle Oscar would be disregarded. But under the Steinmetzes' proposed trust Oscar's inheritance is contingent on FOUR other beneficiaries' dying before they are all over age 25. By the time the youngest one reaches 25, the oldest one will be age 35—i.e., older than age 31. It appears Oscar is NOT disregardable under the Proposed Regulations.

The Steinmetzes cure this problem by selecting a younger "wipeout" beneficiary, a 10-year-old cousin of Stacey's. Now the countable beneficiaries are the four children ages 2 to 12 and the 10-year-old wipeout beneficiary, so the oldest child's life expectancy can be used as the Applicable Denominator for the trust. As with most cases involving trying to mesh estate planning goals with deferral goals, the estate plan has to be changed to accommodate the deferral goals. Is that worth doing? See "E" below.

C. Annual RMDs and Outer Limit Year based on oldest minor child

At age 12, the oldest child's life expectancy is 72.9 years. Is it "bad" that the trust cannot use the life expectancy of each child? Not really. The difference between the life expectancy of the oldest child (age 12, LE = 72.9 years) and the youngest (age 2, LE = 82.8 years) is insignificant. The trustee will almost certainly be drawing out more than the RMD each year regardless of whether the RMD is 1/72.9th (1.37%) or 1/82.8th (1%), to provide for the children's needs.

The next hurdle is, what is the Outer Limit Year for this trust? It is 10 years after the oldest minor-child-EDB attains age 21 or earlier dies. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i), (2)(ii)(A). Since the oldest child is now age 12, the age-based termination will occur19 years from now, at which time the youngest child will be age 21 (2 + 19). If that were the only outer-limit concern it would be acceptable. The retirement accounts will probably be mostly depleted anyway by the time the youngest child reaches age 21.

BUT: There is another Outer Limit Year based on the oldest minor child's death, if that oldest child dies before age 21. Example, the parents both die now while oldest child is age 12. It is

expected the IRA will be winding down/paying out over the (effectively) 19-year term of this trust (based on when the oldest child reaches age 31). But what if the oldest child dies at age 14? If his death triggers the termination of EDB status for the trust (it does for HIM obviously) then the IRA will be paid out in just *12 years* after the parents deaths not 19 years. **That's a big acceleration and may force the parents to consider another plan.**

IRS should fix this!

The Proposed Regs clearly say that the Outer Limit Year for a trust with multiple minor beneficiaries (even if all are EDBs) is based on the reaching-age-21 OR DEATH of the oldest minor child-EDB. Prop. Reg. 1.401(a)(9)-5(f)(2)(ii)(A). They should make the "death termination" trigger the same as it is for disabled beneficiaries, namely, the death of the LAST minor-child EDB to die.

Should they consider separate trusts for each child, so each child's RMDs would be based on his or her own age and (if applicable—not likely to be applicable) premature death should that occur? That can be done if each child's trust is distributable outright to him or her no later than age 31 (so the second-tier beneficiaries can be ignored). Unless each child's trust is a conduit trust, or a trust that is distributable totally to the child by age 31, the second-tier beneficiary(ies) will be countable, and those presumably would be the other children....putting you right back into the picture of having the oldest child's age (or premature death) dictate the annual RMDs and Outer Limit Year!

So, to get the benefit of each child's own age for purposes of determining the life expectancy payout, and each child's own attainment of age 21 (or premature death) for purposes of determining the Outer Limit Year, the surviving parent's retirement accounts would be payable in equal shares to separate trusts, one for each child, under which such child would receive total distribution by age 31.

How much is it worth, in terms of tax savings for the children, to use this separate-trusts approach as opposed to the "pot" trust the parents initially wanted? The estate planner must be prepared to quantify exactly how much money it would save for the family to have separate trusts for each child (to get the maximum deferral for each child's share) vs. having a pooled "pot" trust that must base annual RMDs and the Outer Limit Year on the age of the oldest child.

HOW ARE YOU AS AN ESTATE PLANNER GOING TO MAKE AND EXPLAIN THESE CALCULATIONS?

D. Separate trusts vs. a family "pot" trust

Here is where we have to leave the theoretical framework of "what gets the longest payout" and look at the individual family's situation. Here are some views developed during the planning process:

- If the spouses die in the near future, it appears likely the total family assets of $1,500,000 will be substantially or totally depleted by raising these four children to adulthood. Deferring taxes on the retirement benefits is not a realistic goal in view of the likely financial needs of the children. The retirement plans are likely to be cashed out faster than the RMD rules would require no matter what estate plan structure is used.

- The “pot” trust makes much more sense for this very young family, where the exact amount each child is likely to need to be raised to adulthood cannot be predicted and the asset pool is not so large they can safely assume that each child has more than enough under an equal-share division.

- It is extremely unlikely that both parents (now in their 30s) will die in the near future. The much more likely scenario is that all the children will be well past age 25 when the parents die. It does not make sense to invest legal time and expertise in trying to arrange this trust to get the maximum deferral for every dollar of retirement benefits when (1) doing so would require adopting less desirable fixed-share estate plan and (2) this plan is being written to cover a very unlikely event anyway.

- Even a plan perfectly fine tuned based on the expected final distribution of all the retirement benefits when the oldest child is 21 could be upset if the oldest child does not live to age 21. How does the plan protect against that scenario?

- Another approach would be to have four fixed-share separate trusts to use as beneficiaries of the retirement benefits (to achieve maximum deferral for each child’s share) and a fifth trust, holding all the nonretirement assets, to be the true “pot trust” for the children as a group. Distributions from this trust could be used to (for example) provide the “extra share” the youngest child needs just to catch up with the older ones or the extra expenditures needed for each child’s particular educational, medical, etc. needs. Realistically does it make sense to draft and then administer five separate trusts for this family?

E. Conclusion, comments regarding planning for minor children

If time and money is going to be spent preparing numerical projections, aim those projections at how much money (after tax) should be left in trust to raise these children to adulthood. If it appears that number is more than the current family net worth, consider buying term life insurance on the young parents (very cheap) to cover the gap, rather than trying to increase the pot by squeezing a (slightly speculative) extra deferral out of the retirement benefits. My motto: Pay the insurance company to get an estate plan the clients DO WANT instead of paying the lawyer to draft an estate plan they DON’T WANT!

Can a case *ever* be made for rejiggering an estate plan to capture the benefits of the life-to-age-31 payout for minor children of the participant? Perhaps yes if it involved a substantial retirement account and a much older and wealthier participant who has minor children through a late-in-life union or adoption. This hypothetical client has more at stake (larger retirement plan) and is more likely to die while the child is still a minor (because client is old) and has sufficient other assets that there will be no need to accelerate distribution of the retirement plan just to raise the child to adulthood. Call me when that client shows up.

Here are few more fine points to cover for Stanley and Stacey:

<u>Stan's 401(k) plan</u>: Stan and Stacey and their attorney decide qualification as a Designated Beneficiary Trust (DBT) 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 DBT 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 life-to-age-31 payout allowed for minor children of the participant. See ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits* regarding this "nonspouse beneficiary rollover" option.

<u>Stacey's IRA</u>: Stacey's IRA does offer the life expectancy payout form of benefit. Thus, if the trust that is named as contingent beneficiary of Stacey's IRA qualifies as a DBT, the trustee will qualify for the life-to-age-31 payout applicable to minor children of the participant if the trust for the children is designed to qualify for that. This would be a desirable outcome. It would be nice for the trustee to have the option of deferring distributions from the IRA as long as possible.

F. Can we pay to a "§ 678 grantor trust" (BDOT) instead of to the child?

Under § 678, a beneficiary is deemed the owner of any trust assets he has the right to withdraw from the trust. This is the only one of the "grantor trust rules" that applies to the beneficiary rather than to the creator/funder of the trust. Planners would like to find a way to get the life-expectancy-to-age-31 payout for an IRA payable to the client's minor child without actually paying the IRA over to the child. They would prefer to hold the assets in a trust but have the distributions taxed at the child's tax rate. Can this be done by naming a § 678 grantor trust (nicknamed by practitioners a "beneficiary deemed owner trust" or BDOT) for the minor child as beneficiary of the IRA? The theory is, the trust-drafter and trustee would somehow figure out a way that the child wouldn't actually withdraw the money.

Advocates of this approach suggest that the child would deemed to be the IRA beneficiary either because under § 678 he and the trust are considered "the same person," or because the § 678 trust would be a see-through DBT of which the child would be deemed the sole beneficiary (thereby qualifying for minor child-EDB treatment). Neither theory has been addressed by the IRS.

Clearly under Code § 671 IRA distributions paid to a § 678 grantor trust for "Beneficiary X" will be included in the income of Beneficiary X. It does not automatically follow that a trust for Beneficiary X (§ 678 or otherwise) meets the definition of "designated beneficiary," which is an ***"individual*** designated as a beneficiary by the employee." § 401(a)(9)(E)(1). Although we do have all the IRS rulings starting in 1985 which seem to essentially say "grantor trust = grantor," "your grantor trust is you and you is your grantor trust," nothing has ever extended that viewpoint (which is NOT a viewpoint necessarily dictated by § 671—far from it) to § 401(a)(9)(E)(1). We know IRS has extended it to the point of allowing disabled or minor beneficiaries to transfer personally-inherited IRA to their own grantor trusts, but IRS has shown hostility to allowing such transfers by the IRA owner during life. Some commenters may have requested this treatment in comments on the proposed regs so we'll see if IRS answers the question one way or the other via final regs. In the meantime I don't want to be the first to try it.

Case #4: Planning for a disabled child: How to draft an AMBT

SECURE added to the Code specific provisions intended to facilitate leaving retirement benefits in trust for the benefit of a disabled or chronically ill (D/CI) individual. The Code gave the type of trust it especially authorized for D/CI beneficiaries the cumbersome title "Applicable Multi-Beneficiary Trust" (AMBT). The Proposed Regulations elaborated on and extended the AMBT provisions extensively to facilitate this type of trust planning. This case study focuses on the supplemental needs trust.

A. Client facts and goals

Mr. and Mrs. Dingle, both age 48, have three children, Winnie (age 23), Daisy (age 18), and Tony (age 16). One of the children, Daisy (the 18-year-old), is severely disabled and will need lifelong care. Mr. and Mrs. Dingle have $500,000 in their combined IRAs. Each will leave his or her IRA to the other spouse, who will roll it over into the survivor's IRA. On the survivor's death, the IRA will be left to a trust that will provide for Daisy's supplemental needs throughout her life.

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." A supplemental needs trust should be drafted by a lawyer who is conversant with the asset/income requirements of the disability benefit programs Daisy participates in and with the requirements for a supplemental needs trust (SNT) to be treated as a non-countable asset.

Mr. and Mrs. Dingle will name each other as outright beneficiary of their IRAs, with the supplemental needs trust for Daisy's benefit as contingent beneficiary.

B. Options for Daisy's trust under the RMD rules

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 designated beneficiary. 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 for the benefit of a disabled (or chronically ill) EDB *is* entitled to the EDB treatment/life expectancy payout—even though accumulation trusts for some other categories of EDB are not so entitled.

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. If she dies before the end of her "life expectancy," payouts after her death would continue to be made over her remaining life expectancy but final distribution would be required no later than 10 years after her death (even if her remaining "life expectancy" when she died was longer than 10 years).

C. A type II AMBT

Under SECURE and the Proposed Regulations, in order to qualify for the life expectancy payout, the trust for Daisy must meet two requirements:

- First, it must qualify as a Designated Beneficiary Trust. Since it must be an Accumulation Trust, that means the trust must name one or more individual remainder beneficiaries who will receive the trust property immediately and outright upon the death of either Daisy herself or some other trust beneficiary. The remainder beneficiary cannot be a charity (nonindividual).

- Second, the trust must provide that distributions from the retirement benefits (including proceeds thereof) may not be made to or for the benefit of anyone other than the disabled beneficiary (Daisy) during Daisy's lifetime. § 401(a)(9)(H)(iv), (v); Prop. Reg. § 1.401(a)(9)-4(g).

Oddly, SECURE does not seem to require that the trust make any distributions at all to Daisy or for her benefit—as long as no distributions are made to or for the benefit of anyone else during her life.

To meet the requirement the trust could be structured in either of two ways. One way would be to have a trust that was solely for Daisy's benefit during her lifetime, with the trustee making distributions from the trust to Daisy or for her benefit for her supplemental needs; the trust could hold the IRA only, or the IRA plus other assets. This trust could provide that it would terminate and be distributed to Daisy's two siblings at her death. This would make the trust a DBT since Daisy would be the First Tier beneficiary and the other siblings the secondary beneficiaries, and they are all individuals. (A contingent or wipeout beneficiary that would inherit at Daisy's death only if her siblings predeceased her is disregardable).

Another approach would be to have the trust be for the benefit of all the Dingell children but require the trustee to segregate the retirement account and all distributions from it and all "proceeds" (reinvestments) of such distributions; these retirement plan distributions and proceeds could be used only for Daisy, with other trust assets available to all the children. Someone will have to figure out how the trustee can reliably keep the IRA and its distributions and reinvestments separate from other

trust assets and remember to make distributions from this segregated account to or for nobody other than Daisy. On Daisy's death this segregated account would pass outright to the other two siblings.

Either approach works and will qualify as a "Type II AMBT."

Under either of those structures, because the trust (or the segregated IRA-plus-distributions-from-the-IRA account) is to terminate at Daisy's death and pass immediately outright to two other named individual beneficiaries (the siblings), the trust qualifies as a Designated Beneficiary Trust. The applicable distribution period (ADP) for required minimum distributions (RMDs) to this trust under pre-SECURE law would have been the life expectancy of the oldest of the three siblings. Under the Proposed Regulations it would be the life expectancy of the oldest disabled beneficiary, in this case Daisy.

Here are the RMDs for the above-described Type II AMBT (either structure):

- If the IRA owner died before his RBD, the payout period would be over Daisy's life expectancy because she is the oldest D/CI beneficiary, even though she is not the oldest child. Prop. Reg. § 1.401(a)(9)-5(f)(1)(ii). [If the IRA owner died after the RBD, the payout would be based on the "greater of" the IRA owner's life expectancy or Daisy's, but since Daisy is younger than her parents this would still be Daisy's life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii).]

- The Outer Limit Year would be the final year of Daisy's life expectancy, or, if earlier, 10 years after Daisy's death, because she is the oldest D/CI beneficiary of the trust. Prop. Regs. § 1.401(a)(9)-5(e)(1), (3), § 1.401(a)(9)-5(f)(2)(iii).

So, at first, it appears that all is well—the Dingells can leave their IRA to a see-through supplemental needs trust for Daisy that will qualify for the life expectancy payout, just as they could have done before SECURE. However there are important differences between these parents' 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 other beneficiaries, for example Daisy's siblings. That would have enabled the trustee to pass out such "excess" gross 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 retained in the trust and be taxed at (high) trust tax rates to the extent the retained distribution exceeds the trust's exemption and lower-taxed income brackets.

- 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.

- 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 even if her "remaining life expectancy" was more than 10 years.

If Daisy's trust 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.

D. Other planning ideas to benefit a D/CI individual

The Dingles as noted have limited assets with which to provide for Daisy after their deaths, and correspondingly limited planning choices. A SNT is essential for their plan. Here are other options that would-be benefactors of a D/CI beneficiary can consider; the options are different for wealthier clients vs. those of more limited means, and differ depending on whether a SNT is part of the mix, whether the client has charitable intent, and whether the D/CI individual is capable of managing his/her own finances,

A wealthier client with some charitable intent could consider naming a charitable remainder trust (CRT) as beneficiary of the IRA. The IRA would pass income-tax-free to the CRT which would then pay a life-long annual income (either a fixed dollar amount or a fixed percentage of the trust's assets revalued annually) to the D/CI beneficiary. The annual income paid to the D/CI beneficiary would be includible in his/her gross income. On death of the beneficiary, the principal would pass to the charity.

The Dingles could consider naming a CRT as beneficiary of the IRA. The annual unitrust or annuity payments from the CRT could be paid to a special needs trust (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. Also, Rev. Rul. 2002-20 appears to require that the SNT be includible in Daisy's estate on her death; see the Ruling for details. For full explanation of charitable remainder trusts (CRTs) and the advantages of naming a CRT as beneficiary of a retirement account, see ¶ 7.5.04 *et seq.* o f *Life and Death Planning for Retirement Benefits*.

Another approach that some planners might consider is, using a conduit trust 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) supplemental needs trust, 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 a supplemental needs trust created by the disabled individual him or herself with his or her own assets. While permitted by applicable law governing various 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.

A client who has a very large retirement account balance, likely to generate annual RMDs after the client's death in excess of the D/CI beneficiary's needs, should consider the tax rate that will apply to large post-death IRA distributions paid to the trust. If the client's personal tax rate is lower than what is likely to apply to these post-death distributions the client should consider doing annual partial Roth conversions from the IRA, which would be taxable at the client's tax rate rather than the trust. The Roth IRA's distributions to the trust would be income tax-free.

Case # 5: Beverly: Providing for NoMoTTYY Beneficiaries

One category of EDB is an individual who (1) is not a member of any other category of EDB and [i.e., not the participant's spouse, not disabled, etc.] and (2) is "not more than ten years younger than" the participant. The not more than ten years younger [or "NoMoTTYY"] individual might be older than the participant, or the same age as the participant, or even younger than the participant—as long as he/she is not more than 10 years younger.

Leaving an IRA to a trust for the benefit of a NoMoTTYY is no easier than leaving a trust for any other EDB. For one thing, the fixed-term life expectancy payout may end well short of the actual lifespan of the NoMoTTY, which is not good if the NoMoTTYY will be depending on this income stream. Also, the early death of a NoMoTTYY could accelerate the payout unexpectedly for other trust beneficiaries who were counting on him/her to live to at least within 10 years of his/her IRS life expectancy.

A. Facts and goals: Beverly

Beverly is age 76, unmarried, and childless. She wants to leave her $3 million IRA to a trust for the benefit of her three siblings Molly (age 74), Billy (72), and Kelly (70). Her goal is to provide them with professional management of the funds, a predictable (not necessarily large) income for life, and a fund that can be tapped disproportionately for extra expenses when needed. Preserving the fund for other possible beneficiaries after all the siblings are all deceased is not one of Beverly's goals for this trust. However, if there are funds left over they will go to charity, or (if that would cause the trust not to pass the "all beneficiaries must be individuals" test) to Beverly's nieces and nephews. None of the siblings is disabled. All are NoMoTTYYs.

The parents of these four children only recently died, at ages 98 (mother) and 102 (father); they were killed when struck by lightening while hiking in Baxter State Park, Maine, and are mourned by their four children and their many siblings who were on the hike with them.

Here are possible structures and the pluses and minuses of each based on the assumption Beverly dies right now.

B. Trust options to utilize life expectancy payouts

Beverly considers the following trust configurations to utilize her siblings' "EDB" status:

- **A single "conduit" trust fund which would pay out to all of the siblings as needed.** As a conduit trust, the remainder ("tier 2") beneficiaries would be disregarded so charity could be named as the remainder beneficiary. Since all countable beneficiaries would be EDBs, the life expectancy payout would apply based on the life expectancy of Molly, the oldest sibling. The 10-year Outer Limit Year would apply based on Molly's death—100% distribution of the IRA and the trust would be required within the earlier of about 15 years (Molly's approximate life expectancy) or 10 years after Molly's death (if she dies in the next five years, i.e., when her life expectancy is still over 10 years). This last feature makes this structure unacceptable. Since anyone can die at any time, you have to look at what happens if Molly dies suddenly, shortly after Beverly, say at age 77? The whole trust would be paid out by the year Molly would have turned 87, when Billy and Kelly are still living and with many years to go on their probable life expectancy. This result would destroy the plan for the IRA to provide a lifelong source of income and financial security managed by a professional trustee for the younger siblings.

- **3 separate "conduit trusts," one for each sibling.** This gets closer to the goal. Although each sibling would have an equal predefined share (which is not QUITE the ideal—the ideal was to have some flexibility to pay more to one than another based on relative needs), each sibling would have a life expectancy payout based on his or her own life expectancy, and not be surprised by a speeded up payout based on the unexpected death of the oldest sibling. If a sibling died, his or her remaining share would be placed into a trust for the benefit of the other siblings. This "one third remainder trust" would NOT be a conduit trust and would not be subject to ANY of the restrictions applicable to see through trusts...for example, it could accumulate IRA distributions, spend unequally between the surviving siblings based on need, and have a charitable remainder beneficiary. This remainder trust would have to withdraw the deceased sibling's share of the IRA in annual instalments over the remainder of the deceased sibling's life expectancy (with an Outer Limit Year of 10 years after such sibling's death—even if the remaining life expectancy payout would have been longer than 10 years). **Drawbacks:** A conduit trust forces the trustee to pay out to or for the benefit of the sibling the RMD each year; the trustee is not able to accumulate distributions for possible needs in later years. And, as the IRA payout ends at the end of the sibling's life expectancy, the sibling may have many years left to live, but the trust for that sibling is then "gone" and the sibling has to fend for him/her self. For example, at age 72, Billy's life expectancy is about 17 years. If he lives into or past his 90s (as their parents did), Billy will no longer have any income from his conduit trust. Once again, this structure does not fit well with Beverly's goals.

- **3 separate "accumulation trusts," one for each sibling.** Here is how this trust would be drafted. The trust for, e.g., Kelly, would say "the trustee will use income and principal for

the benefit of Kelly as long as she lives [setting forth the goal of a lifelong income plus extra funds as needed etc.]. Upon her death, if both of the other siblings are then living, the trust shall continue for their benefit on the same terms, or, if only one of them is then living, the trust shall terminate and the fund shall be distributed outright to such surviving sibling, or, if none of them is then living to Charity X." Assuming all 3 siblings survive Beverly, here's how this trust is tested. Countable beneficiaries are Kelly (first tier) and Molly and Billy (second tier). Charity is disregarded because it can inherit only if both of the other two siblings die before the first tier beneficiary Kelly. Prop. Reg. § 1.401(a)(9)-4(f)(3)(i), (ii)(A). *Since all countable beneficiaries are EDBs, the trust is entitled to the life expectancy payout*. The life expectancy payout and Outer Limit Year are both determined based on the oldest sibling's (i.e. Molly's) life expectancy. Thus, the trust has a foreseeable payout of about 15 years (Molly's life expectancy) after Beverly's death if Beverly dies in the near future. That anticipated payout would be accelerated by up to five years if Molly dies less than 10 years after Beverly (because then the Outer Limit Year would be 10 years after Molly's death). But regardless of when exactly Molly dies, the trustee would have the ability to accumulate IRA distributions and (after paying tax on them) save them for future years' needs. **Drawbacks**: If two of Beverly's siblings predecease her, she would need to take a different approach since in that case the two countable beneficiaries would be last surviving sibling + charity, and the trust would not qualify as a DB. In that case the payout would be over Beverly's then remaining life expectancy, with no option to elect the 10-year rule (since Beverly is past her required beginning date).

C. Conclusion about Beverly's IRA trust plan

No matter how you slice and dice it:

This IRA is going to have to be distributed within no more than about 15 years after Beverly's death and even that short payout period gets shorter each year that Beverly and the siblings live. Based on their family history there is a good chance that one or more siblings will live beyond the IRS table life expectancy.

And: Beverly has to make some compromises to get even that much "life expectancy payout" (such as possibly diverting the remainder to nephews to avoid having a countable charity/nonindividual beneficiary). And: The trust will have to pay trust income tax rates on any significant IRA distributions accumulated for the purpose of providing for the siblings' later years and/or for unexpected large expenses. And: The trust will be in a higher income tax bracket than Beverly is right now.

So: Beverly has a problem if this is the only asset she has to fund her goal of providing for the siblings. If that is the case, she should consider annuity solutions and/or consider doing Roth conversions during life so the trust can be funded with an asset that does not creates such income tax complications.

On the other hand, if this asset is just one of many, then the conduit trust for each beneficiary for his/her 1/3 share can make sense. The siblings could be advised to regard the life expectancy payouts as temporary income, to be saved for the future or used for nonrecurring expenses. Or, the manager of the other assets could level out each beneficiary's cash flow by reducing distributions

from the "main" trust (holding Beverly's substantial other assets) in the "early" years, then increasing distributions from the main trust when the IRAs ran out. The main trust provisions would say exactly what Beverly wants them to say with no compromises (in either drafting or trust administration) to accommodate the RMD rules.

And/or (again, if Beverly has other assets besides the IRA), Beverly could leave the IRA to a charitable remainder trust (CRT) which would pay the siblings a predictable *lifelong* income AND eliminate all income tax on the IRA death benefit AND provide for her charitable intent AND even provide an estate tax charitable deduction. The CRT distributions would provide the *lifelong* income which is one of the goals and other (nonIRA assets) could be used to provide the slush fund for extra/unforeseen expenses to supplement the income from the CRT. For full explanation of charitable remainder trusts and the advantages of naming a CRT as beneficiary of a retirement account, see ¶ 7.5.04 *et seq.* o f *Life and Death Planning for Retirement Benefits*.

In summary, **qualifying for EDB status/"life expectancy payout" does not by itself accomplish the client's goals.** As a supplement to substantial other assets providing for the beneficiary(ies), it can work. As is often the case, the life expectancy payout does not provide a long enough "payout period" to substantially increase the value of the inherited plan, while its attendant complications and drawbacks may force compromises with the client's goals if those goals cannot be achieved with other assets.

Case #6: How to leave retirement benefits to a marital-credit shelter trust (or other trust that will split into subtrusts).

While focusing on required minimum distributions and the exciting Proposed Regulations, don't forget some basics haven't changed: Do not use a pecuniary funding formula in a trust that may have substantial retirement accounts!

A. Facts: A credit shelter trust estate plan

Dan wants to leave all his assets, including his retirement accounts, to a trust that will take maximum advantage of his estate tax exemption via a "credit shelter trust" or "family trust," with all assets above the exemption amount passing to a QTIP-type trust for his wife Anne. The QTIP or marital trust would provide life income to Anne, plus principal distributions if needed for her health or support. The family trust would be for Anne's primary benefit during her lifetime but the trustee would also be permitted to make distributions to Dan's issue for health, education, support, or any other purpose consistent with the purposes of the trust if this would not jeopardize Anne's financial security.

B. Fine, just don't use a "pecuniary" formula

There are two ways the trust instrument could be drafted to command the split of all assets between the marital and family trusts. One is to specify a fixed dollar (pecuniary) amount that will be allocated to one share, with the "residue" of assets remaining to be allocated to the other share. The other way would be to devise a fractional formula for splitting up the assets.

Example of "straight" pecuniary gift with residue to other share: "The trustee shall allocate the federal estate tax exemption amount as it exists at my death to the family trust. The remaining assets if any shall be held as the marital trust."

Example of "formula" pecuniary gift with residue to other share: "The trustee shall allocate to the marital trust the smallest amount which can be allocated, upon my death, to a marital deduction trust without increasing the federal estate taxes on my estate." This is called a "formula" bequest because, although ultimately when all the numbers are crunched it will be a flat dollar amount, the exact dollar amount cannot be determined until administration of the estate is further advanced with all assets valued, all deductions determined, and the expenses of administration that are to be deducted from the estate for estate tax purposes are determined. See Reg. § 1.663(a)-1(b)(1).

Example of "fractional" formula gift to the two shares: "The trustee shall allocate to the marital trust that fraction or percentage of the assets of the trust attained by multiplying the total value of all trust assets net of debts and expenses by a fraction, the numerator of which is the smallest amount which can be allocated, upon my death, to a marital deduction trust without increasing the federal estate taxes on my estate and the denominator of which it said total value of all trust assets net of debts and expenses."

What difference does it make, with respect to the retirement accounts payable to this trust, which formula you use to split the trust between marital and family trusts?

It can make a huge difference. The IRS has stated its position that if a retirement account is transferred to a subtrust or share in fulfillment of a pecuniary bequest, that transfer is treated as a "sale" of the retirement account for purposes of the fiduciary income tax. See Chief Counsel Advice (CCA) 2006-44020. I believe this IRS position is totally wrong, especially when applied to the situation where the trustee has no choice regarding which asset to use to fund which share—for example, if the trust's only asset is the retirement account for reasons explained in ¶ 6.5.08 of *Life and Death Planning for Retirement Benefits* (8th ed. 2019) . However, unless you want your client's case to be the landmark case attacking this IRS position, it is recommended that you avoid pecuniary gifts or pecuniary formulas as the means for dividing a trust into subtrusts when retirement benefits are a significant portion of the trust.

A second reason for stepping carefully if using pecuniary gifts in a trust that will contain retirement benefits is, there is no DNI deduction for paying a pecuniary bequest. There are exceptions to that rule such as for formula pecuniary bequests, and bequests payable over more than three years, but this issue must be kept in mind especially in a trust that is funded primarily with retirement benefits.

C. The difference for Dan

Dan's total trust upon his death is worth $15 million of which $6 million is in an IRA. Assume the estate tax exemption is $12 million. If his trust uses a pecuniary formula (or amount) to specify how much will be placed in the marital trust, the marital trust will receive $3 million. The trustee can fund the marital trust without using the IRA—but that means the IRA will be held in the residuary "exemption" trust, which means that some of the exemption will be "wasted" paying income taxes on the IRA when it is ultimately distributed. Assuming a 40% income tax rate, the

exemption trust will be left with only $9,600,000 after paying 40% income tax on the $6 million IRA. Or if half of the IRA ($3 million) is transferred to the marital trust in fulfillment of the $3 million pecuniary bequest, the IRS will treat that as a "sale" of half the IRA by the residuary trust—and once again the exemption trust will be stuck with the income taxes on the IRA, but in this case sooner rather than later.

You don't avoid that problem by drafting the "pecuniary" share to be the exemption trust, with the marital trust as the residuary, because the IRS would say the residuary marital trust is transferring all or part of the IRA to the exemption trust in fulfillment of a pecuniary gift, result = taxable sale of the IRA (or part of the IRA).

If Dan uses a fractional formula, in contrast, the trustee can use the IRA to fund either share (preferably the marital share) without income tax consequences.

[There is one time you CAN use an IRA to fund a pecuniary gift—see the Charity" Case study, next!]

Case #7: How to leave benefits to charity through a trust or otherwise

Traditional retirement benefits are a good asset to leave to charity. Other heirs will have to pay income taxes when they draw money out of an inherited retirement plan but a charity, being income tax exempt, collects the full account tax-free. The $1 million IRA may be worth only $400,000 to your family after taxes, but it's worth $1 million to your favorite tax-exempt charity.

The best way to leave a retirement account to charity is to name the charity as beneficiary on your beneficiary designation form. The account goes directly to the charity no fuss no muss.

If the client has multiple charities to be named as beneficiary, and the client loves to change the identity and/or percentages of the chosen charities, consider naming a Donor Advised Fund (DAF) [see IRC § 4966(d)(2)] as beneficiary of the IRA, then "advising" the DAF that the fund is to be distributed to your list of charities at your death. It's usually easier to change beneficiaries' names and amounts through a DAF account than to revise a beneficiary form....plus the DAF will be much more skilled at and comfortable with getting the funds disbursed to the charities than the charities are likely to be themselves when dealing with the plan administrators. But sometimes the charitable gift must be made through a trust.

Lucien's Trust: Lucien, age 73, has $10 million of assets, including $4 million of retirement accounts. He leaves everything to a trust that was to be for the life benefit of his wife but she has predeceased him by a month. The trust provides that on the death of the surviving spouse the trustee is to distribute $100,000 to each of 10 charities (total $1 million), and to distribute the rest of the assets in three equal shares to Lucien's two children, Lucien Junior and Lucinda, and another charity. Upon Lucien's death, the trustee finds itself holding $4 million of inherited IRAs plus $6 million of other assets, and the need to distribute about $4 million to charities and $3 million to each of the children. The trustee's very first thought is, "Boy it would be nice to use the IRAs to fund those charitable gifts. Can I do that?"

If the trust is drafted to simply say the above, with no special provisions for how the charitable gifts will be paid, guess what. There will be no income tax charitable deduction for paying

either the 10 $1 million "pecuniary" charitable gifts or the $3 million charitable "residuary" gift. The trustee could cash out $4 million of IRAs and be liable for the income tax on that amount, with no charitable deduction to offset the income.

Why not? **Fit Fact #6: There is no DNI deduction for distributions to charity** [see Appendix A]. A distribution to charity is deductible only if it qualifies for the fiduciary income tax charitable deduction under § 642(c). There are several hurdles to clear in § 642(c); see detailed explanation in ¶ 7.4.03 of *Life and Death Planning for Retirement Benefits*.

The easy way out of this problem is to specify IN THE TRUST INSTRUMENT that the charitable gifts must be paid out of the IRAs to the extent possible. See example in PLR 2016-11002.

It is not recommended to use the phrase "income in respect of a decedent" (IRD). Instead specify the retirement account(s) to be used (by name or by type) (even if part of the money in the account(s) is after-tax money so it may not be "IRD"). Why? Because IRD might be considered a "class of income" and an instruction to fund a charitable bequest with a "class of income" will not be respected for fiduciary income tax deduction purposes unless it has "economic effect." Even though IRD has never been defined as a "class of income," there is nothing that says it is NOT a "class of income." And even though what exactly constitutes "economic effect" is not known in all cases, why get involved with that issue at all? A retirement account is an asset, not a "class of income."

If Lucien is deceased so it is now too late to add these words to the trust, I am not aware of any way the trustee can shift IRA income to the charities that are receiving pecuniary bequests. The IRS's position is that transferring the IRA in fulfillment of a pecuniary bequest is treated as a sale of the IRA (which would generate equivalent income at the trust level) and of course there is no DNI deduction for a distribution to charity and no charitable deduction either since these bequests do not meet the requirements of § 642. However, the trustee can shift IRA income to the residuary charitable beneficiary by transferring a $3 million inherited IRA to the charity intact. This is **FIT Fact # 7** [Appendix A]. Transfer of an IRA to a residuary beneficiary does not trigger realization of income at the trust level. The charity takes over the IRA and cashes it out tax-free because the charity is income tax-exempt.

Case #8: How to leave retirement benefits to a trust with a variety of beneficiaries.

So far we have looked primarily at retirement benefits left to one beneficiary or one type of beneficiary (such as a minor child of the participant or a disabled individual). If the trust is for the benefit of a varied collection of people with possibly different classifications in the DB/EDB system, what happens? The RMD effects will have to be painstakingly parsed out from the proposed regulations. The planner will have to consider whether the estate plan could be rearranged to get better RMD results for at least some of the beneficiaries. The planner will have to be able to determine and convey to the client what would be the likely economic benefit to the estate plan if RMD results could be improved.

A. Hiram's complicated facts and family

Hiram, age 55, has about $10 million of assets, of which $2.5 million is in several traditional retirement plans and $500,000 is in a Roth IRA. He wants to provide for his spouse (Holly, age 46, his second wife), his children from his first marriage (Hugo, age 30, and Hester, age 28; Hester is disabled) and his children from his second marriage (Hilda, age 16, and Harry, age 14). He is not worried about estate taxes. His plan is just to leave everything to one giant family trust, where the trustee would pay income and/or principal to or for the benefit of the family members, giving priority to wife Holly's lifelong support; lifelong support and care for Hester the disabled child; support and education and care into adulthood for Hilda and Harry; and (upon death of survivor of Hiram and his wife) everything distributed outright equally to the children, except that Hester's share would stay in trust to provide for her care for life, and the younger children's shares would be held in trust for their education and support until age 25.

B. RMD treatment if trust is written as Hiram has described it

The family group at this time has four EDBs: spouse Holly, disabled daughter Hester, and participant's minor children Hilda and Harry. If the trust qualifies as a DBT, and Hiram dies in the near future, here is the applicable distribution period that would apply to this trust. As a preliminary matter we SHOULD probably first make sure the trust qualifies as a "DBT," but let's leave that aside for a moment and assume we can make it so qualify if necessary.

Even though the surviving spouse is a beneficiary and she is an EDB, the trust does not get a life expectancy payout based on her status because (1) she is not the sole beneficiary (it's not a conduit trust for her) and (2) the other countable beneficiaries are not all EDBs. One of the four children (Hugo age 30) is not an EDB—he is neither a minor child nor D/CI.

Even though disabled daughter Hester is also an EDB, there is no life expectancy payout based on *her* status since she is not the sole beneficiary (it is not a conduit trust as to her) and it is not an AMBT (there is no requirement that any retirement plan be set aside solely for her during her lifetime).

However, there are two beneficiaries who cause this big pot trust to qualify for a life expectancy payout of some type: the two minor children-EDBs, Hilda, age 16, and Harry, age 14. Because the trust has one or more minor child-EDBs, the Applicable Denominator (payout period) for the trust will be the life expectancy of the oldest countable beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). That would be wife Holly, age 46 (assuming we don't add a "wipeout beneficiary" who is older than Holly). At age 46, her life expectancy is 40 years. So the first year's payout would be 1/40th of the account balance, the second year's 1/39th, and so on until the final distribution year.

Note this odd situation—the trust gets a life expectancy payout because it has minor child-EDBs (even though not all the trust beneficiaries are EDBs) but that life expectancy payout is not based on those children's life expectancies—it's based on the oldest trust beneficiary's life expectancy, even though the oldest trust beneficiary is not a minor child.

The final (Outer Limit) distribution year would be 10 years after the oldest minor child reaches age 21 or earlier dies. Hilda is the older of the two minor children; she is 16, so she will turn

21 in 5 years, meaning the Outer Limit Year will be in 15 years when Hilda turns 31...unless Hilda dies before age 21 in which case it will be 10 years after her death.

So, this picture is a little better than the "10-year rule." Essentially there would be a 15-year payout if Hiram dies right now. Of course as minor child Hilda gets older the payout period shrinks. Unless Hiram has some more children, the trust will not "do better" than the 10-year rule once baby Harry (now 14) reaches age 21 (because after that point there will be no more minor child-EDBs). "Screwy" is how I would describe the payout period rules for this trust.

C. Slicing and dicing may be better for Hiram

It might be worth running numbers to slice and dice these numbers. Hiram has a large enough estate he could consider leaving particular separate IRAs to different beneficiaries (or trusts for them) to get substantially longer deferral for the benefit of most of the family. In particular:

- Leaving some IRA assets to wife Holly directly (either through a conduit trust to get a life expectancy payout over her 40-year life expectancy----without being subject to a 15-year end point just because daughter Hilda reaches age 31) or outright for her to roll over to her own IRA.

- A separate IRA could be left to a trust for disabled daughter Hester; structured as a Type II AMBT, it would have a life expectancy payout based on Hester's very long (57 years) life expectancy.

- Separate trusts for Hilda and Harry would take full advantage of their minor child-EDB status.

- Hiram might consider weighting the Roth to Hugo; since Hugo (as the only "PODB") is stuck with the 10-year rule and doesn't get whatever bits of "stretch" payout are available for his two youngest siblings.

The rest of the assets could be left to a pot trust administered by the same trustee with explicit directions, in administering the pot trust, to take into account each beneficiary's share of the retirement benefits. Or Hiram could specifically deduct from each beneficiary's share of the "pot" trust the value of the IRA he/she received, though that would be quite difficult, since it involves comparing pretax and after tax assets.

Unlike with some other clients, where striving to "fit" into the minimum distribution rules' requirements produced little apparent tax benefit (while sacrificing other goals), the number crunching and slicing and dicing seems to produce real benefits for Hiram's estate plan. It works because he has a large estate with large retirement account assets, and plenty of nonretirement assets as well, and multiple beneficiaries entitled to EDB status.

D. First things last: Make sure the trust qualifies as a DBT

Again looking at the trust the way Hiram wants it written, we have to make sure the trust qualifies as a Designated Beneficiary Trust (DBT). That means it must have all individual beneficiaries. Testing the trust based on what we know so far:

First tier: The beneficiaries are the people who will definitely or probably or perhaps receive funds from this trust after the participant's death, without having to wait for someone else to die. The first tier consists of wife Holly and all four children.

Second tier: As Hiram envisioned it, his trust would terminate on death of wife Holly and be distributed outright to the children equally (with the shares of minor or disabled children held in further trust). What if a child has died? The other children would get that child's share. But under the IRS's testing system, the children cannot be considered secondary beneficiaries because they are already in the first tier. *The IRS Proposed Regulations' testing system kind of breaks down with a spray trust. If everybody in the family is already in the First Tier there's nobody left to put into the second tier.*

And we have to ask Hiram who gets the money if all the children die before Holly, or before the youngest child reaches age 25? In a normal world, Hiram would probably solve this problem by naming a charity as wipeout beneficiary—but you can't do that here because then your second tier beneficiary is "countable" and you can't have a nonindividual beneficiary be "countable" because then the client doesn't have a designated beneficiary.

In a semi-normal world, Hiram would then name some relative such as his Uncle Oscar the Potato Farmer age 63. BUT you do not want to name someone who is older than your oldest already-countable beneficiary if you have minor-child EDBs in the trust! Because with a minor-child EDB in the trust, the trust is entitled to a life expectancy payout based on the oldest countable beneficiary's life expectancy. As the trust is written so far, that's Holly age 46. If you put in Uncle Oscar as the wipeout beneficiary, he would be countable, and HIS much shorter life expectancy would become the payout period.

So: Choose a younger wipeout beneficiary; OR use the "last man standing" approach. Provide that if the trust is ever down to just one beneficiary (*e.g.* if Holly and three of the four children are deceased while there is still money in the trust), it will terminate and pass immediately outright to that last living beneficiary. Now there is no one else "countable," and your planned distribution scheme is preserved. This kind of crazy outcome may be a reason to use a separate trust or separate fund within a trust just for the retirement benefits. You don't have to have a crazy wipeout beneficiary for the nonretirement assets.

This paragraph "D" is considering a trust for all the family members in one pot...and the limitations again push in the direction of using separate trusts funded with separate retirement accounts for each beneficiary. In this case, that apparently more complicated approach seems to produce definite benefits.

PART 3: THE NEW RMD RULES FOR ONE BENEFICIARY

1. The new RMD rules: Basics

A. Is death before or after the RBD? This matters a LOT

Step one in determining RMDs to the beneficiary of an inherited retirement account is determining whether the decedent died before or after his/her "Required Beginning Date" (RBD). The RBD is the deadline for starting to take RMDs from the retirement account during the account owner's lifetime. YOU CANNOT DETERMINE POST-DEATH RMDS FOR ANY BENEFICIARY UNTIL YOU KNOW WHETHER THE DECEDENT DIED BEFORE OR ON/AFTER THE RBD.

- The RBD for a "traditional" [i.e., non-Roth] IRA is April 1 of the year after the year the IRA owner turns age 72 [or 70½ if the participant was born before 7/1/1949].

- For a qualified retirement plan (such as a 401(k) plan) or 403(b) plan it is the same as for an IRA *if* the participant owns more than 5% of the employer ("5% owner"). For a non-5%-owner, it is April 1 following the *later of* the year the employee retires from the employer that sponsors the plan or the year the employee attains age 72 [70½ if born before 7/1/1949].

- Roth IRAs have no RMDs during the account owner's life so death is always before the RBD regardless of age. This does not apply to "designated Roth accounts" in a qualified retirement plan, which are subject to the lifetime RMD rules applicable to qualified plans.

For more details and citations regarding the RBD, see Chapter 1 of *Life and Death Planning for Retirement Benefits* (but substitute age 72 for age 70½ as above); regarding designated Roth accounts see Chapter 5.

B. Designated beneficiary (DB) vs. Non-DB; "PODB" vs. "EDB"

The Code mandates different RMDs for the beneficiary who inherits a retirement account based on whether the beneficiary is or is not a "designated beneficiary." The Code defines "designated beneficiary" (DB) as "any *individual* designated as a beneficiary by the employee." § 401(a)(9)(E)(I). Emphasis added. The IRS must work within that requirement and that definition. The Proposed Regulations define DB as "an individual who is a beneficiary designated under the plan." Prop. Reg. § 1.401(a)(9)-4(a)(1).

C. Required annual distributions vs. the Outer Limit Year

The Proposed Regulations provide, for each type of beneficiary, in effect, an annual distributions track plus a final payout year. When the final payout year arrives, it overrides any life expectancy payout then in progress. Of course the life expectancy could run out in less than 10 years.

And under the "pure" 10-year rule there are no annual distributions in years 1-9 so the annual payout track is zero. So I don't know if my way of visualizing these requirements is helpful or just further muddies the waters. Either way, that is the way information is presented in the RMD charts in Appendix B of this Outline.

The wrap up year, which is called the Outer Limit Year in this Outline (not an official term) is provided by Prop. Reg. § 1.401(a)(9)-5(e) which imposes a "notwithstanding anything else" provision—that regardless of what the schedule of annual payments is, the payouts must be completed and end in a certain year—100% distribution is required in that final year. I sometimes refer to the RMDs preceding the Outer Limit Year as the "Annual Track" or "Annual Track Distributions."

For EDBs generally, the Outer Limit Year is the tenth calendar year following the calendar year of the EDB's death; in other words the Outer Limit Year concept generally *does not apply to the EDB himself*, it applies to the successor beneficiary of the EDB. Prop. Reg. § 1.401(a)(9)-5(e)(3). However, for an EDB who is an EDB solely because he or she is the child of the employee who had not reached majority ("minor child-EDB"), it is the tenth calendar year following the year the beneficiary reaches majority, i.e., the calendar year of his/her 31st birthday. Prop. Reg. § 1.401(a)(9)-5(e)(4). As applied, it means the calendar year that contains the 10th anniversary of the earlier of the minor's death or the minor's 31st-birthday.

D. The life expectancy payout: Then and now

A life expectancy payout refers to a method of calculating RMDs: The annual RMD is determined by dividing the prior year-end account balance by the remaining life expectancy of the designated beneficiary. For a young beneficiary, the method produces small RMDs because the divisor is so large. For an old beneficiary, the opposite is true. Either way, annual RMDs tend to get larger over the years as the beneficiary's life expectancy (formerly called the divisor, now called the Applicable Denominator) gets smaller. See the IRS life expectancy tables in Appendix C of this Outline.

Prior to SECURE the life expectancy payout method was utilized in estate planning by making a client's retirement benefits payable to a young designated beneficiary. SECURE took away that option for most clients, as explained throughout this Outline. However, the life expectancy payout method still exists for disabled beneficiaries, surviving spouses, and other "EDBs" as well as (strangely) for PODBs if the participant died after his RBD. For how to calculate RMDs using the life expectancy payout method, see ¶ 1.2 of *Life and Death Planning for Retirement Benefits*.

2. RMDs for a Non-designated beneficiary (Non-DB)

The determination of RMDs for a Non-DB is unchanged by SECURE and unchanged by the Proposed Regulations. SECURE did not change the definition of Non-DB or the payout rules for Non-DBs. The 10-year rule, all varieties of the life expectancy payout, and the privilege of post-death direct rollovers from a qualified plan to an IRA [see ¶ 4.2.04 of *Life and Death Planning for Retirement Benefits*] are reserved for "designated beneficiaries" (DBs) and therefore are never available for a Non-DB

A Non-DB is a beneficiary who does not qualify as a DB. That would mean a beneficiary that is not an individual, such as the participant's own estate, charities, and any trust that either does not qualify as a "Designated Beneficiary Trust" (DBT). The payout rules for a Non-DB are as follows:

- **5-year rule.** If the participant dies before his RBD, the 5-year rule applies. All benefits must be distributed by the end of the year that contains the fifth anniversary of the participant's date of death (or sixth anniversary, if such death occurred in the years 2015–2019). No payments are required before the final payout year, In the final year, 100% of the account becomes the RMD.

- **Ghost life expectancy.** If the participant dies on or after his RBD, the Non-DB must take annual distributions over what would have been the *participant's* life expectancy if he hadn't died. This has been nicknamed the "ghost life expectancy." For details on how to compute the ghost life expectancy, see ¶ 1.5.08 of *Life and Death Planning for Retirement Benefits*. As in all cases of participant's death after the RBD, the beneficiary must also take the distribution for the year of death if the participant had not taken it prior to death.

3. RMDs for a Plain old designated beneficiary (PODB): The 10-year rule

A PODB is subject to the 10-year rule regardless of whether the participant died before or after the RBD. § 401(a)(9)(H)(i). The "10-year rule," created by SECURE, was modeled on the 5-year rule. It applies to a Designated Beneficiary (DB) who is not an Eligible Designated Beneficiary (EDB). Under the Proposed Regulations, the 10-year rule can *also* apply to an EDB in some cases if the participant died before his RBD; see PART 3, #4(C). Here is how the 10-year rule works:

A. 10-year rule distinguished from other 10-year RMD periods

The 10-Year Rule discussed here is not to be confused with other 10-year limits in the post-SECURE RMD rules, namely, the requirement that all benefits be distributed no later than 10 years after the death of an EDB (see PART 3, #4(E)), or after a minor-child EDB reaches majority (PART 3, #6(B)), or after the post-2019 death of the designated beneficiary of a pre-2020 decedent (PART 9, #1). Those 10-year periods are merely outer limits on a Life Expectancy Payout already in progress. In contrast, the 10-Year Rule discussed here is a separate RMD rule applicable to PODBs which (1) requires no distributions prior to the 10th year and (2) is not connected to any life expectancy payout—HOWEVER, be aware that in both respects a DIFFERENT rule, the ALAR rule explained below, requires annual life-expectancy payments with the 10-year rule in cases of death after the RBD!

B. How the 10-Year Rule works

The proposed regulations confirm the general understanding that the "10-year rule" introduced by SECURE (inserting § 401(a)(9)(H)(i) into the Code) works the same way as the 5-year rule (on which the 10-year rule is modeled) has always worked: No distributions are required until

the 10th year at which time the entire account becomes the RMD. Prop. Reg. § 54.4974-1(c): "(3) 10-year rule. Distributions satisfy this paragraph (c)(3) if the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the date of the employee's death. For example, if an employee dies on any day in 2021, the entire interest must be distributed by the end of 2031 in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii), as extended to 10 years by section 401(a)(9)(H)(i)." Prop. Reg. §1.401(a)(9)-3(c)(3).

Unfortunately, the Proposed Regulations have managed to destroy the rare clarity and simplicity of this concept by insisting that ANOTHER RMD rule, the "at least as rapidly rule," does dictate annual distributions during the first nine years of the 10-Year Rule payout period, in cases of death after the RBD:

C. Shocker: Death *after* RBD: Annual RMDs under 10-year Rule!

If the participant dies after his RBD, the IRS says the 10-year rule isn't the only RMD rule that applies! In a surprise move, the proposed regulations assert that annual RMDs must continue to be made after the participant's death if he dies after his RBD—even when the 10-year rule applies. Treasury is not saying this is how the 10-year rule is to be interpreted—Treasury agrees there are no distributions required *under the 10-year rule* until the 10th year. Rather, Treasury is saying that in enacting SECURE Congress did not repeal § 401(a)(9)(B)(i), so § 401(a)(9)(B)(i) is still in force and applicable and still must be complied with—even when the 10-year rule *also* applies! § 401(a)(9)(B)(i) provides that, in cases of participant's death after RBD, distributions must continue to be made (to his beneficiary) "at least as rapidly" as before the participant's death ("at least as rapidly" or "ALAR" rule). Here is how that would work, along with a walk-through of the complicated process by which Treasury arrives at and implements this dual RMD requirement in cases of death after the RBD:

D. Death after RBD: ALAR rule payout requirements for PODB

To apply the ALAR rule alongside the 10-year rule, the proposed regulation require a plain old designated beneficiary (PODB) to take annual RMDs, based on such PODB's life expectancy, beginning the year after the year of the participant's death.

How long does the PODB keep taking these annual distributions? Until the year that contains the 10th anniversary of the participant's death, at which time the 10-year rule takes over and requires 100% distribution of the account. Prop. Reg. § 1.401(a)(9)-5(d)(1)(i) (last sentence), -5(e)(1), (2).

What if the PODB dies before year 10? Such RMDs must continue "up to and including the calendar year that includes the beneficiary's date of death." Prop. Reg. § 1.401(a)(9)-5(d)(1)(i). Then what? Presumably, the successor beneficiary continues to withdraw over the deceased PODB's life expectancy, with 100% distribution required in the 10th year, however citation not found for this.

Here is the detail behind the preceding summary. The detail is hard to parse out because each provision seems to cover more than one situation (intentionally? by mistake?) and therefore contains some wording not applicable to the situation you are interested in.

- The problem starts with this Code provision: § 401(a)(9)(B)(i) provides that "if—(I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and (II) the employee dies before his entire interest has been distributed to him, the remaining portion of such interest will be distributed ***at least as rapidly*** as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death." Emphasis added. This is popularly [among ERISA people] known as the "at least as rapidly rule," hereinafter the ALAR rule.

- Prop. Reg. § 1.401(a)(9)-5(d): **"Applicable denominator after employee's death--(1) Death on or after the employee's required beginning date**--(i) In general. If an employee dies after distribution has begun as determined under §1.401(a)(9)-2(a)(3) (generally, on or after the employee's required beginning date), distributions must satisfy section 401(a)(9)(B)(i) [the ALAR rule]. In order to satisfy this requirement, the applicable denominator after the employee's death is determined under the rules of this paragraph (d)(1). The requirement to take an annual distribution in accordance with the preceding sentence applies for distribution calendar years up to and including the calendar year that includes the beneficiary's date of death...." Pause, ok, so far so good: The ALAR rule applies to the deceased participant's beneficiary *along with* whatever other post-death RMD rule applies to such beneficiary, apparently. So if the beneficiary is a "PODB" (subject to the 10-year rule), the PODB must take annual distributions for years one through nine, then 100% of any remaining balance in year 10. How much are these annual distributions such PODB must take?

- "The distributions also must satisfy section 401(a)(9)(B)(ii) [the 5-year rule] (or, if applicable, section 401(a)(9)(B)(iii) [the exceptions to the 5-year rule]" This statement is extremely puzzling because the 5-year rule never applies in cases of death after the RBD which is supposedly what Prop. Reg. § 1.401(a)(9)-5(d)(1) is about; this reference to the 5-year rule and its exceptions seems to be an error in this regulation.

- "....taking into account sections 401(a)(9)(E)(iii) [minor child of participant ceases to be an EDB upon attaining majority], and 401(a)(9)(H)(ii) and (iii) [the life expectancy payout for EDBs and the 10-year cap after death of the EDB]). In order to satisfy those requirements, in addition to determining the applicable denominator under the rules of this paragraph (d)(1), the distributions also must satisfy any applicable requirements under paragraph (e) of this section..." [i.e. the outer limit for distribution of 100% of the account in the 10th year after the death of the participant if the beneficiary is a PODB, or after the death of the eligible designated beneficiary if the beneficiary is an EDB, or attainment of majority of a minor-child EDB, etc. whichever is applicable].

- What annual distributions are required to satisfy the ALAR rule? A "greater of" rule applies: Prop. Reg. § 1.401(a)(9)-5(d) says this: "(ii) Employee with designated beneficiary. If the employee has a designated beneficiary as of the date determined under §1.401(a)(9)-4(c) [that would be ANY DB, whether such DB is an EDB or a PODB], the applicable

denominator is the greater of--(A) The designated beneficiary's remaining life expectancy; and (B) The employee's remaining life expectancy. (iii) Employee with no designated beneficiary. If the employee does not have a designated beneficiary as of the date determined under §1.401(a)(9)-4(c), the applicable denominator is the employee's remaining life expectancy."

- Under the "greater of" rule, if the DB or EDB is *younger than* the decedent, the minimum annual distribution under the ALAR rule will be determined using the beneficiary's life expectancy. However, this life expectancy payout will "run out" in the 10th year (the Outer Limit Year under the 10-year rule) in the case of a PODB, as 100% distribution is required in that year. What if the DB is *older than* the decedent? Ha! Then he/she can't be a PODB, because any DB older than the decedent is an EDB! See PART 3, #8, in that case.

E. Is Treasury right about the ALAR rule?

Though practitioners generally assumed that the 10-year rule was the only rule that applied to PODBs in case of the participant's death, Treasury obviously came to a different conclusion. Treasury as above discussed concluded that the ALAR rule was not repealed and therefore still applies. Are they right about that?

- § 401(a)(9)(B)(i) provides that, when an employee dies after lifetime RMDs have begun (i.e., after his RBD), "the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death." This is the "at least as rapidly rule" (ALAR rule), which has been part of the Code since forever. Though Treasury's own regulations have applied the ALAR rule "creatively" (to say the least), Treasury raises a valid question. Did Congress intend the 10-year rule to "overrule" the ALAR rule or not?

- In the Committee Report that provides background for SECURE's changes to the RMD rules, the drafter noted the existence of the ALAR rule in the description of the existing (pre-SECURE) rules; see Committee Report Note 231. Then, in describing SECURE's proposed changes, the Report states that "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....Ten-year after-death rule for defined contributions plans: In general: Under the proposal, the five-year rule is expanded to become a 10-year period instead of five years ("10-year rule"), such that *the 10-year rule is the general rule for distributions to designated beneficiaries after death (regardless of whether the employee (or IRA owner) dies before, on, or after the required beginning date)* unless the designated beneficiary is an eligible beneficiary.... Thus, in the case of an ineligible beneficiary, distribution of the employee (or IRA owner's) entire benefit is required to be distributed by the end of the tenth calendar year following the year of the employee or IRA owner's death." See https://www.govtrack.us/congress/bills/116/hr1994/text. Emphasis added.

- The Committee Report does not directly address "repeal" of the ALAR rule. Treasury's interpretation of that omission is that Congress did not intend the 10-year rule to replace BOTH the life expectancy payout AND the ALAR rule, only the life expectancy payout (since the ALAR rule was not deleted from the Code by SECURE, nor was it specifically referenced in § 401(a)(9)(H)(i), the section that inserts the 10-year rule). However, the interpretation that Congress intended the 10-year rule to replace both rules (the life expectancy payout and ALAR rule) in the case of "ineligible beneficiaries" (called PODBs in this Outline) would appear to be comparably valid, in view of the Committee Report's emphasis that the 10-year rule applies for these beneficiaries "whether or not the employee (or IRA owner) dies before, on, or after the required beginning date" [sic], and the statute's wording that the 10-year rule "shall apply whether or not distributions of the employee's interests have begun in accordance with subparagraph (A)."

F. Reminder: What happens if you miss the 10-year deadline

As is true under existing regulations, if the beneficiary fails to take the 100% distribution in year 10, then that "missed RMD" will continue to be the RMD from that account every year after that until it is distributed....accruing the 50% excise tax annually. Prop. Reg. § 54.4974-1(e).

4. EDB: General RMD rules for EDBs

The Code, as amended by SECURE, provides that only an "eligible designated beneficiary" (EDB) is entitled to the "life expectancy payout exception" of § 401(a)(9)(B)(iii).

The definitions of the five types of EDBs (participant's surviving spouse or minor child, a disabled or chronically ill individual, or an individual who is none of the above and is not more than 10 years younger than the participant) are found in Prop. Reg. § 1.401(a)(9)-4, and are set out in the applicable section of this Outline for each category.

This section discusses the general RMD rules for the EDB category; particular variations for each type of EDB are discussed in the Outline section for that category.

A. Background: Where does the life expectancy payout come from?

If you're interested, carefully read § 401(a)(9) of the Code, the section that creates the "required distributions" rules applicable to qualified plans and (by extension via other Code sections) IRAs and 403(b) plans. You will see that § 401(a)(9)(A) sets out the requirement for distributions that are required *during the employee's lifetime*, beginning on a "required beginning date" (RBD) specified elsewhere in § 401(a)(9).

Next comes (B), which provides the post-death RMD rules if the employee still has money in the plan when he dies. "(B)(i)" provides the post-death RMD rule that applies if the employee dies after the RBD—the (B)(i) rule is known as the "at least as rapidly" rule, see PART 3, #3(C)-(E).

Then "(B)(ii)" provides a general rule for what happens if the employee dies *before* that RBD. It's a very simple rule: "the entire interest of the employee will be distributed within 5 years after the death of such employee." The infamous "5-year rule." That's a bit harsh of course, so the

Code next provides a generous exception in "(B)(iii)": If there is a designated beneficiary, benefits are to be distributed over the life expectancy of such designated beneficiary. (B)(iii) created the life expectancy payout and, for planners and clients, the entire industry of "stretch IRAs."

As we know, SECURE stepped in to end stretch IRAs. It attempted to do so by adding a "notwithstanding"-type rule in new Code subsection § 401(a)(9)(H): (H)(ii) provides that "Subparagraph (B)(iii) shall apply only in the case of an eligible designated beneficiary." In other words, the life expectancy payout previously available under (B)(ii) to ANY designated beneficiary would now be available only to EDBs.

But the (B)(iii) exception being limited by the new (H)(ii) is an exception to the 5-year rule...and the 5-year rule only applies in cases of death *before the RBD*.

Did SECURE intend the life expectancy payout to CONTINUE for PODBs of participants who died AFTER the RBD? Whatever Congress intended, the Treasury interprets (H)(ii) as applying to all PODBs regardless of whether the participant died before or after his RBD.

The life expectancy payout for beneficiaries in cases of death *after* the RBD is not specifically set out in the Code anyway. It came into existence entirely through IRS regulations interpreting the "at least as rapidly rule" (§ 401(a)(9)(B)(i); see PART 3, #3(C-E)) and the rule that the employee's interest must be distributed either entirely before the RBD or, "beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary)." § 401(a)(9)(A)(ii).

SECURE seems to assume that the life expectancy payout for EDBs under the "(B)(iii) exception" will apply regardless of whether death is before or after the RBD even though (B)(iii) does not apply to deaths after the RBD. The Proposed Regulations go along with that assumption.

B. RMDs for EDBs during the EDB's life

Generally, RMDs to an EDB are calculated using the life expectancy payout, just as was done for all designated beneficiaries prior to SECURE, but there are some other options (see "C") and variations (see "D").

Here is the explanation of the life expectancy payout method:

Life expectancy is calculated as a fixed term of years (except for the surviving spouse if he/she is sole designated beneficiary; see PART 3, #5). The method of calculating RMDs under the life expectancy payout is not changed from before SECURE. Annual RMDs are computing (starting the year after the year of the participant's death) by dividing the prior year end account balance by the factor for the beneficiary's age on his/her birthday in that year after the death (see Appendix C, "Single Life Table"), and repeating the process annually, reducing the divisor by one each year until the factor drops to one or below. See Chapter 1 of *Life and Death Planning for Retirement Benefits* and Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii).

Example: Rita dies in 2022, before her RBD, leaving her IRA to her twin sister Lolita. Lolita is a NoMoTTYY and so is an EDB. Lolita will turn 67 in 2023, the year after Rita's death. The life expectancy at age 67 is 21.2 years, so the RMD for 2023 is [the account balance of the IRA as of

12/31/22] divided by 21.2. The RMD for 2024 will be the account balance as of 12/31/23 divided by 20.2, and so on every year until 2043 when the divisor drops to .2, requiring 100% distribution of the account in that year.

One thing that has changed since before SECURE: If the EDB dies before his life expectancy has run out, the successor beneficiary will continue to take RMDs on the same schedule the EDB was using—that rule applied before SECURE and continues to apply. What's changed: The successor beneficiary must withdraw 100% of the account in the year that contains the 10th anniversary of the EDB's death even if the "life expectancy payout period" has not run out yet. See "E."

C. Participant dies before RBD: 10-year rule may apply to EDB

The Code's bare assertion is that the life expectancy payout "shall apply only in the case of an eligible designated beneficiary." Under the proposed regulations, however, the life expectancy payout is not the EDB's only option *if* the participant died before his RBD. In cases of participant's death before the RBD, the 10-year rule could apply to the EDB instead of the life expectancy payout if either:

- the applicable plan document requires it, or
- the participant directs in the beneficiary designation form that the 10-year rule will apply (and such direction is permitted by the plan), or
- the EDB elects it (and such election is permitted by the plan).

Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii). If the plan has no provision on this point [presumably that situation will be rare], the "default" rule for an EDB is the life expectancy payout. Prop. Reg. § 1.401(a)(9)-3(c)(5)(i)(C).

If an "individual" EDB is defaulted into the life expectancy payout by the preceding rule, there is an *automatic* waiver of the 50% excise tax on such individual's missed life-expectancy RMDs if the individual EDB-"payee elects the 10-year rule...by the end of the ninth calendar year following the calendar year of the employee's death." Prop. Reg. § 54.4974-1(g)(2). Not clear how the payee makes this election. ***The fact that this automatic waiver is limited to "individual" EDBs may indicate it is not available to a trust named as beneficiary or may be a mistake.

The Proposed Regulations contain provisions dealing with EDB's ability to "roll over" funds from a plan that requires the 10-Year rule to another plan or IRA that permits the life expectancy payout. This aspect is not covered in this Outline.

The option to elect the 10-year rule is not available to the DB of a pre-2020 decedent. Prop. Reg. § 1.401(a)(9)-1(b)(iii) (Example 3).

D. Participant dies after RBD: The "longer of" rule

If the participant died after his RBD, the Applicable Denominator for an EDB is the longer of the EDB's life expectancy and the participant's life expectancy (the "longer of" rule). Prop. Reg. § 1.401(a)(9)-2(a)(4). This is a carryover from pre-SECURE treatment of all DBs. See Reg. § 1.401(a)(9)-5(d)(1)(ii).

The "longer of" rule appears to be "good news" for older EDBs, but this good news is undercut by two other factors: First, the imposition of the "shorter of" rule as an Outer Limit Year (payout ends in final year of the EDB's life expectancy). See "E." Second, there is no option for the EDB to elect the 10-year rule in cases of death *after* the RBD; compare "C." This adds up to a horrendous and unjustifiable tax meltdown for older beneficiaries (see "F").

E. Three types of Outer Limit Year for EDB payouts

There are three types of "outer limits" applicable to EDB payouts.

10 years after death of EDB. One is a limit introduced by SECURE which puts a limit on how long a life expectancy payout can continue after the death of the EDB. Prior to SECURE, the beneficiary's successor beneficiary would step into the shoes of the deceased DB and simply keep taking RMDs over the remaining life expectancy of the DB until it was reduced to one year or less. Under the Code as amended by SECURE, that process still happens—the successor beneficiary steps into the shoes and keeps taking RMDs based on the remaining life expectancy of the deceased EDB—but now there is a cap on how long that payout can continue: 100% of the account must be distributed no later than the year that contains the 10th anniversary of the death of the EDB. § 401(a)(9)(H)(iii); Prop. Reg. § 1.401(a)(9)-5(e)(3).

If the EDB dies more than 10 years prior to the end of his life expectancy, this limit will cap the post-death payout to the successor beneficiary at the 10th year. If the EDB dies within less than 10 year prior to the expiration of his life expectancy (as most people presumably do) this 10-year limit will never come into play because the EDB's remaining life expectancy will run out before the 10th year.

10 year limit ≠ 10-year rule

Note that SECURE's wording ("remainder....shall be distributed within 10 years after the death of...") , though it creates a 10-year rule of sorts, is not the same as the wording applying the "10-year rule" as the general rule for (plain old) designated beneficiaries. One *could* conclude that the 10-year limit applicable on death of an EDB would work the same way as the other 10-year rule (i.e., the year of the EDB's death would be the final year of the life expectancy payout, with no further payouts required until the year containing the 10th anniversary of the EDB's death, at which time 100% of the account would become the RMD). Although that would appear to be a reasonable interpretation, the Proposed Regulations have a different view: The life expectancy payout based on the life expectancy of the now-deceased EDB *continues*, with annual RMDs in years one through nine after the EDB's death, and a final payout of 100% of the account due in the year containing the

10th anniversary of such death (or, of course, in the final year of the life expectancy payout if that is less than 10 years). Prop. Reg. § 1.401(a)(6)-(F)(6)(i) (Example 1).

EDB's life expectancy: The second type of Outer Limit Year is the final year of the EDB's life expectancy. If the EDB lives beyond his life expectancy, the account will be reduced to zero before he dies. The final year of the EDB's life expectancy is a hard cap on distributions (100% must be distributed by the end of that year)...

- ...even if the EDB's life expectancy was less than 10 years [unless the participant died before his RBD and the 10-year rule applies—see "C" above]. Prop. Reg. § 1.401(a)(9)-5(e)(3).

- ...even if the participant died after his RBD and the EDB was older than the participant and so was calculating annual distributions using the participant's life expectancy under the "longer of" rule ("D" above). Despite calculating annual RMDs using the deceased participant's longer life expectancy, RMDs are accelerated and 100% distribution is required no later than the final year of the *EDB's* life expectancy under the "shorter of" rule! Prop. Reg. § 1.401(a)(9)-5(e)(5).

For Minor-child EDB, 10 years after age-21 birthday (or after death if death occurs before 21st birthday). SECURE further provides that in the case of a minor child of the participant, EDB status ends upon reaching majority, so the payout must end 10 years after the earlier of the year of such child's death or the year in which he reaches majority. § 401(a)(9)(E)(iii). See #6 in this PART 3.

We next proceed to the particular life-expectancy-payout deals and wrinkles applicable to each of the five types of EDB.

F. Shorter-of rule: Some EDBs now worse off than before SECURE

The general understanding has been that the purpose of SECURE was to retain the existing life-expectancy payout rules for (only) "eligible designated beneficiaries"—the participant's surviving spouse, minor children, etc.—while shortening (in some cases drastically shortening) the payout period for other designated beneficiaries and for the "successor beneficiaries" of the EDBs. Nothing in SECURE indicated any intent to make things WORSE for EDBs—they are supposed to be the protected class for whom the pre-SECURE rules are preserved (or, in the case of disabled and chronically ill beneficiaries, even made more favorable).

But with the "shorter of" rule of Prop. Reg. § 1.401(a)(9)-5(e)(5), the IRS is making things decidedly WORSE for elderly EDBs. Under the existing regulations (pre-SECURE) the distribution period for the designated beneficiary of an employee who died after his RBD is "the longer of—(i) The remaining life expectancy of the employee's designated beneficiary...; and (ii) The remaining life expectancy of the employee..." Reg. **§** 1.401(a)(9)-5, A-5(a)(1). The proposed regulations swap a "shorter of" rule for the existing "longer of" rule for (effectively) all EDBs who are older than the participant, if the participant died on or after his RBD.

SECURE did not get into the fine points of existing regulations when it simply stated that the beneficiary's-life-expectancy payout rule would apply only to EDBs. Either Congress didn't notice the little ways in which existing regulations extended the "life expectancy of the beneficiary" (such as the "longer of" rule of Reg. § 1.401(a)(9)-5, A-5(a)(1)) or (is this really likely?) Congress wanted to clamp down on elderly EDBs who were piggybacking on the longer life expectancy of their deceased benefactor. Since the deceased benefactor was by definition over age 72 (since this rule applies only in cases of death after the RBD), the longest possible "ghost life expectancy" he/she could generate would be 17.2 years, and the only people negatively affected by this switch are beneficiaries who are even older than age 72.

Example: The designated beneficiary of Tommy's IRA is his mother Lucy who is 22 years older than Tommy. If Tommy dies at age 72 (before his RBD), so Lucy inherits at age 94, Lucy's life expectancy is only 4.3 years....but as an EDB [NoMoTTYY], she can elect the 10-year rule and so withdraw the IRA gradually over that period of time. But if Tommy dies at age 73, after his RBD, Lucy is now 95 with a life expectancy of 4.0 years....and no more option to elect the 10-year rule! Tommy would have been better advised to leave the IRA to his own estate, which would at least get the benefit of his "ghost life expectancy" (about 16 years at age 73). That would produce better results for Lucy, who is the sole beneficiary of his estate!

5. EDB: Participant's surviving spouse (S/S)

The participant's surviving spouse (S/S) is an Eligible Designated Beneficiary and as such entitled to a life expectancy payout. For convenience, the deceased participant is referred to as "he" and the S/S as "she."

The special rules for determining when payouts to the S/S must commence, how such payments are computed, and what happens if she dies before she is required to start taking such distributions appear not to have been changed by SECURE or the Proposed Regulations (except that the age at which the deceased spouse would have had to commence distributions is changed from age 70½ to age 72 if the deceased spouse was born after June 30, 1949). See Chapter 3 of *Life and Death Planning for Retirement Benefits*.

A. Commencement date for annual payments.

Although the general rule is that a beneficiary who is required to take life-expectancy-based RMDs must commence such RMDs the year after the year of the participant's death, there is a special rule for the surviving spouse. If the participant died before the year in which he would have turned age 71, the spouse is not required to commence distributions until the later of the year after his death or the year in which he would have attained age 72 [age 70½ if the deceased participant was born before July 1, 1949]. § 401(a)(9)(B)(iv); Prop. Reg. § 1.401(a)(9)-3(d).

B. Recalculation of life expectancy.

Unlike other EDBs, the surviving spouse's life expectancy is recalculated annually. The effect of this is to extend the life expectancy, since the life expectancy is not reduced by one year each year; life expectancy extends as the individual lives longer (ask your neighborhood actuary how this works). Because the S/S's life expectancy is recalculated annually, the S/S (while living) will not be required to withdraw 100% of the inherited account until she reaches age 120, when the life expectancy finally drops to one year or less. Thus, unlike other EDBs, the S/S cannot outlive her own life expectancy—unless she lives to age 120.

If the S/S dies earlier than that age, her life expectancy is "frozen" at that point, and thereafter reduced by one each year for purposes of calculating RMDs to her successor beneficiary. [That's according to the *Preamble* to the Proposed Regulations; I could not find this rule in the Proposed Regulations. See Prop. Reg. § 1.401(a)(9)-5(d)(3)(iv); compare (3)(ii).] Thus if S/S dies after approximately age 81 (when life expectancy drops to about 10 years), her successor beneficiary (who must continue to withdraw the life expectancy RMDs) will be required to withdraw 100% in less than 10 years after S/S's death. Of course the successor beneficiary is also subject to the 10-year limit on withdrawals after S/S's death if she died more than 10 years before the end of her IRS table life expectancy (see PART 3, #4(E)).

C. Spousal rollover or election

The surviving spouse's right to roll over retirement benefits payable to her from an inherited plan or IRA was not changed by SECURE. Briefly, as a reminder, the spousal rollover is not a "minimum distribution" rule; it is a totally separate Code section and concept, so it is not subject to various limitations that can arise under the minimum distribution rules. For example:

S/S does not have to be "sole beneficiary" of the inherited IRA to roll over the portion payable to her (or part of such portion). See Prop. Reg. § 1.408-8(d)(1)(ii); compare Prop. Reg. § 1.408-8(c)(1)(iii).

Also, there is no requirement that the spousal rollover occur within a certain time after the participant's death. It could occur one, five, or 10 years after his death or even later. See Prop. Reg. § 1.408-8(d)(1)(ii); compare Prop. Reg. § 1.408-8(c)(1)(ii).

Benefits payable to the spouse indirectly through a trust or estate can be eligible for rollover if the spouse is *entitled* to such benefits (i.e., her right to the benefits is not dependant upon a trustee's discretion or on meeting some standard such as "health or support"). See ¶ 3.2 of *Life and Death Planning for Retirement Benefits*.

Another option the S/S has is to elect to treat the inherited IRA as her own IRA. This election right is not in the Code, it is a creation of IRS regulations. The tax effects of the spousal election are the same as for a spousal rollover, possibly with the benefit of sidestepping some requirements of a rollover (such as the "once per year" limitation). The new Proposed Regulations for the first time put a time limit on the election. See Prop. Reg. § 1.408-8(c).

D. Anti-Gaming provision targets delayed spousal rollovers

Suppose the surviving spouse is approaching or past age 72. If the participant-spouse died before his RBD, and the S/S elects the 10-Year Rule [see #4(C) in this PART 3], then the S/S could effectively delay RMDs for about nine years, then in year 9 of the 10-year payout roll over the inherited account to the S/S's own IRA, thus sidestepping several years of RMDs. Prop. Reg. § 1.402(c)-2(j)(3)(iii) blocks this maneuver: A S/S's rollover, if it occurs in any year after the year she turns age 71, must be reduced by a deemed RMD amount—the cumulative total of what would have been RMDs if the account had belonged to her during the delayed rollover period.

6. EDB: Participant's minor child

SECURE provides that a minor child of the participant is an EDB. However, unlike with other EDBs, such child's EDB status does not last for life. Instead it terminates when the child "reaches majority." The account must be fully distributed 10 years after that point (or 10 years after the child dies, if he dies before reaching majority). § 401(a)(9)(E)(ii)(II), (E)(iii), (H)(iii). SECURE left it to the IRS to define "reaches majority."

The Preamble states the IRS's wise observation that a definition of "reaches majority" that depended on definitions under 50 potentially different state laws and/or on a subjective or hard to determine status such as completing a specified course of education would be unworkable for the administrators of plans and IRAs required to interpret or apply the minimum distribution rules. In view of which the IRS wisely adopted a single objective definition to apply to all plans in all states.

A. "Reaches majority" means the 21st birthday.

The proposed regulations define "majority" (as in "a child of the employee who has not reached majority," the Code's definition of a minor child-EDB; § 401(a)(9)(E)(ii)(II)) as attaining age 21, without any reference to state law or subjective factors such as completing a course of education: "(3) Determination of age of majority. An individual reaches the age of majority on the individual's 21st birthday." Prop. Reg. § 1.401(a)(9)-4(e)(3). This makes administration easier for plan administrators: no need to worry about what state's law might apply to a "minor" or whether the beneficiary might have dropped out of school.

An exception is allowed for defined benefit plans that had a pre-SECURE different definition of "majority" based on an old minimum distribution regulation that rarely applied (tying "reaching majority" to completing a specified course of education but not later than age 26); these plans may continue to use that definition. This "grandfather" exception would rarely if ever be encountered by estate planners.

B. Outer Limit Year for minor child-EDB

A minor child-EDB has his own Outer Limit Year in the Code, namely 10 years after "reaching majority." § 401(a)(9)(E)(iii). As an EDB, the minor child is apparently ALSO subject to the 10-years-after-death-of-an-EDB deadline in § 401(a)(9)(H)(iii). The Proposed Regulations

smooth out these deadlines a bit to being *the year in which such event occurs*, not the actual birthday or death day. So, the entire account payable to a minor child-EDB must be distributed by the end of the year that contains the minor's 31st birthday (or date of death, if death occurred before age 21). Prop. Reg. § 1.401(a)(9)-5(e)(3), (4). See Prop. Reg. § 1.401(a)(9)-5(e)(1), (3), (4). This interpretation is confirmed by Prop. Reg. § 1.401(a)(9)-5(f)(2(ii) (describing the rule for multiple beneficiaries where at least one is a minor child-EDB), which states that both the -5(e)(3) rule and the -5(e)(4) rule are applied "using the oldest" minor child-EDB—in other words, both rules apply, so the Outer Limit Year is the earlier of the two dates. The Preamble confirms this (pp. 49-50).

C. Trusts for minor-child EDBs: pre-SECURE problems

A major uncertainty for planners after enactment of SECURE has been the options for structuring a trust for minor children: How can such beneficiaries be provided with the protections of a trust (needed due to their youth) while minimizing the negative tax impacts of a trust?

The Proposed Regulations make several generous special rules for trusts for minors, but have at least one significant glitch.

Under pre-SECURE rules, a protected life expectancy payout could easily be established by using a "conduit trust" for the minor, under the assumption that annual RMD payouts to the trust based on the minor's long life expectancy would be small enough (due to the beneficiary's extreme youth) that the trustee would have no problem distributing the annual payouts "for the benefit of" the minor beneficiary, thereby complying with the annual payout requirement of the conduit trust and also benefitting from the minor's lower tax bracket relative to the trust's bracket. But the conduit trust concept did not work well with enormous IRAs (annual distributions too large to be absorbed by expenditures on minor's behalf). Also, pre-SECURE, it was unclear whether a "pot trust" for multiple children could qualify as a conduit trust (the Proposed Regulations give a clear YES answer to that question; Prop. Reg. § 1.401(a)(9)-4(1)(ii)(A)).

There was also a problem with "accumulation trusts" for minor children: Typically the trust would hold funds until the minor reached a certain age such as 30, 35, or 40. But then the trust had to specify who would receive what was left in the trust if the minor died before reaching that age...and if this contingent remainder beneficiary were older than the minor, the remainder beneficiary's life expectancy, not the child's, would be the payout period. Or if the remainder beneficiary were a charity, the trust would flunk the RMD trust rules altogether because it had a countable non-individual beneficiary. The Proposed Regulations provide an easy way to eliminate this problem—just specify that the minor will receive his share outright by age 31. Any beneficiary who will take the share only if the child dies BEFORE age 31 is disregarded in applying the RMD rules to the trust. Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B).

D. SECURE's apparently harsh impact on trusts for minors

SECURE made these planning problems more severe because it limited the "life expectancy payout" for minors to minor children OF THE PARTICIPANT (not just any old minors); and the so-called "life expectancy payout" could not last past 10 years after the minor "reached majority," meaning 100% had to be distributed by that 10th year; and "majority" was left to the IRS to define,

but in some states majority is as early as age 18 which would require 100% distribution by age 28; and, under existing regulations one would conclude that even these reduced advantages were available only for "conduit trusts," not "accumulation trusts" (see Reg. § 1.401(a)(9)-5, A-7(c)(3), Examples 1 and 2) because the minor would not be deemed the "sole beneficiary" of an accumulation trust.

The Proposed Regulations *substantially improve* the picture for trusts for minor child-EDBs (and in one way for all young beneficiaries) with the following new rules: Defining majority as age 21 (as discussed above); trust with ANY minor-child EDB qualifies for "EDB" treatment in computing annual RMDs (see "E"); the 10-years-after-reaching-majority limit is based on the trust's oldest minor child-EDB, even if he/she is not the oldest countable beneficiary of the trust (see PART 5(#3)); and the "age-31-disregard" rule (see "F"). There is, however, a big problem with the Proposed Regulations' Outer Limit Year for a trust for multiple minors (see "H").

E. Life expectancy payout based on oldest DB (not oldest minor child)

If the retirement account is left to a trust of which ANY countable beneficiary is a minor child-EDB, that trust will receive "eligible designated beneficiary" treatment, which means, in Proposed Regulations-speak, that it will use a life expectancy payout (not be subject to the 10-year rule)—because the employee is deemed to have an EDB: "If any of the employee's designated beneficiaries is an eligible designated beneficiary because the beneficiary is the [minor child of the employee]...then the employee is treated as having an eligible designated beneficiary *even if the employee has other designated beneficiaries who are not eligible designated beneficiaries*." Prop. Reg. § 1.401(a)(9)-4(e)(2). Emphasis added.

The Applicable Denominator for determining RMDs after the participant's death would be based on the life expectancy of the oldest countable beneficiary of the trust—who may or may not be an EDB. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). For example, suppose there is a trust for the participant's children as a group, and some of the children are over 21 and some are under (and none is disabled or chronically ill). The payout period is based on the oldest child's life expectancy even though (being over age 21) she is not an EDB.

If the employee died after his required beginning date, the Applicable Denominator would be the *longer of* the life expectancy of the oldest countable trust beneficiary (oldest designated beneficiary) and the participant's life expectancy. Note: this rule can apply only when the deceased parent of the minor child was over age 72 at death; weird effects can happen in that scenario; see "Weird effects" elsewhere in this Outline.

F. Outer Limit Year based on oldest minor child-EDB

This is going to be a bit confusing: the life expectancy payout is computed based on one beneficiary's life expectancy (the oldest countable beneficiary *of the whole trust*) but the Outer Limit Year is based on the *oldest minor child-EDB's* reaching majority or earlier death. So the life expectancy payout and the Outer Limit Year are calculated based on different trust beneficiaries!

As noted, the RMD rules have an Outer Limit Year concept under which (regardless of what annual distributions are or are not being made) 100% of the account must be distributed by a certain

year which I call the Outer Limit Year. The Outer Limit Year overrides all other RMD schedules then in progress. Prop. Reg. § 1.401(a)(9)-5(e). The general Outer Limit Year rule, if the employee has multiple designated beneficiaries, is that the Outer Limit Year is "applied with respect to the oldest of the employee's designated beneficiaries." Prop. Reg. § 1.401(a)(9)-5(f)(2)(i). However, under Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii), if ANY of the employee's multiple designated beneficiaries is a minor child-EDB, then the trust gets the following three special deals:

- The Outer Limit Year rule is based on the *oldest minor-child EDB* (not the oldest trust beneficiary). Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii). Thus, the deadline for 100% distribution of the benefits to the trust would be 10 years after such oldest minor child-EDB turns age 21 (or dies if earlier).

- The Outer Limit Year normally applicable to a PODB (i.e., the 10-year rule) does not apply even if some trust beneficiaries are PODBs or even if the oldest trust beneficiary is a mere PODB. Prop. Reg. § 1.401(a)(9)-5(f)(2)(B).

- The "shorter of" rule (Prop. Reg. § 1.401(a)(9)-5(e)(5)) also does not apply. This bit deals with a weird effect that can happen in unusual scenarios; see "Weird Effects," PART 5, #7.

G. Minor child-EDB trust example

Example: [This is my example; there is no example in the proposed regulations illustrating these special rules.] Employee dies in 2022 before his RBD leaving his IRA to a trust for the benefit of his four children who are now ages 16, 18, 20, and 22. No child is disabled or chronically ill. Three of them are EDBs because they are minor (under age 21) children of the deceased participant. The trust provides that the trustee will use income and principal as the trustee deems best for the care, support, health, education and welfare of all the children, based on relative need, until there is no child living who is younger than age 25, at which time the trust will terminate and be distributed to the then living children equally.

Because at least one trust beneficiary is an EDB as a minor child of the participant (three are), the trust gets the following special deals:

- The oldest child is age 22 so he is a PODB. Normally the Outer Limit Year for a trust for a PODB would be the year that contains the 10th anniversary of the participant's death (10-year rule). That rule does not apply to this trust because the trust has a minor child-EDB as a countable beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii).

- Instead, the life expectancy payout will apply. The life expectancy of the oldest child (age 22) will be the applicable denominator, even though that child is not an EDB.

- The Outer Limit Year for this trust will be 10 years after the child who is now age 20 (and who is therefore the oldest *minor child-EDB*) reaches age 21 or earlier dies. So not actually

much difference—just one year longer than the 10-year rule that would apply for a PODB. The entire benefit must be distributed to the trust no later than that Outer Limit Year.

- Reminder: Just because the IRA is fully distributed no later than the Outer Limit Year, that does not mean the trust itself must terminate. The IRA is gone, the trust now holds all the distributions from the IRA (minus amounts paid out to or for the children, and minus income taxes and/or trust expenses), but the trust itself does not have to end then. It continues as long as the trust instrument dictates, administering those net IRA proceeds (and any other assets that were placed in this trust) until all four children have either reached age 25 or died, at which time the trust terminates and is distributed to the living children.

What I didn't mention in the Example: What happens if all four children die before the youngest reaches age 25? The trust has to say SOMETHING about what happens in that scenario. Suppose the trust would pass to a charity in that case. Would the trust in that case "flunk" the RMD trust rules because it has a countable nonindividual beneficiary? I THINK the "age 31" rule saves this trust. Assuming the children all live until the youngest reaches age 25 nine years from now (youngest is now age 16), the oldest child (now age 22) will get his/her share outright no later than age31. In order for the charity to come in, all four children would necessarily have to die before age 31, so the charity can be disregarded. I think. See PART 4, #10.

H. Glitch in the minor child-EDB trust regulation

There is one potentially big problem with the RMD scheme set out in the Proposed Regulations for trusts for minors. It arises when there is a trust for multiple minor child-EDBs. The Outer Limit Year is set as the 10th year after the year the *oldest minor child-EDB* either reaches majority *or dies* whichever comes first.

In a trust for multiple very young minor child-EDBs, the estate plan would anticipate that the IRA will have to be fully distributed 10 years after the oldest minor child reaches age 21. Suppose the children are now ages 2 through 12 (see the "Steinmetz Case Study," PART 2, Case #3). The estate plan would anticipate, if the parents die right now, that the IRA would be paid out over the next 19 years, i.e., the nine years until the 12-year-old reaches age 21 plus 10 years after that. By then the youngest child (now 2) will be 21 years old and the bulk of the costs of raising the family will have been paid.

However, this plan and expectation would be completely derailed in the unlikely event the oldest child dies prematurely. If the 12-year-old dies at age 14 (an admittedly unlikely occurrence), the Outer Limit Year for the IRA would be accelerated by 7 years (to 10 years after that child's death instead of 10 years after that child reaches age 21). The account would have to be fully distributed by the year the 2-year-old reached just age 14, well before the costs of raising the family have been fully incurred. This wild card could push planners to recommend separate trusts for each child (so the child is not subject to surprise acceleration due to a sibling's premature death) or maybe even to consider some kind of term life insurance on the life of the oldest child.

The IRS should correct this defect by providing [similarly to what it has provided with respect to a Type II AMBT; see Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii) and PART 5, #2] that the Outer Limit Year is 10 years after the year that there is no living minor child-EDB under age 21.

7. EDB: Disabled or chronically ill ("D/CI") individual

Here is the drill the proposed regulations provide for qualifying for a life expectancy payout as an EDB on the basis that the designated beneficiary is disabled (§ 401(a)(9)(E)(ii)(III)) or chronically ill (§ 401(a)(9)(E)(ii)(IV)).

First, the beneficiary must meet the definition of "disabled" (there are three paths to this status; see "A") or "chronically ill" (see "B"). In either case the status must exist as of the date of the participant's death. A beneficiary who does not become disabled or chronically ill until some later time (even if it is only one day after the participant's death) is not disabled or chronically ill for EDB purposes: See, *e.g.*, the Preamble to the Proposed Regulations (p. 26), where it is stated that "the employee's 10-year-old child who is not disabled but who becomes disabled 5 years after the employee's death" is not "disabled" for purposes of determining EDB status because EDB status must exist as of the employee's death, therefore, the outer limit for payout to this minor child will be the 10th year after he or she attains age 21 (or earlier dies).

Second, the beneficiary must fulfill the "documentation requirement." See "C."

If the beneficiary passes those two tests, see "D"-"G" for favorable RMD treated granted to certain trusts ("AMBTs") that can be created for such D/CI individuals.

A. Definition of disabled.

One category of EDB under SECURE is a "disabled" individual, with disability defined by reference to § 72(m)(7). Since § 72's definition of disability is defined by reference to the individual's inability to "engage in any substantial gainful activity," it is not apposite for determining the disability of a young child. The proposed regulations would cure this by adding a different definition of "disabled" if the designated beneficiary is under age 18.

If the beneficiary has been determined to be disabled for the purposes of qualifying for Social Security disability benefits, the beneficiary does not need to separately convince the IRS or the plan administrator of his disability.

Thus, Prop. Reg. § 1.401(a)(9)-4(e)(4)(i) offers three paths to disabled status: "Subject to the documentation requirements of paragraph (e)(7)...an individual is disabled if, as of the date of the employee's death, the individual is described in paragraph (e)(4)(ii) or (iii) of this section, or paragraph (e)(4)(iv) of this section applies."

- "An individual who, as of the date of the employee's death, **is age 18 or older** is disabled if, as of that date, the individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration." Prop. Reg. § 1.401(a)(9)-4(e)(4)(ii).

- "An individual who, as of the date of the employee's death, **is not age 18 or older** is disabled if, as of that date, that individual has a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or to be of long-continued and indefinite duration." Prop. Reg. § 1.401(a)(9)-4(e)(4)(iii).

- "If the Commissioner of Social Security has determined that, as of the date of the employee's death, an individual is disabled within the meaning of 42 U.S.C. 1382c(a)(3), then that individual will be deemed to be disabled within the meaning of this paragraph (e)(4)." Prop. Reg. § 1.401(a)(9)-4(e)(4)(iv).

B. Definition of chronically ill

The term "chronically ill" is used in the Code, in § 7702B(c)(2), for purposes of defining qualified long-term care insurance. The insurance-related Code definition is slightly altered for purposes of establishing EDB status: A beneficiary is chronically ill for EDB status purposes if he or she is "a chronically ill individual (within the meaning of section 7702B(c)(2), except that the requirements of subparagraph (A)(i) thereof 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).

Here is the definition as expanded in the Proposed Regulations: "An individual is chronically ill if the individual is chronically ill within the definition of section 7702B(c)(2) [of the Internal Revenue Code] and satisfies the documentation requirements of paragraph (e)(7) of this paragraph. However, for purposes of the preceding sentence, an individual will be treated as chronically ill under section 7702B(c)(2)(A)(i) only if there is a certification from a licensed health care practitioner (as that term is defined in section 7702B(c)(4)) that, as of the date of the certification, **the individual is unable to perform (without substantial assistance from another individual) at least 2 activities of daily living** for an indefinite period which is reasonably expected to be lengthy in nature (and not merely for 90 days)." Prop. Reg. § 1.401(a)(9)-4(e)(5). Emphasis added.

NOTE: This Proposed Regulation definition seems to ignore the Code's alternative definition of chronically ill, which is (regardless of whether the individual can perform activities of daily living) "requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment," even though this is also part of § 7702B(c)(2)(A), last sentence.

The Code's list of "activities of daily living": Eating, Toileting, Transferring, Bathing, Dressing, Continence. § 7702B(c)(2)(B).

The Code's definition of "licensed health care practitioner": "The term "licensed health care practitioner" means any physician (as defined in section 1861(r)(1) of the Social Security Act) and any registered professional nurse, licensed social worker, or other individual who meets such requirements as may be prescribed by the Secretary." § 7702B(c)(4).

Presumably for some beneficiaries it will be easier to qualify as an EDB under the "chronically ill" category than the "disabled" category.

C. Documentation requirement.

It is not enough for the beneficiary to merely be disabled or chronically ill (D/CI) as of the participant's death. To qualify as an EDB, the D/CI beneficiary must also supply "documentation" to the "plan administrator" by a certain deadline: "(7) Documentation requirements for disabled or chronically ill individuals. This paragraph (e)(7) is satisfied with respect to an individual described in paragraph (e)(1)(iii) [disabled] or (iv) [chronically ill] of this section if documentation of the disability or chronic illness described in paragraph (e)(4) or (5) of this section, respectively, is provided to the plan administrator no later than October 31 of the calendar year following the calendar year of the employee's death. For individuals described in paragraph (e)(1)(iv) of this section, the documentation must include a certification from a licensed health care practitioner (as that term is defined in section 7702B(c)(4))." Prop. Reg. § 1.401(a)(9)-4(e)(7).

D. "AMBTs" facilitate trust planning for D/CI beneficiaries

SECURE granted special dispensations to what it calls "Applicable Multi-Beneficiary Trusts." § 401(a)(9)(H)(iv), (v). It is generally understood that the purpose of these dispensations was to facilitate creating a "supplemental needs trust" (SNT) for a disabled or chronically ill (D/CI) beneficiary while still qualifying for the life expectancy payout granted to such beneficiary as an EDB.

Under a SNT, the trust provides only for "supplemental needs" of the beneficiary. The trust is not allowed to provide funds for the beneficiary's needs that are paid for through government programs (such as, typically, medical care or housing), and the beneficiary has no automatic right to receive "income," or a pass-through of retirement account distributions, or anything else beyond provision for his "supplemental needs." A SNT allows the disabled individual's benefactor to provide financial assistance to the individual by contributing to the trust without having the trust or its distributions counted as "assets" or "income" of the beneficiary that would disqualify him from the government benefit programs.

In enacting SECURE, Congress was aware that, under existing regulations, a D/CI beneficiary would not be treated as the sole beneficiary of a trust under which he had no rights to demand much of anything, or under a trust that divided (on the employee's death) into separate trusts only one of which was for the D/CI beneficiary. Congress was thus aware that, without special rules, typical SNTs would not qualify for the life expectancy payout reserved for EDBs, since the D/CI beneficiary would not be considered the "sole beneficiary" of the trust under existing (i.e. pre-SECURE) regulations. Congress thus included rules, in the form of the "AMBT," to assure that SNTs could get the life expectancy payout for which the D/CI beneficiary individually was eligible.

E. Definition of AMBT: Code and Proposed Regulations

There is no way to explain an AMBT except to provide the Code's definition: "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)." § 401(a)(9)(H)(v).

...and the Proposed Regulations' definition: "An applicable multi-beneficiary trust is a See-through Trust with more than one beneficiary and with respect to which--(i) All of the trust beneficiaries are designated beneficiaries; and (ii) At least one of the trust beneficiaries is an eligible designated beneficiary who is disabled (as defined in paragraph (e)(1)(iii) of this section) or chronically ill (as defined in paragraph (e)(1)(iv) of this section)." Prop Reg. § 1.401(a)(9)-4(g)(1).

F. Type I and Type II AMBTs

The proposed regulations go further and define two types of AMBTs. "Type I" is an AMBT that "is to be divided immediately upon the death of the employee into separate trusts for each beneficiary." A Type II AMBT is an AMBT the terms of which "identify one or more individuals" who are disabled or chronically ill and who are "entitled to benefits during their lifetime," [sic] provided that "no individual (other than...[an individual so identified]) has any right to the employee's interest in the plan until the death of all of the eligible designated beneficiaries described in...[(A), i.e., the D/CI individual(s) "identified" as receiving benefits during "their lifetime"]."

- **Effect of a Type I AMBT**. The purpose of singling out Type I AMBTs is to exempt such AMBT from the effects of Reg. § 1.401(a)(9)-4, A-5(c), which (controversially) does not allow "separate accounts" treatment (for purposes of determining the applicable distribution period) for subtrusts created out of a single trust upon the death of the participant, even if the creation of such subtrusts is mandated at the employees' death under the terms of the trust. See PART 6, #2. If the single ("funding") trust qualifies as an AMBT, the Applicable Denominator is determined separately for *each of the subtrusts*. Note that each subtrust so created has its payout period determined as if it were a separate trust, not just the subtrust that has one or more D/CI beneficiaries. § 401(a)(9)(H)(iv); Prop. Reg. § 1.401(a)(9)-8(a)(1)(iii)(B). **In other words a Type I AMBT is exempt from Reg. § 1.401(a)(9)-4, A-5(c).** For the "irrational" result produced by exempting Type 1 AMBTs from this regulation, but not other similar "subtrusts" that have no D/CI beneficiary, see PART 6, #2.

- **Effect of a Type II AMBT**. By providing that no beneficiary other than the D/CI beneficiary "has any right to the employee's interest in the plan" so long as the D/CI beneficiary is living (or as long as any D/CI beneficiary of the trust is living, if there are more than one), the Code allows a trust to accumulate plan distributions received during the lifetime of the D/CI beneficiary(ies) (i.e., not be a conduit trust) and still use the life expectancy payout applicable to the disabled EDB, even though there are other trust beneficiaries who are not EDBs. For a Type II AMBT's RMDs and Outer Limit Year, see PART 5, #2.

G. Comments on AMBT as a planning tool.

See PART 2, Case #4, for an example of how to use an AMBT and for comments on why, despite the special dispensations granted to AMBTs, SNTs are still generally "worse off" under SECURE than before in terms of reducing income taxes on a large IRA.

The AMBT presumably will achieve its purpose of facilitating SNTs, but it is not a way to "beat" SECURE. Plan distributions received by the trust that are not paid out in the same year for the beneficiary's supplemental needs will be subject to income tax at trust rates. Thus, while, it is helpful for its purpose of providing for supplemental needs over the beneficiary's life expectancy, the AMBT will not be much of a "tax shelter" for a large IRA. Which is presumably consistent with Congressional intent not to allow nondisabled family members to piggyback on the EDB status of the D/CI individual in order to get low taxes through a "stretch" IRA payout.

8. EDB: Not more than 10 years younger (NoMoTTYY)

SECURE's fifth category of EDB is "an individual not described in any of the preceding subclauses who is not more than 10 years younger than the employee." § 401(a)(9)(E)(II)(v). This category is referred to in this Outline as NoMoTTYYs (for Not More Than Ten Years Younger).

To qualify as this category of EDB, the individual must meet two requirements. One, he/she does not fit into any of the other EDB categories (*e.g.,* he/she is not the participant's spouse). Two, he/she must be either *older than* the participant; or *the same age as* the participant; or *younger—but not more than 10 years younger—than* the participant.

A. Based on birth days, not birth years

The proposed regulations define this category of EDB based on the actual dates of the parties' birth, not the *year* of birth: "Prop. Reg. § 1.401(a)(9)-4(e)(6): "Individual not more than 10 years younger than the employee. Whether a designated beneficiary is not more than 10 years younger than the employee is determined based on the dates of birth of the employee and the beneficiary. Thus, for example, if an employee's date of birth is October 1, 1953, then the employee's beneficiary is not more than 10 years younger than the employee if the beneficiary was born on or before October 1, 1963."

B. NoMoTTYY RMDs if Participant dies before RBD.

In general this category of EDB will have RMDs determined based on the life expectancy of the EDB. If the participant died before his RBD, the Applicable Denominator will be the EDB's remaining life expectancy, with RMDs starting the year after the participant's death. Prop. Reg. § 1.401(a)(9)-3(c)(4), § 1.401(a)(9)-5(d)(2). The Outer Limit Year for this situation is the year that contains the 10th anniversary of the EDB's death. Prop. Reg. § 1.401(a)(9)-5(e)(3). So the final year of RMDs will be the final year of the EDB's life expectancy, or the year that contains the 10th anniversary of the EDB's death, whichever comes first. See PART 3, #4.

However, if permitted by the plan, the EDB can elect the 10-year rule instead of the life expectancy payout—or the 10-year rule may be imposed on the EDB by the plan or by the participant himself. Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii). If the 10-year rule applies, the Outer Limit Year would be the year that contains the 10th anniversary of the participant's death.

C. NoMoTTYY RMDs if Participant dies on or after RBD.

The Proposed Regulations' opening bid for a NoMoTTYY is that, if the participant died on or after his RBD, the Applicable Denominator for the beneficiary is the "greater of" the beneficiary's life expectancy or the participant's life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(ii). So far so good—if the beneficiary was older than the participant, the participant's (longer) life expectancy is used to determine annual RMDs to this EDB. This is usually called the "longer of" or "greater of" (the two life expectancies) rule.

Then comes the zinger: For the Outer Limit Year, a "shorter of" rule (created in these Proposed Regulations) kicks in: If the EDB was older than the participant, 100% of the account must be distributed no later than the final year of the EDB's life expectancy! The "shorter of" (or "lesser of") rule! Prop. Reg. § 1.401(a)(9)-5(e)(5).

This "shorter of" rule is a new creation. Under existing regulations, the distribution period for a designated beneficiary in cases of participant's death after the RBD was the *longer of* the beneficiary's or the participant's life expectancy! See Reg. § 1.401(a)(9)-5, A-5(a)(1).

This zinger almost exclusively affects the NoMoTTYY. It does not affect the surviving spouse, even if she is older than the participant, because if she is the beneficiary she can roll over the benefits to her own IRA and escape the problem. It would apply to a conduit trust for the surviving spouse, if the S/S is older than the decedent and he died after his RBD, but since the surviving spouse's life expectancy is recalculate annually it does not run out until she reaches age 120. It cannot affect a Minor Child-EDB, since the participant's minor child cannot be older than the participant who is by definition over age 72. It does not apply to trusts for minor-child-EDBs or to AMBTs because both those types of trusts are specifically exempted from this rule; see PART 5, #7 and #8. Thus, the only types of beneficiaries actually subject to this rule are NoMoTTYYs who are older than the participant, and D/CI beneficiaries who are older than the participant AND who are named directly as beneficiary (rather than benefitting through an AMBT named as beneficiary).

9. Double qualification as EDB

What if the beneficiary qualifies as an EDB in more than one category?

This subject is addressed only once in the Code, which requires (in connection with qualifying for EDB status as a NoMoTTYY) that the individual must not be "described in any of the preceding subclauses." § 401(a)(9)(E)(ii)(V). The Proposed Regulations add no further enlightenment.

An individual could be both Disabled and Chronically Ill, presumably, but that would make no difference since both categories receive identical RMD treatment. Therefore, it appears that the only way an EDB can "double qualify" is if he is both the surviving spouse and D/CI, or both a minor child-EDB and D/CI. Here is the apparent effect of such double qualification.

A. Minor child who is also D/CI

If the individual qualifies as both a minor child of the participant AND as D/CI, then his EDB status would not terminate at the age 21 birthday—it would last for life.

A *trust* for the benefit of this child could be a Type II AMBT if the child is the sole permissible beneficiary (with respect to the trust's retirement benefits) for his/her entire life. In that case the annual distributions would be based on the *child's* life expectancy. The Outer Limit Year would be 10 years after the death of the oldest D/CI trust beneficiary, presumably the child.

If the trust does not qualify as a Type II AMBT, then annual distributions would be based on the life expectancy of the oldest countable trust beneficiary (as always for trusts that have a minor-child EDB as a countable beneficiary). When would the Outer Limit Year be? That is not entirely clear. For a Type II AMBT, the Outer Limit Year is 10 years after the death of the last surviving D/CI beneficiary, but if the trust does not qualify as a Type II AMBT? The normal Outer Limit Year for an IRA payable to a trust for the benefit of a minor child-EDB is 10 years after such child reaches 21 (or earlier dies), but that Outer Limit Year does not apply to this particular child because he is D/CI. This is a gap in the Proposed Regulations.

B. Surviving spouse who is also D/CI

If the surviving spouse is disabled or chronically ill, the question is whether she can somehow benefit from dual qualification. In my opinion the answer is no.

Clearly she could choose "either/or"—for example, if there is a conduit trust for the surviving spouse's benefit, it can use the surviving spouse's life expectancy recalculated annually (and the delayed commencement date for RMDs if the deceased spouse died before age 72) because with a conduit trust the spouse is deemed to be the "sole beneficiary," a requirement of spousal-EDB perks. Or if there is a Type II AMBT for her sole life benefit, remainder beneficiaries of the trust can be disregarded for purposes of determining RMDs during her lifetime, because that is a "perk" of a Type II AMBT.

However, suppose the trust is a Type II AMBT of which the surviving spouse is the sole life beneficiary, but he/she is NOT entitled necessarily to any distributions from the trust or retirement plan—for example because the trust is a "supplemental needs" trust and distributions are made to the spouse only if need for his/her supplemental needs in the judgment of the trustee. In my opinion, such trust would not be entitled to recalculation of the surviving spouse's life expectancy (even if she is the oldest trust beneficiary and/or the oldest D/CI beneficiary) because she is not the SOLE beneficiary any way you cut it. Recalculation of life expectancy (and delayed commencement date) apply only if the surviving spouse is the sole beneficiary. That status cannot be achieved by a trust unless it is a conduit trust.

PART 4: TRUST AS BENEFICIARY OF A RETIREMENT ACCOUNT

1. If a trust is named as beneficiary: The new IRS RMD trust rules

Naming a trust as beneficiary of a retirement account is a widely used estate planning technique. Since a "designated beneficiary" must be an "individual" (§ 401(a)(9)(E)(i)) and a trust is not an individual, the IRS wrote rules in the 2002 regulations under which, if the participant left his retirement account to a trust, the beneficiaries of the trust could be treated as if they had been named directly as beneficiaries of the plan. If the regulation's rules were complied with, the individual trust beneficiary(ies) could qualify as designated beneficiaries and the trust would be entitled to a life expectancy payout. Over the years, some persistent problems developed in applying these rules. The Proposed Regulations restate, and substantially expand and improve, the "RMD trust rules." Despite the new clarifications and other improvements, figuring out the Applicable Denominator (payout period) for a trust named as beneficiary is not easy in many cases. This Outline attempts to explain the required steps as clearly as possible in the following sections.

2. Steps required to determine the Applicable Denominator for the trust

The goal is to determine the Applicable Denominator (payout period; RMD requirements) for a retirement account payable to the trust. This requires the following process.

Step 1: Does the trust qualify as a See-through Trust? Figure out if the four basic trust rules are complied with; see #3 below. If so, you have a See-through Trust; proceed to Step 2. If not, go to Step X.

Step 2: Determine whether your See-through Trust qualifies as a Designated Beneficiary Trust (DBT)—i.e., are all countable beneficiaries individuals? See #6 through #13, the "tier system," below. If the answer is NO, go to Step X on this page. If the answer is YES, you have a DBT and can proceed to:

Step 3: Determine the Applicable Denominator, including the "Outer Limit Year." How to do this is explained in PART 5 of this Outline.

Step X
Step X: If you landed here it means your trust is a Non-DB. The distribution period is the 5-year rule if participant died before his RBD (Prop. Reg. § 1.401(a)(9)-3(c)(2)), or the ghost life expectancy if he died on or after his RBD (Prop. Reg. § 1.401(a)(9)-5(d)(1)(iii)).

3. The four basic trust rules; unchanged except "identifiable" requirement.

To "test" a trust under the minimum distribution rules, you start with these four basic requirements. These are nominally unchanged from the existing four rules, but the meaning of one of them (#3, "identifiable") is substantially altered by the Proposed Regulations. For the meaning of Rules 1, 2, and 4, see ¶ 6.2 of *Life and Death Planning for Retirement Benefits*. The four basic "RMD trust rules" are as follows:

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."

4. A copy of the trust (or a summary of its terms meeting certain requirements) must be provided to the plan administrator by October 31 of the year after the year of the participant's death. Prop. Reg. § 1.401(a)(9)-4(f)(2).

Under the existing (2002) regulations, "identifiable" required identifying the beneficiary with the "shortest life expectancy" (i.e., the oldest countable beneficiary of the trust). Under the 2002 regulations the oldest potential beneficiary's life expectancy would be the Applicable Denominator for distributions to the trust. That step is generally no longer needed to determine the Applicable Denominator, since the 10-year rule now applies to most designated beneficiaries, and since the life expectancy payout is limited to individuals who are EDBs. Prop. Reg. § 1.401(a)(9)-4(f)(ii)(A). The identity of the oldest "countable" trust beneficiary still matters in some cases for purposes of determining the Applicable Denominator, but no longer matters for purposes of qualification as a See-through Trust. Prop. Reg. § 1.401(a)(9)-4(f)(2)(iii), (5)(i); compare Reg. § 1.401(a)(9)-4, A-1.

Under the Proposed Regulations, the definition of "identifiable" is changed to mean only that "it is possible to identify each person eligible to receive a portion of the employee's interest in the plan through the trust." Prop. Reg. § 1.401(a)(9)-4(f)(5)(i). The Proposed Regulations use the "identifiable" requirement as a springboard to explain whether potential post-death changes in the identity of the trust beneficiaries (*e.g.*, via exercise of a power of appointment, or a trust reformation or decanting) will or will not affect the trust's qualification as a See-through Trust (and if so how and when). See PART 7.

A trust that passes these four rules is called, in the Proposed Regulations, a "**See-through Trust**." Prop. Reg. § 1.401(a)(9)-4(f)(1)(i), last sentence. A See-through Trust *may or may not* qualify as a Designated Beneficiary, however. Such qualification will depend on whether all "countable" beneficiaries of the trust are individuals. To make that determination you must first determine whether your trust is a conduit trust or an accumulation trust. Proceed to #5 below after reading the following fascinating paragraph.

4. Which trust...or subtrust...are you testing, exactly?

Often, the trust named as beneficiary on the beneficiary designation form is required by its terms to divide up into separate trusts following the trust grantor's death. A separate trust so created is called a subtrust. A "subtrust" is not in any legal or tax way different from a plain old "trust," it's just a convenient term to denote a trust that was created out of another trust. Once the subtrust is calved out of the "funding" trust, it's treated just like any other trust for all legal and tax purposes.

Generally for RMD purposes you will always be "testing" the funding trust under Step 1 and Step 2 described at #1 above. Once those hurdles are cleared, and it's time for Step 3 (determining the Applicable Denominator), the question of whether Step 3 is applied to all subtrusts collectively or each individual is a matter of whether the subtrusts qualify for "Separate Accounts" treatment: See PART 6, #2.

If the separate subtrusts were named separately on the Beneficiary Designation Form, you test each subtrust separately. Thus, if one of the subtrusts so named as beneficiary has a countable nonindividual beneficiary that would not contaminate the other subtrusts if each subtrust was named directly as beneficiary.

5. **Definitions: See-through Trust, Conduit Trust, Accumulation Trust.** The Proposed Regulations adopt as official terms See-through Trust, Conduit Trust, and Accumulation Trust. The terms "Conduit Trust" and "Accumulation Trust" have been in common use for years by practitioners (and have appeared in PLRs) to describe the types of trusts illustrated in Reg. § 1.401(a)(9)-5, A-7(c)(3), Examples 1 and 2. Though the term "See-through Trust" has also been around for years, its meaning has shifted a bit in these Proposed Regulations; see below. Here are the definitions in the Proposed Regulations, along with some additional enlightenment provided by the Proposed Regulations:

- A **See-through Trust** is a trust that is "designated as the beneficiary of an employee under a plan" and which meets the requirements of Prop. Reg. § 1.401(a)(9)-4(f)(2) (i.e. it complies with the four "trust rules"; see above). The effect of a See-through Trust is that "certain beneficiaries of the trust that are described in...[Prop. Reg. § 1.401(a)(9)-4(f)(3)] are treated as having been designated as beneficiaries of the employee under the plan, provided that those beneficiaries are not disregarded under...[Prop. Reg. § 1.401(a)(9)-4(f)(2)]." Prop. Reg. § 1.401(a)(9)-4(f)(1)(i). Having a See-through Trust therefore is just the first step: It gets you in the door but does not guarantee that the trust will qualify for any life expectancy payout or even the 10-year rule. A TRUST MAY QUALIFY AS A SEE-THROUGH TRUST AND STILL NOT HAVE THE TRUST BENEFICIARIES QUALIFY AS "DESIGNATED BENEFICIARIES." And note: Even though, with a See-through Trust, the trust beneficiaries are deemed to be the beneficiaries of the retirement plan, the trust is considered the "payee" for purposes of the 50% excise tax on missed RMDs (§ 4974), so the trustee will be responsible for paying that tax. Prop. Reg. § 1.401(a)(9)-8(a)(1)(iii).

- A **Conduit Trust** is a See-through Trust that provides, with respect to the deceased participant's interest in the retirement plan account, that "all distributions [from such retirement account] will, upon receipt by the trustee, be paid directly to, or for the benefit of, specified beneficiaries." Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(A). This definition of conduit trust has not changed from the existing regulations or common understanding, though the existing regulations do not use that term; see Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2. For the first time, this definition provides

official recognition that a conduit trust can be for more than one designated beneficiary, a question considered unresolved under the 2002 regulations.

- An **Accumulation Trust** is "any See-through Trust that is not a conduit trust." Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(B).

6. For a trust to be a DBT, all countable beneficiaries must be individuals

The post-death minimum distribution rules depend on who is/are the deceased employee's (or IRA owner's) beneficiary(ies). The 10-year rule is available only for "designated beneficiaries." The life expectancy payout is available only for "eligible" designated beneficiaries, who also must be "designated beneficiaries." A designated beneficiary is "any **individual** designated as a beneficiary by the employee." § 401(a)(9)(e)(i). So our task will be to look through a See-through Trust and figure out whether its countable beneficiaries are "individuals" or not. If all the countable beneficiaries are individuals, the trust qualifies as a **Designated Beneficiary Trust** (**DBT**). After THAT has been determined, you look at your various countable individual trust beneficiaries and determine the trust's Applicable Denominator based on the status of those countable individuals (see PART 5). Whew!

7. Testing the trust: "Mere potential successor" concept replaced by a two-tier system with more specific (but still elusive) "disregard" rules

"The determination of which beneficiaries of a see-through trust are treated as having been designated as beneficiaries of the employee...depends on whether the see-through trust is a conduit trust or an accumulation trust." Prop. Reg. § 1.401(a)(9)-4(f)(ii).

The 2002 (existing) regulations say that in testing trust beneficiaries for designated beneficiary status, you would ignore a beneficiary who was a "mere potential successor" to another beneficiary (Reg. § 1.401(a)(9)-5, A-7(c)(1)) but the meaning of that term proved elusive. Practitioners struggled with whether to count or ignore remote contingent beneficiaries or potential appointees under a power of appointment.

The Proposed Regulations have dropped the term "mere potential successor." The approach for determining which trust beneficiaries are "countable" or not has been somewhat improved in two ways:

- The concern about powers of appointment and other possible post-death changes has been taken out of the trust-testing process. Instead it has been worked into the "identifiable" requirement (one of the four trust rules), with the general approach now being that such potential post-death changes can be ignored until they happen. See PART 7.

- All other beneficiaries and potential beneficiaries of the trust are collected and tested under a two-tier system. Tier one beneficiaries count. Tier two beneficiaries may or may not count.

8. The Two-tier System for Determining which Trust Beneficiaries Count

In describing which beneficiaries of a trust "count" as beneficiaries and which can be disregarded (all for purposes of determining whether the participant who left his benefits to this trust has a "designated beneficiary" or not, and other trust matters), the Proposed Regulations describe two "tiers" of trust beneficiaries without calling them that or giving a title to each tier. Here are the definitions of the tiers and then how to apply the system to the two types of See-through Trusts.

A. **First tier: Beneficiary(ies) eligible or entitled to receive the benefits upon participant's death.** The definition of what I call first-tier beneficiaries is, "Any beneficiary who could receive amounts in the trust representing the employee's interest in the plan that are neither contingent upon, nor delayed until, the death of another trust beneficiary..." Prop. Reg. § 1.401(a)(9)-4(f)(3)(i)(A). In other words, a beneficiary who is entitled or eligible to receive distributions after the death of the participant; the first-tier beneficiary does not have to wait until some other beneficiary dies. These "first-tier beneficiaries" are always "countable," or, in the Proposed Regulations' language, "treated as having been designated as beneficiaries." For example, under a Conduit Trust, all distributions will, upon receipt by the trustee be paid "directly to, or for the benefit of, specified beneficiaries." Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(A). The "specified beneficiaries" are first-tier beneficiaries, though that term is not used in the Proposed Regulations.

   - Note that some event *other than death* (such as remarriage of the surviving spouse) that brings a new beneficiary in to sharing the benefits makes that beneficiary a first tier beneficiary. Example: The trust says "pay income to my spouse until his death, then distribute the trust to my children." Spouse is first tier, children second tier. But if the trust says "pay income to my spouse until his death or remarriage, then distribute the trust to my children," spouse AND children are first-tier according to the Preamble, p. 32. Why this is treated so differently from an exercise of a power of appointment by the surviving spouse (see PART 7, #7) is unclear.

B. **Second tier: Will or may inherit what's not distributed to first tier**. A "second-tier" [my term] beneficiary is a beneficiary "that could receive amounts in the trust representing the employee's interest in the plan that were not distributed to the beneficiaries described in paragraph (f)(3)(i)(A) of this section," i.e., the first-tier beneficiaries. The Proposed Regulations refer to these second-tier beneficiaries as "secondary" beneficiaries later on, in the titling of Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A): "(A) *Entitlement conditioned on death of secondary beneficiary...*"

Once you set up your "tiers," you next attempt to figure out which if any second-tier beneficiaries you can "disregard" i.e., they will not be "countable" for purposes of determining the Applicable Denominator. First-tier beneficiaries are "always" countable.

9. Conduit trust: Disregard all second-tier beneficiaries.

If the trust is a Conduit Trust, only the First Tier beneficiary(ies) are countable. All second-tier beneficiaries are disregarded. Prop. Reg. § 1.401(a)(9)-4(f)(6)(i) (Example 1).

Remember: "The term conduit trust means a See-through Trust, the terms of which provide that, with respect to the deceased employee's interest in the plan, all distributions will, upon receipt by the trustee, be paid directly to, or for the benefit of, specified beneficiaries..." Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(A).

10. Age 31 rule: Accumulation trust: Disregard 2nd-tier beneficiary who inherits only if another individual who was to take outright at age 31 (or earlier) dies before such age.

A perennial problem under the existing regulations has been the rule that, with an accumulation trust set up for a young individual (such as the participant's child or grandchild), the remainder beneficiary of the trust is "countable" regardless of how unlikely it is he/she will actually inherit—for example, if the young individual is to receive outright distribution at age 25, and his 75-year-old great aunt (his next of kin) will inherit the trust if the young beneficiary dies before age 25, the 75-year-old great aunt is a countable beneficiary and since she is the oldest trust beneficiary her life expectancy would have been the distribution period under the old life expectancy payout rules (mostly eliminated by SECURE). The Proposed Regulations eliminate that problem IF the trust creator is willing to have the young beneficiary receive outright distribution of his or her share by age 31.

If a first-tier beneficiary is entitled to outright distribution of his/her trust share at age 31 (or earlier), the second-tier successor beneficiary who will inherit that share only if that first-tier beneficiary dies before such date is disregarded. Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B). Accordingly if that successor beneficiary is a charity it won't cause the trust to lose its DBT status (normally as a nonindividual second-tier beneficiary the charity would disqualify the accumulation trust). Similarly, if the first-tier beneficiary is a minor child of the participant (an EDB), who will receive outright distribution of his/her share at age 31 or earlier, an older individual who will receive that share if the EDB dies before attaining that age will be disregarded for purposes of determining the Applicable Denominator (which for a minor child-EDB's trust is normally the life expectancy of the oldest countable beneficiary).

This age-31-disregard rule has two significant planning effects. First it means that a trust for a minor child-EDB does not have to be a conduit trust to qualify for a life expectancy payout; it will qualify as long as the minor-child EDB becomes outright owner of the retirement account and its proceeds no later than age 31. In other words it doesn't have to be a conduit trust for ages zero through 30...it only has to effectively "become" a conduit trust at age 31.

Second, this provision can be used by anyone leaving benefits in trust for a person under age 31 (even a young person who is not the participant's own child and/or is not under age 21) and have a charitable remainder beneficiary and still qualify for the 10-year rule.

11. Accumulation trust: Disregard second-tier beneficiary "who could receive amounts from the trust that represent the employee's interest in the plan solely because of the death of another beneficiary described in paragraph (f)(3)(i)(B) of this section."

I.e., disregard a second-tier beneficiary who inherits only if some *other* second-tier beneficiary ("beneficiary described in paragraph (f)(3)(i)(B) of this section") predeceases the first tier beneficiary(ies). The Proposed Regulations' "exceptions" to that "disregard" rule really don't add anything to the preceding sentence but here they are:

- The interest must be contingent on the prior death of another actual second-tier beneficiary i.e. someone who survived the participant— individuals who predeceased the participant don't count! (I don't think anyone would think they did). Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)(1).

- If the second-tier beneficiary whom you are trying to exclude as "disregarded' is ALSO a first-tier beneficiary, then he/she/it is not disregarded. Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A).

As further discussed below (#13), application of this particular "disregard" rule is hazy in many situations. It is imperfect....really just a reworded version of the old "mere potential successor" rule.

12. All trusts: Disregard anyone who predeceased the participant

Just for the record, beneficiaries are not countable merely because they are named in the trust instrument. A person who is so named but *who actually died before the participant* is completely disregarded under these testing rules—he or she is NOT a "beneficiary" of the trust. Prop. Reg. § 1.401(a)(9)-4(c)(2)(i).

A common example: "The trust shall pay income to my spouse for life and on my spouse's death distribute the principal of the trust to my three children." If "spouse" predeceased the participant, spouse is *not* a beneficiary of the trust—so the three children are the first-tier trust beneficiaries. The same is true if spouse actually did survive, but is "deemed" to have predeceased the participant due to a qualified disclaimer or a simultaneous-deaths provision of state law.

13. Easy and hard examples of the tier system

Using this tier system and its "disregard" rules we can (in some but not all cases) figure out which beneficiaries are countable, i.e., "treated as having been designated" by the participant, and which are "disregarded," i.e., not treated as having been so designated (and therefore not countable) *for simple-structure trusts*:

- First tier beneficiaries are **always** countable.

- Second tier beneficiaries are always disregarded in a conduit trust. Prop. Reg. § 1.401(a)(9)-4(f)(3).

- Second-tier beneficiaries are generally countable in an accumulation trust, except that:

  - A second-tier beneficiary is disregarded if his/her/its rights are conditioned on another beneficiary's dying before age 31, if such other beneficiary would have inherited the applicable benefit if he/she had lived to the applicable age.

  - A second-tier beneficiary is disregarded if he/she/it would be entitled to a share only if another secondary beneficiary fails to survive the first tier beneficiary(ies).

See Prop. Reg. § 1.401(a)(9)-(5)(f)(6) for IRS examples of how to use the tier system to test a trust. Example 1 is a conduit trust for "D." All plan distributions received by the trust during D's life must be distributed to D, so D is the only first tier beneficiary. If there is anything left at D's death, it is distributed to E, but E (the second tier beneficiary) is disregarded because this is a conduit trust.

Here are some more examples of applying the Tier system (or attempting to)

Example 1: Income to my spouse for life, remainder at my spouse's death outright to my daughter Susy if living, otherwise to charity. This is an accumulation trust. Spouse and daughter both survive the participant. Countable beneficiaries are spouse and daughter. Charity is disregarded because it inherits only if Susy (second-tier beneficiary who is living when participant died) dies before spouse (the only first-tier beneficiary). Trust is a "Designated Beneficiary Trust" (DBT) because all its countable beneficiaries are individuals. Note: It doesn't matter whether Susy ACTUALLY survives spouse. As long as she survived the participant (and is not somehow "deemed" to have predeceased the participant via e.g. a disclaimer) she is the countable second-tier beneficiary and the charity (which is also a second tier beneficiary) is disregarded. See Example 2 in Prop. Reg. § 1.401(a)(9)-4(f)(6)(ii). *This is exactly the same as the "mere potential successor" rule under the existing regulations*.

Example 2: "Income and principal shall be paid to or for the benefit of my spouse and our four children for their health, education, and support as long as my spouse is living. On the death of the survivor of my spouse and myself, the trust shall terminate and be distributed outright to my issue then living. If I have no issue then living, then to charity." At participant's death, his spouse and four children are living and there are no other issue. The first tier beneficiaries are spouse AND CHILDREN, because all are eligible/entitled to receive distributions after the participant's death (without having to wait until some other beneficiary dies). The charity (second tier beneficiary) inherits only if all four children predecease spouse. However, the ability to disregard a second tier beneficiary who will only inherit if another second tier beneficiary predeceases the participant *does not apply here* because the charity only has to survive first tier beneficiaries.

Under the Proposed Regulations, the client in this example would be best advised to avoid naming a charity as the second tier beneficiary. Instead name a human wipeout beneficiary, or use a last man standing trust, or use a conduit trust [all plan distributions must be paid out in year received to one or more members of group consisting of spouse and children], or avoid using a spray trust where all your desired beneficiaries are in the "first tier" and you don't have a candidate for the second tier. Here is an example of a last-man-standing approach:

Example 3: "Income and principal shall be paid to or for the benefit of my spouse and our four children for their health, education, and support as long as my spouse is living. On the death of the survivor of my spouse and myself, the trust shall terminate and be distributed outright to my issue then living. Notwithstanding the foregoing, if at any time there is only one person living among the group consisting of my spouse and issue the trust shall terminate at such time and be distributed outright to that person." Now there are no beneficiaries you need to "disregard."

Example 4: "Death or remarriage." The Preamble to the proposed regulation notes (regarding the example of a spouse-for-life-remainder outright to sibling on spouse's death, or to charity if sibling is not then living) that if "sibling" would succeed to the trust property upon spouse's death *or remarriage*, then sibling would be treated as a first tier beneficiary because his rights were not contingent on the *death* of another beneficiary, and in that case "the charity would be treated as a beneficiary" of the deceased employee (which of course would cause the employee not to have a "designated beneficiary"). The charity would essentially be moved from disregardable second-tier status to countable second-tier status; the charity would become the only second tier beneficiary.

Example 5: Multi-generation trust. "The trustee shall pay to or for the benefit of such of my issue living from time to time as the trustee deems advisable for their care, support, and education, until there is no issue of mine living at which time the trust shall terminate and be distributed to My Favorite Charity." At the time of his death, the participant had four living children, six living grandchildren, and no other issue. Those 10 living "issue" are all first-tier beneficiaries. The only "second-tier" beneficiary in sight is the Charity, so the trust flunks. The potential future issue of the living children and grandchildren cannot be counted because they don't exist yet.

"At the end of the day" the new trust-testing rules are almost the same as the old trust-testing rules: As Kathy Sherby, Esq., put it, "you keep counting until you get to someone who can put the retirement plan benefits in their pocket." The regulation is looking for when the retirement plan money comes out of the trust and *goes into someone's pocket.* **Thus, perpetual or multi-generation trusts are not going to fit well with these regulations.** If the trust is designed so the money never "goes into someone's pocket" it may not be possible to test the trust under the tier system and it may not be possible to have a Designated Beneficiary Trust.

PART 5: DETERMINING THE APPLICABLE DENOMINATOR FOR A TRUST

After completing all the steps in PART 4 above, you have your list of "countable" beneficiaries of your trust. These will determine the payout period for the trust—what the regulations

call the Applicable Denominator. All you need to do now is figure out which one of the following sections 1-5 describes your trust and you will know your Applicable Denominator (including annual track required distributions and Outer Limit Year).

1. Trusts that get "EDB treatment"....or not

"EDB treatment" is used in this Outline to indicate that the trust is entitled to the "life expectancy payout" based on the life expectancy of one of the trust beneficiaries (which one varies depending on the type of trust as we shall see).

The approach of the Proposed Regulations is to allow such "EDB treatment" for three types of trusts: a Type II AMBT (PART 5, #2); a trust that has at least one countable beneficiary who is a minor child-EDB (PART 5, #3); and any trust all "countable" beneficiaries of which are EDBs (PART 5, #4). ;; and. for a trust means the trust is entitled to a life expectancy payout. Prop. Reg. § 1.401(a)(9)-4(e)(2) provides that if the beneficiary of the retirement account is one of the above three types of trust, "then the employee is treated as having an eligible designated beneficiary." If the account is left to any other type of trust "then the employee is treated as not having an eligible designated beneficiary."

So, clearly this "EDB treatment" applies to these trusts for purposes of determining the Applicable Denominator. It presumably also extends to allowing the trust to elect the 10-year rule instead of the life expectancy payout if the participant died before his RBD (see PART ***), though this point is not explicitly stated in the Proposed Regulations.

2. Applicable Multi-beneficiary Trust (AMBT) Type II

Under a Type II AMBT, there is a disabled or chronically ill (D/CI) beneficiary and during the lifetime of such D/CI beneficiary no distributions from the retirement plan may be paid to anyone other than such D/CI beneficiary. See PART 3, #7(E). That includes reinvestments and "proceeds" of such retirement plan distributions. Plan distributions (and proceeds thereof etc.) may be applied to or for the benefit of the D/CI beneficiary, or held for such use in the future, but may not (so long as the D/CI beneficiary is living) be paid to or applied for the benefit of anyone else. This provision of SECURE was apparently created especially having in mind supplemental needs trusts for the benefit of a disabled individual who was receiving means-tested government benefits for the disabled.

The Applicable Denominator for this type of trust is:

Generally, the life expectancy of the oldest countable D/CI beneficiary of the trust. (If there is only one D/CI beneficiary, then his or her life expectancy.) Prop. Reg. § 1.401(a)(9)-5(f)(1)(ii).

Generally, the Outer Limit Year for this type of trust is: 10 years after the death of the D/CI beneficiary (or of the last D/CI beneficiary to die, if there are more than one). Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii).

Note the following wrinkles in the above general rules:

- If the participant died before his RBD, there are situations where the 10-year rule can apply even though the trust is a Type II AMBT. See PART 3, #4.

- If the participant died after his RBD, and the participant's life expectancy ("ghost life expectancy") was longer than the oldest D/CI beneficiary's life expectancy, the ghost life expectancy would determine annual distributions. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). But see the section entitled "Weird effects under the ghost life expectancy" in PART 5, #8.

3. Trust with a minor-child EDB.

If at least one countable beneficiary of the trust is a minor child of the participant ("minor-child EDB"), the trust is entitled to the life expectancy payout. The applicable denominator will be the life expectancy of the oldest countable beneficiary of the trust. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). NOTE, this is the oldest countable designated beneficiary, who may or may not be a minor child-EDB....the oldest countable beneficiary may be a mere "PODB." But that's whose life expectancy will be the Applicable Denominator for determining RMDs to this trust.

An example would be, a spray trust for the benefit of the deceased participant's children, three of whom are still minors and one of whom is age 22. Even though one trust beneficiary is not an EDB the trust gets to use the life expectancy payout to determine annual distributions because it has at least one child who is still a minor. The life expectancy the trust must use is the life expectancy of the 22-year-old child (if he is the oldest countable beneficiary).

Another example: Trust for the benefit of the participant's 5-year-old child, to be held for the child's benefit until she reaches age 45. If she dies before that age, the trust passes to the child's aunt who is age 43. This is not a conduit trust. The aunt is countable, and she is the oldest trust beneficiary, so her life expectancy determines the annual RMDs. Note: If the trust property were distributable outright to the child by age 31, rather than age 45, then auntie could be disregarded and the trust would use the child's life expectancy as the Applicable Denominator.

The Outer Limit Year for a trust with a minor child-EDB is 10 years after the oldest minor-child beneficiary reaches age 21 (or earlier dies). Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii).

Confusing point: As with Type II AMBTs, the trust with one or more minor-child EDBs has different "measuring lives" for the annual distributions (life expectancy of the oldest countable beneficiary of the trust) vs. the Outer Limit Year (10 years after oldest minor-child EDB reaches age 21 or earlier dies). This kind of distinction keeps you on your toes.

Exceptions to the general rules: If the participant died before his RBD, there are cases where the 10-year rule can apply to an EDB (see PART 3, #4(C)) or a trust for an EDB (PART 5, #1). If the participant died after his RBD, and the oldest countable trust beneficiary is older than the participant, Weird Effects can ensue. See PART 5, #7, Weird Effects.

4. Trust which is neither of the above but all countable beneficiaries are EDBs.

This is complicated.

A See-through Trust is entitled to "EDB" treatment if all countable beneficiaries of the trust are EDBs.

How do we know this? Because, first, Prop. Reg. § 1.401(a)(9)-4(e)(2)(i) says that if there are multiple designated beneficiaries and any of them "is not an" EDB, "then the employee is treated

as not having an eligible designated beneficiary" [with two exceptions—for special rules for AMBTs and for any trust with a minor-child EDB beneficiary]. This leads to the conclusion (not explicitly stated) that if there are multiple designated beneficiaries and all of them ARE EDBs, the life expectancy of the oldest one is the Applicable Denominator [unless the "greater of" rule applies; PART 3, #4(D), or the trust is a Type II AMBT (PART 5, #2)].

Thus, the oldest EDB's life expectancy is the Applicable Denominator. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii), (2).

See also Prop. Reg. § 1.401(a)(9)-4(f)(6)(ii) (Example 2). In the example, the life beneficiary of the trust is the participant's surviving spouse (an EDB), but it is not a conduit trust because she is entitled only to income of the trust, not to receive all distributions the trust receives from the plan (as would be the case if this were a conduit trust). After the surviving spouse's death, the trust is to pass outright to the deceased participant's sibling who is younger than the surviving spouse and who is less than 10 years younger than the decedent—so the sole remainder beneficiary is also an EDB (he is a NoMoTTYY). Both spouse and sibling survive the participant.

A charity takes the trust on the surviving spouse's death if the sibling has predeceased her; but this nonindividual beneficiary is not countable (i.e., it is disregarded) because it takes only if another second-tier beneficiary (the sibling) predeceases the first-tier beneficiary (the spouse). See PART 4, #11.

Even though the oldest EDB is the surviving spouse, however, the trust will not get the special spousal RMD deals such as recalculation of life expectancy because the surviving spouse must be "sole" designated beneficiary to get those deals. See, *e.g.*, Prop. Reg. § 1.401(a)(9)-3(d), (e), -5(c)(2), (d)(3)(iv).

Upon the death of the surviving spouse, RMDs will continue to be made to the trust [or to the individual successor beneficiary assuming the trust terminates at that point] based on the life expectancy of the surviving spouse [assuming she died before that LE payout period ended], with a final RMD of 100% of the account due in the year of the 10th anniversary of the surviving spouse's death if the account was not previously exhausted by the life expectancy payout. Prop. Reg. § 1.401(a)(9)-5(e)(3).

So the Outer Limit Year for this trust is the year the surviving spouse's life expectancy (unrecalculated) goes to 1 or less or (if earlier) the year that contains the 10th anniversary of the surviving spouse's death

HOWEVER: The above general description is subject to the exceptions noted below....

<u>If death occurred *before* the RBD</u>, the 10-year rule can apply in some cases instead of the life expectancy payout. See PART 3, #4(C).

<u>If death occurred *after* the RBD</u>, and the oldest EDB is *younger than* the decedent, the annual distributions track is annual distributions over the life expectancy of the oldest EDB (not recalculated) and the Outer Limit Year being the year the oldest EDB's life expectancy drops to one or below, or, if earlier, 10 years after the death of such oldest EDB.

<u>If death occurred *after* the RBD</u>, and the oldest EDB is *older than* the decedent, the annual distributions track is annual distributions over the *greater of* the life expectancy of the oldest EDB or the ghost life expectancy....with the Outer Limit Year being 10 years after the death of such oldest EDB, or, if earlier, the year such oldest EDB's life expectancy drops to one or below. Yes, the Outer Limit Year for an EDB who was older than the participant is the final year of the EDB's life

expectancy (lesser of rule) even though lifetime payouts to the trust were based on the "greater of" the decedent's and the EDB's life expectancy!

Another example of how this multi-EDB rule can work in an unexpected or unfair way: Generally for a trust with multiple beneficiaries, with a life expectancy payout applicable, the Outer Limit Year (deadline for final distribution of 100% of the retirement account) is determined with reference to the trust's oldest designated beneficiary. Prop. Reg. § 1.401(a)(9)-5(e)(3), (f)(1)(ii). So if participant left his IRA to a trust for his three younger brothers, all of whom were less than 10 years younger than he was (so all are NoMoTTYs), there would be a life expectancy payout based on the oldest beneficiary-brother's life expectancy with the ultimate 100% payout due 10 years after the oldest brother's death—*even if the oldest broth died way prematurely and the other brothers are hale and hearty with many years to go.* Similar to the effect of a premature death with respect to a trust for multiple minor-children EDBs (see PART 5, #3).

5. Trust which is a DB Trust but is not a Type II AMBT, has no minor-child EDBs, and not all beneficiaries of which are EDBs.

If all countable beneficiaries are individuals (DBs), but not all of them are EDBs (and the special rules for AMBTs or trusts with a minor-child EDB do not apply) the trust has "PODB" status and the 10-year rule will apply.

If the participant died before the RBD, the annual track is zero distributions through the ninth year (trustee can withdraw as much or as little as it wants as far as the RMD rules are concerned), with 100% distribution required in the year that contains the 10th anniversary of the date of death.

If the participant died after the RBD, the trust is required to withdraw annual distributions over the life expectancy of the oldest countable beneficiary of the trust through year 9, and to withdraw the entire remaining balance in the year that contains the 10th anniversary of the date of the participant's death. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i).

6. Conduit trust for one beneficiary

This is the easiest one. If the trust is a conduit trust for one individual beneficiary, the Applicable Denominator and Outer Limit Year are the same as if the benefits were payable directly to that individual beneficiary. Prop. Reg. § 1.401(a)(9)-4(f)(6)(i) (Example 1).

For example, a conduit trust for the benefit of the participant's surviving spouse is entitled to the spouse's full "EDB" treatment—life expectancy payout with life expectancy recalculated annually and commencement of required distributions delayed until the year the deceased spouse would have reached age 72 [70½ if deceased spouse was born before 7/1/1949]. Upon the spouse's later death, any benefits remaining in the trust would be distributable to the successor beneficiary over the spouse's remaining life expectancy (not recalculated) with an Outer Limit Year of the year containing the 10th anniversary of the surviving spouse's death. Prop. Reg. § 1.401(a)(9)-5(e)(1), (3).

A conduit trust for a PODB gets the 10-year rule.

There are reasons to name a conduit trust as beneficiary—some "RMD reasons" and some other reasons. The non-RMD reason would normally be that the participant does not want to leave

a lump sum to the beneficiary. The participant would rather have a trustee control the investment of the account and the rate of distributions from the IRA (subject to the RMD rules of course).

The two main "RMD reasons" would be to guarantee DBT [designated beneficiary trust] status for the trust without so much worry about whether your accumulation trust passes all the tests and to enable the trust to have a charitable remainder beneficiary and still have DBT status.

7. Weird effects, Minor's trust: Death after RBD: oldest DB older than participant.

Under some very unusual circumstances the "ghost life expectancy" could be longer than the general "Outer Limit" date provided by Prop. Reg. § 1.401(a)(9)-5(e). For example, supposed the participant died at age 74 leaving his IRA to a trust for the benefit of his one minor child who is age 10, with distribution to go outright to that child at age 40, but if the child dies before age 40 without issue the trust passes to participant's sibling who is age 78.

Since the 10-year old does not have any issue at this time, the only countable beneficiaries are the child and the sibling, so the oldest countable beneficiary is the sibling age 78 with a life expectancy of 12.6 years. Since there is a minor-child EDB, the Applicable Denominator would be the life expectancy of the oldest trust beneficiary (under Prop Reg. § 1.401(a)(9)-5(f)(1)(i)) if the participant died before his RBD. However, since he died after his RBD, it is the "greater of" the "designated beneficiary's" life expectancy and the "employee's remaining life expectancy" (the ghost life expectancy) which at age 74 is 15.6 years. So annual distributions are made over the ghost life expectancy, 15.6 years.

But what is the Outer Limit Year for this trust? Normally if a payout is being made to an older DB based on the participant's life expectancy under the "greater of" rule [Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii)], there is a special overriding rule saying that, notwithstanding the greater of rule, a "shorter of" rule determines the Outer Limit Year—namely, the Outer Limit Year is the year that older beneficiary's life expectancy drops to one, which would occur about 12 years after the employee's death, not the 15.6 years of the ghost life expectancy being used to determine annual RMDs. Prop. Reg. § 1.401(a)(9)-5(e)(5) (the "lesser of" of "shorter of" rule).

But wait! Prop. Reg. § 1.401(a)(9)-5(e)(5) *does not apply to a trust that as of the employee's death had a minor-child EDB as a beneficiary*! Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii)(B). So that trust would continue using the ghost life expectancy until the Outer Limit Year. But now suppose the minor child dies the year after the employee, at age 11. The Outer Limit Year would be 10 years after that minor child's death (before age 21) normally. Does the child's premature death cause the trust to lose ca. 4 years of the remaining ghost life expectancy? Unknown. My guess is yes it probably does. If the sibling had been the only countable trust beneficiary, he would have been subject to the "shorter of" outer limit rule. It would not appear logical to allow him more years of payout by "piggybacking" on the EDB status of a now-deceased minor child.

8. Weird effects cont.: Death after RBD Type II AMBT, D/CI beneficiary older than participant.

The ghost life expectancy would apply to a Type II AMBT if the oldest D/CI beneficiary were older than the participant. For example, the participant dies at age 74 (life expectancy about 15 years) leaving the trust to a Type II AMBT of which the oldest D/CI beneficiary is age 78 (life expectancy about 12 years). The remainder beneficiaries who will inherit when the 78-year-old dies are individuals but not EDBs.

The trust starts taking RMDs using the ghost life expectancy under the "greater of" rule. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii), (f)(1)(ii). Normally the Outer Limit Year on an older EDB who is using the "greater of" rule is the "lesser of" rule of Prop. Reg. § 1.401(a)(9)-5(e)(5) [the "life expectancy limit for older" EDBs]. That limit year would be the year the older EDB's life expectancy became less than or equal to one. If applied to this Type II AMBT it would result in an Outer Limit Year about 12 years after the participant's death, cutting off the last 3 years of the ghost life expectancy.

However the "lesser of" rule *does not apply to AMBTs*! Prop Reg. § 1.401(a)(9)-5(f)(2)(iii)(B). So the D/CI 78-year old's ca. 15-year ghost life expectancy payout is protected as long as he lives. The next question is, what if the 78-year–old AMBT dies a year after the participant? There are still about 14 years left to run on the ghost life expectancy. Presumably the 10-year limit in Prop. Reg. § 1.401(a)(9)-5(e)(3) would "override" the ghost life expectancy in this situation and the remainder beneficiaries would be required to withdraw the remaining balance (if any) in the year that contained the 10th anniversary of the D/CI beneficiary's death, even if the ghost life expectancy wasn't quite finished.

PART 6: MULTIPLE BENEFICIARIES; SEPARATE ACCOUNTS

1. Multiple beneficiaries designated: the concept of "separate accounts"

All is clear if an IRA is left to one human being as a "designated beneficiary." But what if the retirement account is left to multiple beneficiaries? That raises the question of "separate accounts."

An inherited IRA can be split into multiple inherited IRAs and this is normally done when an IRA is left to multiple beneficiaries.

Example: Mitchell dies in 2022, after his RBD, leaving his $600,000 IRA, invested all in cash, "in equal shares to my three children Huey, Dewey, and Louie." At the boys' request, the IRA provider opens three new "inherited IRAs" in the names of "Mitchell, FBO [for benefit of] Huey," "Mitchell FBO Dewey," etc. [or "Huey, as beneficiary of Mitchell," "Dewey as beneficiary of Mitchell," etc.] and transfers $200,000 of the cash into each account. Assume all three sons are PODBs and the account is subject to the 10-year rule. *This raises two separate RMD questions*:

- **How will the Applicable Denominator be determined for these accounts?** The entire account must be 100% distributed by December 31, 2032, because of the 10-year rule, but in the meantime (under the Proposed Regulations' interpretation of the ALAR rule; see PART 3, #3(C)-(E), annual RMDs will be required based on the life expectancy of the Designated Beneficiary. Will each son's RMD be based on his life expectancy? or is the life expectancy of the oldest son controlling for all three accounts?

- **Regardless of what the Applicable Denominator is, can distributions from any one account satisfy the RMD requirement for all three? And is the "applicable numerator" determined based on the combined value of all three, or is it determined separately for each account?**

2. Existing regulation: What is says and how it is actually applied

Existing regulations state that separate accounts treatment is available for the interests of multiple beneficiaries *for all purposes of the minimum distribution rules* only if the separate accounts are "established" by December 31 of the year after the year of the participant's death. This rule does not distinguish between the "how do we determine the distribution period" question and the questions of the "applicable numerator" and whether each beneficiary is responsible for taking the RMD only for his separate account.

Despite this plain wording in the existing regulation, it became apparent over the years, through private letter rulings, that the December 31 deadline applied to the separate accounts rule *ONLY insofar as it related to determination of the distribution period.* See ¶ 1.8.01 of *Life and Death Planning for Retirement Benefits*. No matter how many separate inherited IRAs the single inherited account was divided into, the distribution period for ALL such accounts became finalized based on the life expectancy of the oldest beneficiary of the (undivided) accounts as of December 31 of the year after the year of the participant's death. But despite missing that deadline, multiple beneficiaries (even if they inherited through a trust or estate) could divide up an inherited account ANYTIME for purposes of having each beneficiary do his own investing and distributing...and following such division, even though all the divided accounts had the same "denominator" for determining each year's RMD, each separate account's RMD (1) was computed based on the prior year end value of *that separate account* (as the "numerator") and (2) had to be distributed from that separate account.

3. Proposed Regulations continue old rule, but fix the anomaly

The proposed regulations fix this anomaly and recognize that multiple beneficiaries can create "separate accounts" reflecting their separate interests *anytime*. Prop. Reg. § 1.401(a)(9)-8(a)(1)(i). If these separate accounts are established by December 31 of the year after the year of the participant's death, they are given effect for purposes of determining the Applicable Denominator for each such account. If they are established after that date, then (beginning the year after such division/establishment) the required distribution for each such account is determined based on the prior year end value of that separate account (and the distribution must come out of that separate

account), but such RMD must be determined using the Applicable Denominator that was finalized (based on the single account with multiple beneficiaries) on December 31 of the year after the year of the participant's death. Prop. Reg. § 1.401(a)(9)-8(a)(1)(ii)(A).

The Proposed Regulations spell out requirements for how to account for separate accounts, whether or not the accounts are separated by December 31. See Prop. Reg. § 1.401(a)(9)-8(a). The separate accounting requirement is very important to comply with. Since this rule is not changed from existing regulations (see ¶ 1.8.01(D)), it is not covered further in this Outline.

4. Separate Accounts for retirement account inherited through a trust

Since 2002, regulations have provided that "...the separate account rules under A-2 of §1.401(a)(9)-8 are not available to beneficiaries of a trust with respect to the trust's interest in the employee's benefit." Reg. § 1.401(a)(9)-4, A-5(c). In other words, "separate accounts" treatment cannot be allowed for multiple subtrusts (or even separate shares distributed outright to different beneficiaries) created under a single trust (called the "funding trust" in this Outline) unless the subtrusts (or shares) were named directly as beneficiaries of the retirement plan. See discussion of this rule at ¶ 6.3.02(A) of *Life and Death Planning for Retirement Benefits*. Since SECURE essentially "overruled" this regulation as it would apply to an Applicable Multi-Beneficiary Trust (AMBT) (see PART 6, #2(B)), there was some hope that the Treasury would repeal the regulation altogether. The proposed regulations did not do so.

A. Separate accounts for separate interests under a single "funding" trust. This rule applied harshly and unreasonably to multiple beneficiaries who were entitled to immediate outright distributions of their predetermined shares of the trust upon the participant's death, and to multiple subtrusts similarly created by mandatory division of the single funding trust upon the participant's death. Prior to publishing the final regulations in 2002 the IRS had allowed separate-accounts treatment for separate interests so established at the participant's death under a trust named as beneficiary; see PLR 2002-34074. (This PLR was actually published in May 2002, after the final regulations with this new provision had been issued...in other words the PLR was invalid the day it was published!) Thereafter the new harsh rule applied: Even if there is no trust that will be ongoing after the participant's death (beyond a wrap-up, termination phase), because the funding trust provides that it terminates upon the participant's death with all its assets passing outright to individual beneficiaries rather than subtrusts, you still test the funding trust, not the separate distributees (unless they were named directly on the beneficiary designation form), and the Applicable Denominator is determined based on all the beneficiaries collectively (minus beneficiaries "removed" by the Beneficiary Finalization Date; see PART 7, #2). See, *e.g.*, PLR 200432027.

B. Congress dumped this rule for AMBTs. This IRS interpretation is so unreasonable that Congress specifically "overruled" it in the case of AMBTs: An AMBT can be treated as a separate EDB even if it is carved out of a single trust that was named as

beneficiary by the participant. See § 401(a)(9)(H)(iv), added to the Code by SECURE. Because the special rule for AMBTs, allowing separate account treatment for an AMBT created as one of multiple subtrusts under a single trust named as beneficiary, could be seen as a rebuke of the IRS by Congress, some hoped that the IRS would eliminate the no-separate-accounts-for-trust beneficiaries for everyone, not just AMBTs. This hope was dashed by the Proposed Regulations.

C. **...But IRS keeps the rule for everybody else.** Treasury did not change the rule. See Prop. Reg. § 1.401(a)(9)-8(a)(1)(iii). This section provides that, except as provided for AMBTs, "section 401(a)(9) may not be applied separately to the separate interests of each of the beneficiaries of a" See-through Trust.

D. **Planning tip: Name subtrusts on the beneficiary designation form.** The "solution" for this problem is (as before the proposed regulations) for the participant to name, directly as beneficiaries of his retirement account, the separate subtrusts or beneficiaries intended to wind up owning the benefits. For example, instead of naming as beneficiary "The Mary Doe Revocable Trust,' which immediately upon Mary's death is to split up into three subtrusts, to name the subtrusts directly ("I name as my beneficiary the separate trusts established for my children and issue under Article 3 of the Mary Doe Revocable Trust, in the proportions indicated in said Article 3 which is hereby incorporated herein by reference") or something like that. If the separate shares or subtrusts are named directly as beneficiary on the beneficiary designation form, then they are entitled to separate accounts treatment, provided the accounting requirements (Prop. Reg. § 1.401(a)(9)-8(a)(2)) and deadline requirement (Prop. Reg. § 1.401(a)(9)-8(a)(1)(ii)) are met.

E. **Can trustees fix this using "decanting?"** If, instead of naming the subtrusts directly as beneficiaries, the decedent named the funding trust as beneficiary, it would be worth exploring whether the problem can be solved by "decanting" the right to the inherited IRA out of the funding trust and into the separate trusts that are entitled to receive that IRA. The Proposed Regulations have generous terms for recognizing reformations and decantings that occur by September 30 of the year after the year of the participant's death. Prop. Reg. § 1.401(a)(9)-4(f)(iii)(B); see PART 7. However, since the "real problem" is the beneficiary designation (naming the single trust) and not the trust itself, it is not clear whether the post-death changes permitted by the Proposed Regulations can fix this problem.

Accordingly, if a retirement account is to be left to a trust [the "funding trust"] that, upon the participant's death, will split into separate shares and/or subtrusts, those separate shares and subtrusts will NOT be recognized as separate beneficiaries for RMD purposes unless one of the following two conditions applies: Either:

- The separate shares/subtrusts are named directly as separate beneficiaries on the beneficiary designation form (as in "I name as my beneficiary the separate trusts established for my children under Article X of the John Doe Living Trust, in equal shares"). **Or:**

- At least one countable beneficiary of the funding trust is a disabled or chronically ill individual, and "under the terms of the trust—(I) it [the funding trust] is to be divided immediately upon the death of the employee into separate trusts for each beneficiary." § 401(a)(9)(H)(iv)(I). A trust so described is called a Type I AMBT [Applicable Multi-beneficiary Trust] in the Proposed Regulations. In this case *all* the subtrusts or separate shares so created are recognized and treated as separate beneficiaries, not just the subtrust or share that will benefit the D/CI beneficiary. See PART 3, #7(F). Note: The wording "into separate trusts for each beneficiary" presumably encompasses separate shares that are not actually ongoing trusts; see PLR 200432027 for an example.

PART 7: POST-DEATH CHANGES IN TRUST TERMS

Under both the existing and the proposed regulations, a trust is tested for designated beneficiary status at the time of the participant's death, with a "second look" on September 30 of the year after the year of the participant's death. For convenience this deadline is referred to in this Outline as the Beneficiary Finalization Date or BFD. See ¶ 1.8.03 of *Life and Death Planning for Retirement Benefits* for general explanation of this term. The rest of this section explains how the Proposed Regulations would expand post-death planning options.

1. What does "identifiable" mean?

Under both existing and proposed regulations, one requirement of a See-through Trust is that the beneficiaries must be "identifiable." From the Proposed Regulations: "The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's interest in the plan are identifiable (within the meaning of paragraph (f)(5) of this section) from the instrument." Prop. Reg. § 1.401(a)(9)-4(f)(2)(iii). Then: "Except as otherwise provided in this paragraph (f)(5) trust beneficiaries described in paragraph (f)(3) [the 2-tier trust-testing system; see PART 4, #8] are identifiable if it is possible to identify each person *eligible* to receive a portion of the employee's interest in the plan through the trust. For this purpose, the specificity requirements of paragraph (a)(3) of this section apply." Emphasis added. By referring to the "specificity requirements" of Prop. Reg. § 1.401(a)(9)-4(a)(3), the regulation simply incorporates the rule that "a beneficiary need not be specified by name"; for example, it could designate "my children" without naming them and they would still be considered "identifiable."

The "identifiable" requirement provides an avenue for the (very welcome) new proposed regulations' treatment of post-death trust modifications via decanting, etc.; it provides the gateway to explaining the effects of powers of appointment, decanting, and trust reformations on the trust's qualification as a See-through Trust and on the question of which beneficiaries "count" for purposes of determining the designated beneficiary.

2. Removing (and, now, adding) beneficiaries by the BFD

Under existing regulations, the second look on the BFD allows for "removal" (via, *e.g.*, disclaimer or distribution) of one or more beneficiaries between the date of death and the BFD. A beneficiary who has been so "removed" as of the BFD does not count as a beneficiary for purposes of determining whether the participant has a designated beneficiary and if so who his designated beneficiary(ies) is/are: "...the employee's designated beneficiary will be determined based on the beneficiaries designated as of the date of death *who remain beneficiaries*..." on the BFD. Reg. § 1.401(a)(9)-4, A-4(a). Emphasis added. The "removed beneficiary" is erased from the picture for purposes of determining post-death RMDs.

Reminders: A person who is named as a beneficiary does not "count" if he/she predeceased the participant or is deemed to have predeceased the decedent by virtue of (for example) a simultaneous deaths provision under applicable state law. But the death of a beneficiary *after* the date of the participant's death does NOT remove that person as a beneficiary even if such beneficiary died before the BFD. Both of these rules are unchanged from existing regulations.

The Proposed Regulations make the following changes in the rules regarding changes in the identity of beneficiaries taking place between the date of the participant's death and the BFD; for more detail on these changes, see PART 9, #4.

- Existing regulations list qualified disclaimer and distribution as possible ways to "remove" a beneficiary between the date of death and the BFD. These are presented apparently as examples, not exclusive means, in the existing regulations. See Reg. § 1.401(a)(9)-4, A-4(a). In the Proposed Regulations, the examples (distribution and qualified disclaimer) are presented as an "exclusive list" of means of "removing" a beneficiary prior to the BFD. Prop. Reg. § 1.401(a)(9)-3(c)(1), (2). However, this restrictive view applies (apparently) only to beneficiaries designated on the beneficiary designation form; changes made through a trust named as beneficiary are treated much more generously:

- *Existing regulations* make no distinction, with respect to changes in the identity of the beneficiaries, between beneficiaries designated on the beneficiary designation form and beneficiaries of a trust that is named as beneficiary on the beneficiary designation form. The *Proposed Regulations*, in contrast, provide extremely liberal rules for changing the identity of the countable beneficiaries under a trust that is named as the participant's beneficiary. Under the proposed regulations, beneficiaries can be not just REMOVED from the trust but also ADDED to the trust between the date of death and the BFD; and the means of removing a beneficiary are not restricted to qualified disclaimer or full distribution: Exercise of a power of appointment, decanting, or reformation will be similarly effective.

3. Effect of post-death changes via decanting, etc., under existing rules

Since the 2001-2002 adoption of the existing regulations, there has been a growth industry in post-death amendments of trusts via "decanting," reformations, and other forms of post-death modifications of trust terms. The existing regulations do not seem to allow for such changes. For

example, one requirement of the trust regulation is that the trust must be irrevocable as of the participant's death. How can a trust be "irrevocable" if it can be amended or terminated at any time in the future via reformation, decanting, etc. under state law even if the trust instrument itself does not authorize such changes? The effect of *the potential* for such changes on an existing "See-through Trust" has been a question vexing practitioners.

The Proposed Regulations adopt a new and flexible approach to post-death changes in the terms of a trust, an approach that for the first time accommodates the possibility of later change.

4. The approach of the Proposed Regulations

Post-death changes in the identity of trust beneficiaries (either adding new beneficiaries or removing existing ones) may occur via exercise of a power of appointment, decanting, or reformation. Under the Proposed Regulations, the *possibility* (as of the date of death or BFD) that such a change may occur later (*e.g.*, a power of appointment may be exercised, or the trust may be reformed or decanted) will not cause the trust to flunk the identifiable test. If such change later actually occurs, such change will cause the trust to be "retested" as of the date of the change. If at that time the change results in shortening the distribution period (accelerated required distributions), the trust's RMDs will be recalculated accordingly. However, such re-testing cannot cause a 100% required distribution until the following calendar year. That is the general idea. More detail follows. Summary so far:

- The trust beneficiaries are "identifiable" (3rd RMD trust rule) "if it is possible to identify each person eligible to receive a portion of the employee's interest in the plan through the trust." Prop. Reg. § 1.401(a)(9)-4(f)(i).

- The existence of powers of appointment, or the possibility that a trust might later be reformed or decanted (potentially causing beneficiaries to be added or remover), does not in and of itself cause the trust to have non-identifiable beneficiaries. Prop. Reg. § 1.401(a)(9)-4(f)(ii)(A), (f)(iii)(A).

- If the power of appointment is exercised or irrevocably restricted, or the reformation/decanting actually occurs, prior to the Beneficiary Finalization Date (BFD; September 30 of the year after the year of the participant's death), then the change is apparently given effect retroactive to the date of death for purposes of determining who are the participant's beneficiaries. See further discussion of each type of event, below.

- If the power of appointment is exercised, or the reformation/decanting occurs, *after* the BFD, the trust will be "re-tested" at that time but will not be retroactively disqualified for flunking the "identifiable" test. Also, the "restesting" cannot *improve* the RMD results. See further discussion of each type of event, below.

5. Powers of appointment: Background

What is a “power of appointment” exactly? In common usage, and as seemingly contemplated by the Proposed Regulations, and as used in this Outline, it is a power *held by a trust beneficiary* to “appoint” income or principal of the trust to other individuals or to entities such as a charity. Typically the beneficiary/powerholder would have a “power to appoint” trust property to or among some particular class of recipients effective upon the death of the powerholder. It is not used in normal conversation to refer to a *trustee’s* power that is exercisable only in a fiduciary capacity to direct principal or interest to one or more beneficiaries.

For transfer tax purposes the term power of appointment also applies to a trustee’s power to “appoint” principal or income; see, *e.g.* Reg. § 20.2041-1(b)(1). The Proposed Regulations deal with the exercise of a power of appointment by an “individual.’ Perhaps this is meant to exclude the trustee’s powers to direct income or principal to various beneficiaries or classes of beneficiaries.

6. Dilemma under existing regulations: Are potential appointees countable?

Under existing regulations, a trust that provides “life interest to spouse [or other specified individual], and at death of spouse remainder outright to my then living issue [or other specified individual(s)], is “easy” to analyze: There are only “identifiable” individual beneficiaries (spouse and donor’s issue living at his death, plus after-born issue living (if any) living at spouse’s later death, and therefore the trust passes that test. That form of trust exactly tracks Example 1 in Reg. § 1.401(a)(9)-5, A-7(c)(3).

But what if the trust says “income to my spouse for life, remainder to such of my issue *and/or such charities* as my spouse shall appoint by will, or in default of appointment, to my issue then living?” Do all the potential appointees including charities “count” for purposes of testing this trust? If so, the trust will “flunk” because it has potential nonindividual beneficiaries (the charities that spouse could appoint to).

The treatment of the potential appointees is unclear under existing regulations. The few PLRs that mention powers of appointment in connection with the minimum distribution trust rules provide only little, no, or muddled “guidance.” So practitioners have been left to choose between two competing view:

The most restrictive position is that all potential appointees (as well as all takers in default of exercise of the power of appointment) are “countable” beneficiaries; therefore, if the spouse could appoint to charity the trust “flunks” the rules (nonindividual beneficiary) and is not a designated beneficiary trust. If the spouse can appoint only to individuals, the trust “passes” and the oldest potential appointee’s life expectancy would be the applicable distribution period for the trust.

In contrast, a less restrictive view is that potential appointees do not count as beneficiaries at all unless and until the power is exercised; this view relies on a provision to that effect in a regulation dealing with qualified subchapter S trusts, and on the general view that “things that haven’t happened yet” are not considered to have happened for purposes of testing a trust for designated beneficiary status. THE PROPOSED REGULATIONS CLEARLY ADOPT THIS VIEW.

7. Proposed Regulations: Potential appointees don't count (until POA exercised)

Under the Proposed Regulations, the trust does not flunk the identifiable test "merely because an individual (powerholder) has the power to appoint a portion of the employee's interest to...beneficiaries that are not identifiable..." Prop. Reg. § 1.401(a)(9)-4(f)(5)(ii)(A). Potential appointees under a power of appointment (POA) are not countable beneficiaries unless and until they are actually appointed. Prop. Reg. § 1.401(a)(9)-4(f)(5)(ii).

If the beneficiary's power of appointment is disclaimed, exercised, or irrevocably fixed in some fashion by September 30 of the year after the year of the participant's death (the BFD), then such pre-September-30 action is apparently given effect in testing the trust retroactive to the date of death. Otherwise, the takers in default are the countable beneficiaries for purposes of testing the trust. "Takers in default" means the beneficiary(ies) who would inherit the trust if the power-holder does not exercise the power. Prop. Reg. § 1.401(a)(9)-4(f)(5)(ii)(A).

If the power is exercised after the September 30 deadline, the trust must be retested at the time of such exercise. Prop. Reg. § 1.401(a)(9)-4(f)(5)(ii)(B). See discussion of retesting, below.

8. Powers of appointment: Examples, issues.

Will the proposed Regulations' approach work? One thing that might need to be made clearer is the difference between a fiduciary power and a beneficiary power. The Proposed Regulations speak of an "individual" holding the power of appointment. Presumably that is to distinguish from a "trustee" holding the power. In the tax code generally, a fiduciary's power to distribute income or principal to someone is a "power of appointment." But in the Proposed Regulations, a trustee's power to make distributions in its discretion to individuals or charities would seem to make such individuals or charities be treated as countable beneficiaries of the trust, not merely potential future beneficiaries. See Prop. Reg. § 1.401(a)(9)-4(f)(3)(i)(A). Here is the power-of-appointment example from the regulation:

> "Under the terms of Trust Q...[the surviving spouse, G, who is the life beneficiary of the trust]...has a power of appointment to name the beneficiaries of the residual in Trust Q." Prior to the BFD, G irrevocably restricts her own power of appointment so she "may exercise the power to appoint the remainder...only in favor of G's siblings (who all are less than 10 years younger than the decedent). By thus restricting the remainder interest to only EDBs, and since she herself is an EDB, G's alteration of her POA makes the trust have only EDBs as its countable beneficiaries, thus enabling a life expectancy payout for the trust. Prop. Reg. § 1.401(a)(9)-4(f)(6), Example 4.

There could be gift tax implications if "G" in the above example has a general power of appointment and restricts it in some way; such gift tax implications are not discussed in the Proposed Regulations or this Outline.

If "G" did not irrevocably restrict her power of appointment prior to the BFD, then the countable beneficiaries of the trust would have been G and the individuals who were the "takers in default" under the power of appointment.

9. Decantings and reformations: Proposed Regulations' approach

The Proposed Regulations' approach to potential future decantings and reformations (hereinafter "modifications") is similar to the approach for powers of appointment. Yes this might happen in the future; we'll worry about it when it happens: "A trust will not fail to satisfy the identifiability requirements....merely because the trust is subject to state law that permits the trust terms to be modified after the death of the employee (such as through a court reformation or a permitted decanting) and thus, permits changing the beneficiaries of the trust." Prop. Reg. § 1.401(a)(9)-4(f)(5)(iii)(A).

- "A trust beneficiary described in paragraph (f)(3)...may be added through a modification of trust terms (such as through a court reformation or permitted decanting). If the beneficiary is added on or before ...[the BFD], paragraph (c)...[the 2-tier trust-testing system] will apply taking into account the beneficiary that was added." Prop. Reg. § 1.401(a)(9)-4(f)(5)(iii)(C). "Paragraph (f)(3)" contains the 2-tier trust-testing system (PART 4, #8) so presumably a "trust beneficiary described in paragraph (f)(3)" means any trust beneficiary who is either counted or disregarded under that system.

- A post-death modification that adds or removes a beneficiary is given effect for minimum distribution purposes if the addition or removal is effective by September 30 of the year after the year of the participant's death (the BFD). Prop. Reg. § 1.401(a)(9)-4(f)(5)(iii)(B), (C).

- If a beneficiary is "added" after that September 30 date, the mere addition does not cause the trust to flunk the "identifiable" requirement, but "Beginning in the calendar year after the calendar year in which the new trust beneficiary was added, the rules of §1.401(a)(9)-5(f)(1) will apply [i.e., testing the trust for see-through status] taking into account the new beneficiary and all of the beneficiaries of the trust that were treated as beneficiaries of the employee before the addition of the new beneficiary..." Prop. Reg. § 1.401(a)(9)-4(f)(5)(iv).

- If this "new" testing as a result of a post-death post-September-30 addition of a new countable beneficiary results would cause the trust to become 100% distributable in that year or an earlier year, AND the year the beneficiary was added was not ALREADY a year in which 100% distribution was required, then the 100% distribution will not be required until the year after the change. Prop. Reg. § 1.401(a)(9)-4(f)(5)(iv), (iv).

10. Decantings and reformations: Comments

A. Trust changes other than adding or subtracting beneficiaries

The proposed regulations speak only of adding or subtracting beneficiaries via post-death changes. Why is there is no mention of a post-death change that modifies the trust terms in some other way? Perhaps that is because, in the proposed regulations' approach, all you need to know (in order to determine the RMD regime for a trust) is which beneficiaries are countable vs.

disregardable. Therefore perhaps what they mean in this post-death changes section of the Proposed Regulations is that we will count the beneficiaries before and after your change, and a change in the identity of the COUNTABLE beneficiaries is what we will be looking at....so either there are new countable beneficiaries added or old ones subtracted; that's the only kind of "modification" that matters for purposes of the RMD trust rules. If your post-death modification doesn't add or subtract countable beneficiaries (for example, a modification that changed applicable state law, or added new investment powers) we don't care about it.

B. What about "reforming" the beneficiary designation?

We've noted the extreme difference in the Proposed Regulations' attitude towards post-death modifications of a *trust* named as beneficiary (Anything goes! Add beneficiaries, subtract them, whatever!... as long as it's done before the BFD it's effective retroactive to the date of death!) vs. post-death modifications of a *beneficiary designation form* (absolutely NO modifications permitted via reformation etc. or otherwise except via qualified disclaimer and full distribution; forget about ADDING beneficiaries, are you kidding???). Why this extreme difference?

The only possible reason for the distinction that occurs to me is the IRS's (understandably) tender attitude towards plan administrators. The plan administrator has to pay the benefits to the beneficiary named in the beneficiary designation form. You can't tell the administrator of the Giant Corp. 401(k) plan to hold up for a few months while we try to figure out who is really going to be the beneficiary here. Any other ideas why the IRS would make this major distinction?

C. State law aspects.

The Proposed Regulations' generous attitude toward post-death changes in the trust terms do not mean that "anything goes" as far as state law or fiduciary obligations. There is no general rule allowing trustees and beneficiaries to get together to rewrite the trust to suit themselves, especially if the proposed change would affect the interests of minor, incompetent, unborn, or charitable beneficiaries. The Proposed Regulations merely describe how changes made *pursuant to applicable law governing the trust* are treated for RMD purposes. And the IRS is not bound by a court determination of what "state law" is unless it is the highest court in the state, under the *Bosch* case.

D. Federal tax aspects.

The Proposed Regulation's apparent blanket acceptance of whatever trust changes get made prior to the BFD, applied retroactively to the date of death, would appear to "overrule" some previous tax law precepts. For example, the normal Treasury standard is that a post-death trust modification is not effective to change the tax consequences of a completed transaction. *Estate of La Meres v. Commissioner*, 98 T.C. 294 (1992). In at least one PLR, the IRS mentioned that it would not recognize, for purposes of determining required minimum distributions, any post-death trust amendments. See PLR 2010-21038. These limits seem to no longer apply to any change completed by the BFD, if the Proposed Regulations are adopted. But see #11 below regarding how this generous apparent new standard is presumably limited to RMD issues and not other federal tax issues.

E. Should trusts add "toggles?"

While the generous treatment of post-death changes (if completed by the BFD) are obviously a godsend for helping survivors clean up a trust to improve RMD outcomes, they also provide a path to allow "toggles" in the planning stage. For example, a trust could give a beneficiary a limited power to appoint to charity. By exercising, disclaiming, or restricting that power prior to the BFD, the beneficiary could facilitate a desired result such as qualifying for the "ghost life expectancy" payout (if that appears more favorable than what would otherwise apply).

11. Permitted trust modifications ok for RMD issues only

Note that the Proposed Regulation deals only with modifications that have the effect of adding or removing a beneficiary for purposes of "testing" the trust and determining the Applicable Denominator. Nothing in the Proposed Regulations addresses (or can be interpreted to "bless") other types of tax-motivated post-death modifications. For example the following rulings regarding post-death modifications relating to tax treatment of retirement benefits did not involve the minimum distribution rules and are not affected (i.e., would not be "reversed") by the Proposed Regulations:

- **Qualifying for spousal rollover.** In PLR 2009-44059, the IRS refused to accept the result of a state court order which gave the surviving spouse the right to distribute to herself, outright, the retirement benefits payable to a discretionary trust for her benefit of which she was sole trustee. The goal of the proposed distribution was to enable her to roll the benefits over to her own IRA. The state court order interpreted state law and the trust instrument as validating the spouse-trustee's right to make this distribution to herself, but the decision was not an interpretation of state law by the state's highest court. The IRS made its own interpretation and (pursuant to *Bosch*) was not bound by the lower court decision, and disallowed the rollover. This was not a minimum distribution issue and the outcome would not have been changed had the Proposed Regulations been in effect at the time.

- **Qualification for charitable deduction under § 642(c).** In PLR 2014-38014, decedent's retirement benefits were payable to a trust that provided for certain pecuniary charitable bequests. The instrument did not specify the source of payment for such bequests. The taxpayer sought and received a court reformation of the trust instrument to avoid taxation of the retirement benefits at the trust level. Specifically, the "purpose of the reformation was to ensure that Trust's distribution of IRA assets to Charity 1 and Charity 2 would be treated as direct bequests to the charities rather than as income in respect of a decedent (IRD) to the trust § 691 [see ¶ 4.6 of *Life and Death Planning for Retirement Benefits*]. Alternatively, the purpose of the reformation was to qualify the Trust for a charitable deduction under § 642(c)." The Treasury ruled, citing numerous authorities, that the trust did not achieve this tax result because the state court's actions was not for the purpose of resolving a conflict; rather "The purpose of the court order was to obtain the tax benefits..." This was also not a minimum distribution and the outcome would not have been changed had the Proposed Regulations been in effect at the time.

PART 9: OTHER SECURE/REGS MATTERS; ABSURD RESULTS CASE STUDY

1. Effect of SECURE on beneficiaries of pre-SECURE decedents.

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 SECURE 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 payout to the EDB's successor beneficiary ends (100% distribution required) no later than the year that contains the 10th anniversary of the death of the EDB. See PART 3, #4(E). So SECURE says that for a participant who died prior to 2020 leaving benefits to a Designated Beneficiary, if that DB is taking a life expectancy payout, and the DB dies after 2019, the DB's life expectancy payout must end (100% distribution required) in the year that contains the 10th anniversary of the DB's death.

The proposed regulation applies that rule in the following way:

- Start with the pre-2020 decedent who had one designated beneficiary, who was taking a life expectancy payout and then died after 2019. The 10-year limit kicks in and all benefits must be distributed by the end of the year that contains the 10th anniversary of that DB's death (if the DB's remaining life expectancy lasts that long). Prop. Reg. § 1.401(a)(9)-1(b)(2)(iii)(A); Prop. Reg. § 1.401(a)(9)-1(b)(3)(i) (Example 1). In years one through nine, apparently, the successor beneficiary continues taking RMDs based on the life expectancy of the deceased DB of the pre-2020 decedent.

- What if that sole DB who was taking a life expectancy payout died before 2020? In that case the 10-year rule never kicks in and the successors to that sole DB continue taking over the deceased DB's life expectancy, under the "old rules," as long as it lasts, with no 10-year Outer Limit. Prop. Reg. § 1.401(a)(9)-1(b)(3)(ii) (Example 2). Now to more nuanced situations:

- SECURE had a gap: What if there were MULTIPLE designated beneficiaries of that pre-2020 decedent? Would the new 10-year limit apply just because ONE of those DB's died? Or would ALL of the pre-2020 decedent's DB's have to die before the 10-year limit would be triggered? If any ambiguity in a tax law must be interpreted in favor of the taxpayer, the answer would be "not until all of them have died." The most federal-fisc-favorable interpretation would be "when any of them dies." The proposed regulations come up with an in-between rule: "If [a participant who died before 2020]...has more than one designated beneficiary, then whether section 401(a)(9)(H) applies [i.e. whether the 10-year limit applies upon death of a DB] is determined based on the date of death of *the oldest of the employee's designated beneficiaries.* Thus, section 401(a)(9)(H) will apply upon the death of the oldest of the employee's designated beneficiaries if that designated beneficiary is still alive on or after the effective date of [SECURE]...." Emphasis added. If such oldest DB dies after 2019, any remaining balance must be distributed by the end of the year that contains the 10th anniversary of such oldest DB's death. Prop. Reg. § 1.401(a)(9)-1(b)(2)(iii)(B).

- But if the oldest DB of that pre-2020 decedent died before 2020, the 10-year Outer Limit Year will never kick in. Prop. Reg. § 1.401(a)(9)-1(b)(2)(iii)(B).

- If the beneficiary of the pre-2020 decedent was a trust with multiple designated beneficiaries, this same multiple DB rule would apply under the proposed regulations. If the oldest one of them died *before 2020*, the rest of the trust beneficiaries are "home free"—they can continue to use the oldest trust beneficiary's life expectancy as long as it lasts. But if the oldest trust beneficiary dies *after 2019*, the 10-year limit will apply and the trust will have to withdraw 100% of the balance by the end of the 10th year. Prop. Reg. § 1.401(a)(9)-1(b)(3)(iv), (v) (Examples 4 and 5).

Is the IRS's interpretation fair and reasonable? It will have a harsh effect on beneficiaries of a pre-2020 decedent where the "oldest DB" dies prematurely. For example, suppose a 2019 decedent left his IRA to a See-through Trust for his 10 grandchildren who were then ages 12 to 25. The trust is taking distributions over the life expectancy of the 25-year old, about 60 years. Then at age 26, in 2020, he dies in a car crash. Under the proposed regulations, the trust must now draw down the entire IRA by the end of 2030 (instead of approximately 2079 as they had expected), according to the Proposed Regulations. That is an extremely harsh result for a supposedly grandfathered trust.

Finally, here's the IRS's answer to a question that would just about never arise: Before SECURE, the DB of a participant who died before his RBD would be entitled to the life expectancy payout (of course, everybody knows that) but also had the option instead, if permitted by the plan, to elect the 5-year rule. I never heard of any DB electing the 5-year rule but for someone who did elect it, can he now switch to a 10-year payout? No. He is stuck with the 5-year rule because his benefactor (the deceased participant) died before 2020. Prop. Reg. § 1.401(a)(9)-1(b)(iii) (Example 3). The Example reminds us that the 5-year rule would be a 6-year rule if 2020 was one of the five years because of the "suspension of RMDS" that occurred in 2020 under the CARES Act.

2. Anti-gaming provisions in Proposed Regulations

Since SECURE's enactment clever tax practitioners have flooded the internet [or at least their tiny corner of it] with ideas for gaming the new rules. Not surprisingly, the IRS read some of these brilliant ideas. The proposed regs put a stop to some of them, and also patch up some holes that had previously only been blocked by notices or rulings (not regulations).

A. Surviving spouse deferred rollover

The proposed regulations permit the surviving spouse, if she is sole beneficiary of a participant who died before his RBD, to elect the 10-year rule instead of the life expectancy payout. Suppose surviving spouse was age 74 when participant died before his RBD naming her as sole beneficiary. What would stop her from electing the 10-year rule; then, in year nine say, taking distribution of the entire amount and rolling it into her own IRA? The distribution would not be an RMD because it was taken prior to the 10th year...and she would have avoided any RMDs for nine years, then presumably get a fresh start with this rolled over amount. No she can't says the proposed regulation. A surviving spouse's rollover, if it occurs in any year after the year she turns age 71, must be reduced by a deemed RMD amount—the cumulative total of what would have been RMDs if the account had belonged to her. See Preamble, and Prop. Reg. § 1.402(c)-2(j)(3)(iii). The bottom line is, this great planning idea is going nowhere.

B. Special lump sum distribution tax treatment

Lump sum distribution tax treatment does not survive rollover from plan to IRA. We already knew this, but this may be the first time it's appeared in regulations. If a participant or beneficiary is entitled to special income tax treatment (such as "net unrealized appreciation" stock treatment) for an "eligible rollover distribution" from a qualified plan, and any part of such distribution is rolled into an IRA, that special treatment does not carry over to the IRA and can no longer apply to the eligible rollover distribution. By requesting a direct rollover, the distributee is deemed to have elected to treat the IRA contribution as a rollover contribution. In the case of an indirect rollover, the person making the IRA contribution must irrevocably elect at the time of the contribution to treat the contribution as either a rollover contribution or a regular contribution. Prop. Reg. § 1.402(c)-2(k). See ¶ 2.5 of *Life and Death Planning for Retirement Benefits*.

3. Proposed Regs.: Non-SECURE matters & miscellaneous cleanups

The proposed regulations provide welcome detail regarding rollovers of distributions to *beneficiaries* from qualified retirement plans. Reg. § 1.402(c)(2), dealing primarily with rollovers of distributions from qualified plans, would be restated in its entirety. As restated it would include the following provisions of interest to estate planners:

A. Direct rollover of inherited qualified plan

For the first time, the IRS would officially acknowledge that qualified retirement plans MUST offer a designated beneficiary the option of direct rollover of distributions from the plan to an IRA. See Prop. Reg. § 1.402(c)-2(j)(2), third sentence.

When this "direct rollover" option for designated beneficiaries was first added to the Code in 2006, the IRS issued "guidance" indicating that the rollover was simply an option a QRP could offer to a designated beneficiary. In 2009, Congress amended the Code to clarify that the direct rollover was the beneficiary's right, not merely an optional benefit a plan could offer or not, but (until now) the IRS never officially revoked its "it's just optional" guidance.

As a reminder, the direct rollover option is not available for RMDs or any other distribution that is not otherwise an "eligible rollover distribution," and is not available to a beneficiary who or which does not qualify as a "designated beneficiary" (such as the participant's estate or a non-See-through Trust). See ¶ 4.4.02 of *Life and Death Planning for Retirement Benefits* for more background and details.

B. Relief for beneficiaries who miss the year-of-death RMD

It has always been true that the beneficiary of an inherited IRA must take the RMD for the year of the participant's death to the extent the participant had not taken it prior to death. Reg. § 1.401(a)(9)-5(c)(1), last two sentences. The problem is that, especially if death occurred late in the year, the beneficiary might very well not know whether the decedent had taken the year-of-death RMD, or even that there was an IRA and that the beneficiary had inherited it. It would be, "Congratulations you have an inherited an IRA from your favorite uncle! Too bad you are already liable for a 50% penalty because you didn't take the RMD for the year of his death." It has always been easy to qualify for a waiver of the 50% excise tax in this situation because it was obviously a legitimate valid reason to not take the RMD (you didn't even know there was an IRA let alone an RMD etc.), but the beneficiary must file form 5329 requesting that waiver.

The proposed regulations grant a BIT of relief here: If the beneficiary misses the year-end deadline, then, "Unless the Commissioner determines otherwise" (???), there is an automatic waiver of the 50% excise tax normally assessed on a missed RMD (§ 4974(a)) if the beneficiary satisfies the year-of-death distribution requirement by taking the distribution "no later than the tax filing deadline (including extensions thereof) for the taxable year of that beneficiary that begins with or within that calendar year." Prop. Reg. § 54.4974-1(g)(3).

C. Clear statement of no-rollover rule for RMDs in first distribution year

Required minimum distributions are not eligible rollover distributions, and the first money that comes out of the plan in a year in which an RMD is required is applied to the RMD and accordingly may not be rolled over. And this applies in the year the employee attains age 72 (or later retires, if applicable): Even though the "RMD" for that year is not required to be distributed until April 1 of the following year, it is still a "required distribution" for the age 72/retirement year and accordingly, if distributed in that year, may not be rolled over. Prop. Reg. § 1.402(c)(2)(f)(1).

D. Clear statement that rollovers ok before first distribution year

But any amount distributed before the age-72 year (or year of retirement if applicable) (i.e., before the first "distribution year," the first year for which distributions are required) is *not* an RMD and accordingly is an eligible rollover distribution (unless blocked by some other factor, such as being a "hardship distribution"). Prop. Reg. § 1.402(c)(2)(f)(2).

E. Defined benefit plans vs. defined contribution plans

Prior to SECURE, the Code's minimum distribution rules made no distinction between defined benefits plans and defined contribution plans (also called "individual account plans") . After years of wrestling with § 401(a)(9), the IRS (appropriately—in fact of necessity) came up with entirely different sets of minimum distribution rules for the two types of retirement plans. SECURE for the first time inserted Code-level differences between the minimum distribution requirements for defined contribution plans and those for defined benefit plans. *This Outline covers only the defined contribution/individual account plan minimum distribution rules.*

F. Age 70½ changed to 72; RBD for participant who died before SECURE

SECURE changed the starting age for lifetime RMDs from 70½ to 72. SECURE's effective date was generally January 1, 2020. How did this change affect someone who died before reaching either age and before 2020? You might wonder–what difference would this change make to that person—he is deceased so does not have to worry about lifetime RMDs at all, so who cares what *would* have been his RBD?

Here is why it sometimes matters: If the participant dies leaving his IRA to his surviving spouse as sole beneficiary, the spouse's required commencement date (under § 401(a)(9)(B)(iv)) for RMDs to be taken as beneficiary is the later of the year after the participant's death or the year the participant would have had to commence taking distributions had he not died.

There was some question whether a surviving spouse whose deceased spouse was born after June 30, 1949, but who died before 2020, was entitled to take advantage of the delayed RBD that would have applied to the deceased spouse had he not died. The Preamble states that "This effective date provision could be interpreted to require the employee to survive until age 70½ in order to have the amended definition apply (that is, if the employee died before attaining age 70½, then the amended definition would not apply with respect to distributions to that employee's beneficiary, even if the employee would have attained age 70½ on or after January 1, 2020, had the employee survived). Instead, for ease of administration, these proposed regulations interpret the effective date language to apply the amendments made by section 114 of the SECURE Act to an employee who died before attaining age 70½ if the employee would have attained age 70½ on or after January 1, 2020 (that is, the employee's date of birth is on or after July 1, 1949). This interpretation also extends to a surviving spouse who is waiting to begin distributions pursuant to section 401(a)(9)(B)(iv). Thus, for example, if an employee who was born on June 1, 1952, died in 2018, and the employee's sole beneficiary is the employee's surviving spouse, then the surviving spouse

may wait until 2024 (the calendar year in which the employee would have attained age 72) to begin receiving distributions."

In 2022, legislative proposals exist for gradually increasing the age for commencement of RMDs, but as of 9/1/22 these have not been enacted.

4. Detail: Proposed Regulations on the "Beneficiary Finalization Date"

Prop. Reg. § 1.401(a)(9)-4 tells us how to determine who is the employee's beneficiary. As has long been true, the beneficiary is determined as of the date of death "minus" beneficiaries who were "removed" prior to the beneficiary finalization date (BFD) of September 30 of the year after the year of the participant's death. The Prop. Reg. continues this approach with more detail added. The Prop. Reg. states that a countable beneficiary "is a beneficiary designated under the plan as of the date of the employee's death and none of the events described in paragraph (c)(2) of this section has occurred with respect to that person by September 30 of the calendar year following the calendar year of the employee's death." Prop. Reg. § 1.401(a)(9)-4 (c)(1). I think the grammar/diction in that sentence is "off," but the meaning is clear nevertheless. Here is (c)(2)'s list of these "events" with my comments inserted:

"(2) Circumstances under which a beneficiary is disregarded as a beneficiary of the employee. With respect to a beneficiary who was designated as a beneficiary under the plan as of the date of the employee's death (including an individual who is treated as having been designated as a beneficiary pursuant to paragraph (f) [dealing with trusts named as beneficiary—see separate discussion] of this section), if any of the following events occurs by September 30 of the calendar year following the calendar year of the employee's death, then that beneficiary is not treated as a beneficiary–

"(i) The beneficiary predeceases the employee; [Comment: In my opinion if the named beneficiary predeceased the employee he/she is not properly described as being "designated as of the date of the employee's death." Any such designation would be contingent on the nominated beneficiary's having survived the employee. The beneficiary's death prior to the death of the employee is not properly classed with "events" that occur between the date of the employee's death and September 30 of the following year. But this quibble does not affect the outcome—the meaning of the proposed regulations is clear.]

"(ii) The beneficiary is treated as having predeceased the employee pursuant to a simultaneous death provision under applicable State law or pursuant to a qualified disclaimer satisfying section 2518 that applies to the entire interest to which the beneficiary is entitled; or

"(iii) The beneficiary receives the entire benefit to which the beneficiary is entitled."

More comments: The existing regulations have the same concept—the beneficiaries are the participant's beneficiaries as of the date of death "minus" beneficiaries "removed" prior to the BFD, but the existing regulations do not provide a finite list of recognized "removal" events as the proposed regulation does. If the proposed regulation becomes law, advisors will need to be a bit

more creative to make sure beneficiary-removal "events" fit into the above list of (i)–(iii). For example, a simultaneous death provision (requirement of survival for a certain period) should be just as effective as a "state law" provision in removing a beneficiary who fails to meet the condition. The advisor would probably conclude that, since state law gives effect to the provisions of the trust instrument, the instrument's survival requirement clause is part of "applicable State law." Or, if the beneficiary's failure to meet some other condition prior to the BFD, with the result that he/she loses his/her right to any benefits under the trust, we could conclude that he/she has "received" the "entire benefit to which" he/she was entitled i.e. zero.

5. Grand Finale: Case Study: Helping John Doe Survivors Compute RMDs

On April 1, 2022, Advisor is on the phone with the executor of John Doe. The task is to help John Doe's survivors compute their RMDs based on the proposed regulations.

Advisor is told the following:

- John Doe was born October 1, 1949, and died in March, 2022. John was unmarried and childless.
- He had three traditional IRAs, which he left to three different beneficiaries.
    - IRA "A" was left to his cousin Danny Doe. Danny was born October 2, 1959.
    - IRA "B" was left to his beloved older sister Daisy Doe. Her DOB was 5/1/1937.
    - IRA "C" was left to his estate—John forgot to fill out the beneficiary form for this account, and the IRA agreement says if no beneficiary is named the account will be payable to the IRA owner's estate.
- Neither Danny or Daisy Doe is disabled or chronically ill (and of course neither is the surviving spouse or minor child of John Doe).

Here is advisor's "first" report:

April 1, 2022

Dear Executor:

The late John Doe was born in 1949, so he turned age 72 in 2021. That means his "required beginning date" or "RBD" is actually *today*, 4/1/22! However, I understand that he died earlier this year, so he died "before his RBD." His age in the year of death (2022) would be 73 (age he reached or would have reached on his 2022 birthday).

Now here are the "required minimum distributions" (RMDs) for each of his IRAs, bearing in mind that he died before his RBD leaving each IRA to a different category of beneficiary.

Start with **IRA C.** Leaving your IRA to your estate, everybody knows that's a bad thing to do, an estate IS NOT and CANNOT BE a "designated beneficiary" because it is not an "individual." § 401(a)(9)(E)(i); Prop. Reg. § 1.401(a)(9)-4(b). So obviously IRA C is going to get the worst treatment because it is left to a "non-designated beneficiary" or "Non-DB."

A Non-DB that inherits the IRA of someone who died before the RBD is subject to the “5-year rule.” Under this rule, the entire account must be distributed by the end of the year that contains the fifth anniversary of the date of death, in other words, by December 31, 2027. The estate may, but is not required to, take any distributions it wants to take during the years 2022–2026, as long as it withdraws 100% of the balance by 12/31/2027. That’s how the family is “punished” for John Doe’s failure to name a beneficiary for this account.

I understand that the sole beneficiaries of the estate are Cousin Danny and Sister Daisy, but that makes no difference. We can’t “look through” the estate, sorry.

Next we turn to **IRA B,** which is left to the “middle” category of beneficiary. The “lowest” (worst) category is the Non-DB (like the estate), and the “highest” category are the glorified “Eligible Designated Beneficiaries” (EDBs) who are protected by SECURE and supposedly given the same great life expectancy payout deal that all beneficiaries received before SECURE. In the middle is the mere “designated beneficiary” who is not an EDB....what we call the “Plain Old Designated Beneficiary” or PODB.

Cousin Danny Doe is not the surviving spouse of John Doe and is not John Doe’s minor child. Danny is neither disabled nor chronically ill. Finally, because he was born on 10/2/1959, he is more than 10 years younger than his cousin John, who was born on 10/1/1949, and therefore does not qualify as an EDB in the “not more than 10 years younger” category (NoMoTTYY). He is *10 years and one day* younger than his cousin John. Cousin Danny Doe who inherited IRA B is in the “middle” category: He is a PODB.

As a PODB, cousin Danny’s IRA B is subject to the “10-year rule.” In this case, the 10-year rule works just like the 5-year rule except it’s for 10 years. So the entire account must be distributed by the end of the year that contains the tenth anniversary of the date of John Doe’s death, in other words, by December 31, 2032. Danny may, but is not required to, take any distributions he wants to take during the years 2022–2031, as long as he withdraws 100% of the balance by 12/31/2032.

Finally we come to sister Daisy and **IRA A**. Daisy is an EDB; since she is older than her deceased brother John (and she is not disabled or chronically ill etc.), she is in the NoMoTTYY category. Therefore under SECURE she is entitled to the life expectancy payout, just as all designated beneficiaries were before SECURE came along.

Hurray! That’s a great deal for her, right? Ummm....not really. Being born in 1937 means she will turn age 86 on her birthday in 2023 (year after the year of John Doe’s death). The life expectancy for age 86 under the IRS’s new life expectancy tables effective for 2022 and later years is 7.6 years. So starting next year (2023) she will have to withdraw the 12/31/2022 account balance divided by 7.6, about 13% of the entire account! And this life expectancy would go down by one each year, indicating 100% distribution would be required in just 8 years, i.e., by 2030 (when the “divisor” drops below one). So that’s not such a great deal.

BUT WAIT!!!! As an EDB, where the IRA owner died before his RBD, Daisy has the option to elect the 10-year rule if permitted by the IRA agreement. Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii). Presumably all IRAs will permit this; if not she can quickly transfer the account by direct transfer to another IRA in the same name (“John Doe, deceased, fbo Daisy Doe”) with a company (IRA provider) that does permit it. By electing the 10-year rule Daisy would not only get a longer payout period (10 years instead of 8) she would not have to take any RMDs during years one through nine.

She can take out as much or as little as she wants during those years, as long as she takes out 100% by 12/31/2032. That gives her two years more than her own single life expectancy, with no annual distributions required before the10th year.

So we end up with both cousin Danny and sister Daisy (by election) using the 10-year rule and the estate stuck with the 5-year rule.

Advisor: "Ok, that's the end of my report, so we're all set? I'll send my bill. But, you know, dear Executor, it's pretty amazing this guy John Doe died just before his RBD. I understand he died just a couple of days ago, right?

"Oh, he died YESTERDAY? You mean he actually died on March 31, 2022? The day before his RBD? No, you say he died LAST NIGHT? Hold on a minute Mr. Executor.....what TIME last night did he die? ***Could you please read me the time and date of death from the death certificate?*** He died at *THREE MINUTES AFTER MIDNIGHT*???? So the date of death is actually *APRIL 1, 2022, AT 12:03 A.M., NOT MARCH 31????*"

There is a pause in the conversation. The Advisor goes crazy for a minute, running around the room and foaming at the mouth. When he finally calms down he says:

"THAT CHANGES EVERYTHING! This means John Doe died ON OR AFTER HIS RBD, not BEFORE it! Tear up the report I just gave you! We have to do everything over, and I have to charge you double the fee! Here is my NEW report based on this new information!"

Advisor's Revised Report

The year of death RMD.

The year of death RMD, to the extent not taken by the decedent prior to his death, must be taken by the beneficiary(ies). This is not a concern for deaths BEFORE the RBD because there are no lifetime RMDs yet accrued, but it always must be investigated in cases of death on or after the RBD.

So, first of all, there is an RMD for the year 2022, actually potentially TWO RMDs, because John died after his RBD, therefore there are RMDs for both 2021 and 2022.

The RMD for **2021** would be computed using the Uniform Lifetime Table based on the account balance as of 12/31/2020 and John's age on his 2021 birthday which was 72; the RMD for **2022** would be computed using the Uniform Lifetime Table based on the account balance as of 12/31/2021 and John's age on his 2022 birthday which was 73.

HOWEVER, two different Uniform Lifetime Tables must be used for these two years, because the IRS adopted new life expectancy tables effective for RMDs in 2022 (and later years). The age 72 factor under the "old" table (through 2021) is 25.6. The age 73 factor under the "new" table (2022 and later) is 26.5. Got that?

Now the *2021 RMD*, to the extent John had not taken it before 4/1/2022, is already late. I would advise the beneficiaries to take that 2021 RMD as soon as possible, and there's no reason to delay the other "year of death" RMD, the 2022 distribution either. Even though one of these RMDs is already late, it appears the IRS will automatically waive the 50% penalty as long as that RMD is

taken by the due date of each beneficiary's 2022 tax return. See Prop. Reg. § 54.4974-1(g)(3). However, I wouldn't push them on this, so just get those distributions out of the IRAs as soon as possible.

Now let's turn to the RMD payout period for each IRA beneficiary for the post-2022 years.

Post-2022 RMDs

Start with **IRA C.** Leaving your IRA to your estate, everybody knows that's a bad thing to do, an estate IS NOT and CANNOT BE a "designated beneficiary" because it is not an "individual." § 401(a)(9)(E)(i); Prop. Reg. § 1.401(a)(9)-4(b). So obviously IRA C is going to get the worst treatment because it is left to a "Non-DB"....right? Let's see...

The payout period for a Non-DB that inherits the IRA of someone who died on or after the RBD is the "ghost life expectancy," i.e., what would have been the decedent's life expectancy if he hadn't died. Based on his age in the year of his death (age 73 on his 2022 birthday), John's life expectancy would have been 16.4 years. The estate must withdraw the funds in annual instalments starting in 2023 over 15.4 years. The first post-death-year (2023) RMD will be the 12/31/2022 account balance divided by 15.4. The next year, 2024, will be the 12/31/2023 account balance divided by 14.4, and so on until the divisor goes to "equal or below one" which will be in 2038 when it goes to 0.4. Thus the final year will be 100% distribution in 2038. Prop. Reg. § 1.401(a)(9)-5(d)(3)(ii). Hmmm. That's not actually so terrible, is it?

Moving on to **IRA B**, inherited by Cousin Danny, the "PODB." Once again, as a PODB, Danny is subject to the 10-year rule, but this time with a twist: Because death occurred ON OR AFTER the RBD, Danny must take annual distributions in years one through nine (2023-2031) based on HIS (Danny's) single life expectancy! The single life expectancy is computed based on Danny's age in 2023 (the year after the year of death), reduced by one year each year thereafter. Prop. Reg. § 1.401(a)(9)-5(d)(3)(iii). Born in 1959, he will turn 64 in 2023. The single life expectancy for age 64 under the new Single Life Table is 23.7. So in 2023 he must withdraw the 12/31/2022 account balance divided by 23.7. In each succeeding year through year 9 (2031) he must withdraw the prior year end account balance divided by the preceding year's Applicable Denominator reduced by one, with a final overriding requirement of 100% distribution in 2032.

Just for the record note this tiny difference for computing a beneficiary's life expectancy vs. computing the "ghost" life expectancy. For the ghost life expectancy, you start with the life expectancy of the decedent *in the year of death*, reduced by one per year thereafter. For a designated beneficiary's life expectancy, you start with the beneficiary's life expectancy *in the year after the year of death*, reduced by one per year thereafter. This is what makes life so fun and exciting for us Advisors.

Just for the sake of curiosity, Danny might want to sharp pencil and figure out whether his "deal" as a "designated beneficiary" (life expectancy payouts for 9 years followed by 100% distribution in year 10) is or is not a "better deal" than the estate got for IRA C (ghost life expectancy payout over 14.4 years).

Finally we come to sister Daisy and **IRA A**. As a NoMoTTYY, she is the exalted "EDB" in the crowd so she must really get the best deal of anybody right? She gets to use a real life expectancy

payout! But wait we already figured out, her life expectancy in the first life-expectancy-payout year (2023) at age 86 will be only 7.6 years, requiring 100% distribution by 2030. That's not so great.

Can she fix this by electing the 10-year rule—as she could have done if John Doe had died BEFORE his RBD? Nope. The proposed regulation allowing the EDB to elect the 10-year rule (Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii)) applies only in cases of employee death before the RBD; the proposed regulation covering distributions to beneficiaries of employees who die after the RBD (Prop. Reg. § 1.401(a)(9)-5(d)) contains no such provision.

Wait a minute...there's a "longer of" rule, right? Yes there is, sort of. The proposed regulations say that if the employee died on/after the RBD, annual distributions are computed using as the "applicable denominator," the "greater of-- (A) The designated beneficiary's remaining life expectancy and (B) the employee's remaining life expectancy." Prop. Reg. § 1.401(a)(9)-5(d)(ii). So for years 2022-2029 she takes RMDs computed using the "ghost life expectancy" under this "greater of" rule.

However, under the proposed regulations, such "annual track" distributions (that's my term for it) are over-ridden by an Outer Limit Year (also my term) in which 100% distribution is required regardless of what was going on under the annual distributions track. The Outer Limit Years and that rule are contained in Prop. Reg. § 1.401(a)(9)-5(e). If the designated beneficiary is an EDB, and the Applicable Denominator is being determined under Prop. Reg. § 1.401(a)(9)-5(d)(ii)(B) [the employee's life expectancy under the "greater of" rule], then the FINAL year in which 100% distribution is required is the final year of the BENEFICIARY'S life expectancy ("the calendar year in which the applicable denominator would have been less than or equal to one if it were determined" based on the beneficiary's life expectancy).

In other words, annual distributions are determined by the *longer-of* life expectancy but a final distribution year is based on the *shorter-of* the two life expectancies!

So to conclude my second report, because John Doe died after his RBD, the (revised) RMD picture is as follows. Note it is topsy-turvy—the bad Non-DB estate gets the BEST deal, the supposedly favored EDB gets the WORST deal! Of course the PODB stays in the middle...

Estate: 14-year payout under ghost life expectancy.
Danny the PODB: 10-year rule, with annual RMDs in years 1-9 based on his life expectancy.
Daisy the EDB: An 8-year payout over her life expectancy (though using the decedent's life expectancy rather than her own to compute the payments in the years 2023-2029).

The "worst" beneficiary (the estate) got the "best deal." The "best" beneficiary (the EDB) got the worst deal...and the "middle beneficiary" (PODB) got the middle deal. TO SOMEONE SOMEWHERE THIS MAKES SENSE!

The End (Mercifully)

APPENDIX A

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?

Disaster can ensue when these two complicated tax vehicles (trusts and retirement accounts) collide. IRA distributions are normally 100% includible in gross income for both human and trust beneficiaries. 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/or trustee do not understand the differences between human income tax rules and fiduciary income tax rules. But if the planner and trustee understand and work within just seven basic rules, they can avoid a tax meltdown.

This section (A) summarizes the 7 facts of FIT (Fiduciary Income Tax) "in English." This summary is followed by a detailed explication of the FIT Facts "in legalese" with citations in (B).

FIT Fact #1: Trust tax rates are higher

A trust goes into our Code's highest income tax rate (37%) with just $13,450 of taxable income (2022 rates), regardless of how poor or rich the trust beneficiaries are. A human doesn't hit that top rate until she has $539,900 of taxable income (if single; or $647,850 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 $13,450 of income. If a client's intended beneficiaries are not in such high income tax brackets themselves, the objective is to avoid having IRA distributions (which are generally includible in 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 rates). But trusts get a deduction humans don't get, called the "DNI deduction." The trust gets an income tax deduction for any of its "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) rate. Needless to say, there are rules around the DNI deduction—for example, the distribution out to the beneficiaries generally has to occur in the same year the income was received by the trust (or shortly thereafter).

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 simply erase the tax on IRA distributions by paying them out to the beneficiaries. Not every distribution from a trust "carries out DNI!"

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 is going to pay all *trust accounting income* to the spouse.

The trustee may receive an item that goes into federal gross income but not 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 DNI. But under most states' trust accounting laws, only a small portion (or none) of that will count as "trust accounting income" so (under the terms of this trust) the trustee can NOT pay it out to the spouse and the trust is stuck with high trust tax rates on the entire IRA distribution.

Moral: 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. For 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. If the trustee has discretion to "pay income or principal to my spouse in any amounts for any reason the trustee deems advisable" the trustee presumably would have discretion to pass out retirement benefit plan distributions to lower income taxes on the family. Another idea: 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. If necessary or if it would be helpful, include your own 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.

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).

Moral: If the trust is to be funded with substantial retirement benefits, be aware that the trust will have to cash out (and pay tax on) retirement plan distributions and pay pecuniary bequests with what's left after taxes. Avoid including substantial pecuniary bequests in this type of trust.

FIT Fact #5: The "separate shares rule"

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.

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 the following year 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. Therefore even if trustee pays it all out to Child A, that distribution will "carry out" only 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.

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. 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

Moral: Pay attention, in planning, drafting, and administering a trust that will receive substantial retirement benefits, to how best to get gross income from IRA distributions steered to lower income 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 complicated demanding rules. For example a pecuniary bequest to charity can (if all requirements are met) get a charitable deduction even though it would never qualify for a DNI deduction.

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.

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.

APPENDIX B

Charts Summarizing The New RMD Rules

by Natalie B. Choate, Esq.

These charts summarize the minimum distribution requirements for certain beneficiaries of a decedent **who dies in 2022** according to the proposed Treasury regulations issued in February 2022 *as if* such regulations were final and effective in 2022. Charts I and II summarize the requirements applicable to one beneficiary. Charts III and IV summarize the requirements applicable to a trust named as beneficiary. The regulations are not final, and so may change. Effective date issues are not covered here. These charts apply only to defined contribution (individual account) plans, not defined benefit plans or annuities.

The new RMD "system" for beneficiaries generally has two parts. First, there is an annual distributions track: What annual distributions are required after the participant's death, if any? Second, there is an Outer Limit Year [not an official term] in which 100% of the account becomes the RMD, regardless of what the "annual distributions track" says. To advise a beneficiary you'll need to explain both the annual distributions requirement and the Outer Limit Year requirement. See Prop. Reg. § 1.401(a)(9)-5(e). The post-death payout must be completed in the Outer Limit Year if the account was not previously exhausted by the annual distributions.

To use the charts you need the following information:

1. Did the decedent die **before or after** his required beginning date (RBD)? To determine the RBD, see ¶ 1.4 of *Life and Death Planning for Retirement Benefits* (but change "age 70½" to "age 72"). You can NOT figure out any beneficiary's RMDs without knowing whether the decedent died before or on/after his RBD.

2. What category is the beneficiary?

...an **Eligible Designated Beneficiary** (EDB)? If so which type— participant's surviving spouse, minor child of the participant, disabled or chronically (D/CI) ill individual, or not-more-than-10-years-younger beneficiary?

...a **plain old designated beneficiary** (PODB)? Or,

...a **non-designated beneficiary** (Non-DB), such as the participant's estate?

3. The "beneficiary's life expectancy" (and the decedent's or "ghost" life expectancy) are calculated using the Single Life Table found at Treas. Reg. § 1.401(a)(9)-9(b). The applicable factor ("Applicable Denominator") is divided into the prior year end account balance. For how to calculate the prior year end account balance, see ¶ 1.5.05 of *Life and Death Planning for Retirement Benefits*.

4. If the beneficiary is a trust, you will need to read the trust sections of the Outline before using the Chart (so you can determine what type of trust it is and who are the countable trust beneficiaries).

Chart I: RMDs for one individual beneficiary or the estate
Participant died before RBD

Beneficiary	RMD for year of Participant's death	Annual distributions required in succeeding years	Outer Limit Year (100% distribution required in this year)
EDB: Participant's surviving spouse	None	Annual distributions over spouse's life expectancy (Notes 1, 3, 4).	Year that contains the 10th anniversary of EDB's death (if that comes earlier than the final year of the life expectancy payout). (Notes 5, 6)
EDB: Minor child of participant	None	Annual distributions over beneficiary's life expectancy (Notes 2, 3)	Year that contains the 10th anniversary of the earlier of the child's death or the child's 21st birthday. Prop. Reg. § 1.401(a)(9)-5(e)(1), (3), (4).
EDB: Disabled or chronically ill individual; or not more than 10 years younger individual	None	Annual distributions over beneficiary's life expectancy (Notes 2, 3)	Year that contains the 10th anniversary of EDB's death (if that comes earlier than the final year of the life expectancy payout) (Note 5)
PODB	None	None	Year that contains the 10th anniversary of participant's death. Prop. Reg. § 1.401(a)(9)-3(c)(3).
Non-DB (participant's estate)	None	None	Year that contains the 5th anniversary of participant's death. Prop. Reg. § 1.401(a)(9)-3(c)(2).

Notes to Chart I:

1. The commencement date for RMDs to the surviving spouse ("S/S") is the later of the year after the year of the employee's death or "the end of the calendar year in which the employee would have reached age 72" (age 70½ if decedent born before 7/1/1949). Prop. Reg. § 1.401(a)(9)-3(d). RMDs are based on the S/S's life expectancy recalculated annually. Prop. Reg. § 1.401(a)(9)-5(d)(3)(iv). If the S/S dies "before distributions have commenced" under the preceding rule then the RMD rules (5-year rule, etc.) are applied "as if the S/S were the employee." To determine who is the S/S's "beneficiary" in that case, see Prop. Reg. § 1.401(a)(9)-4(d). The date "distributions have commenced" to S/S is the end of either (1) the year after the year in which the employee died or (2) the year in which the employee would have reached age 72 (or 70½ if applicable), whichever is later. Prop. Reg. § 1.401(a)(9)-3(e)(1), (3). Any distribution to the S/S in that later-of calendar year would be a nonrollable RMD until the RMD for such year (based on S/S as beneficiary) was satisfied. Prop. Regs. § 1.402(c)-2(j)(3)(i)(A), § 1.401(a)(9)-5(a)(2)(ii). If the S/S dies *after* RMDs have commenced (i.e., on or after the last day of the calendar year in which distributions to him/her were required to begin), RMDs to the successor beneficiary (based on S/S's life expectancy) continue until the year that contains 10th anniversary of S/S's death (100% distribution required) or until the life expectancy payout exhausts the account if earlier. According to the Preamble to the Proposed Regs, recalculation of S/S's life expectancy ends with year of S/S's death, and thereafter RMDs to the successor beneficiary continue based on that year-of-death remaining life expectancy minus one each year. I have not found that rule in the Proposed Regulations, only in the Preamble. Compare Prop. Regs. § 1.401(a)(9)-5(d)(3)(iv), (3)(ii).

2. Life-expectancy RMDs to non-spouse EDB commence year after year of employee's death. Prop. Regs. § 1.401(a)(9)-3(c)(4), § 1.401(a)(9)-5(a)(2)(iii). [Why does this rule appear twice?] Life expectancy of a non-spouse EDB is not recalculated annually. Prop. Reg. § 1.401(a)(9)-5(d)(3)(iii).

3. The retirement plan may require that the 10-year rule "will apply" to some or all EDBs in place of the life expectancy payout; OR allow the EDB to elect 10-year rule instead of life expectancy payout; OR allow the employee to elect that 10-year rule shall apply to the EDB instead of life expectancy payout. Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii). If 10-year rule applies under these provisions, see "PODB" instead of S/S or EDB. Possible use of 10-year rule instead of life expectancy payout for EDB applies *only* if employee died before RBD.

4. The S/S also has the option to "roll over" distributions from the decedent's account into the S/S's own retirement account. Prop. Reg. § 1.402(c)-2(j)(1). Following such rollover, the S/S's RMDs will be calculated using the Uniform Lifetime Table, not the Single Life Table applicable to beneficiaries. This rollover option does not apply to any distribution to the S/S that is a Required Minimum Distribution. Prop. Reg. § 1.402(c)-2(j)(3).

5. Prop. Reg. § 1.401(a)(9)-5(e)(1), (3).

Chart II: Post-death RMDs to One Individual Beneficiary or Participant's Estate ...if Employee Died ON OR AFTER his/her Required Beginning Date

Beneficiary	RMD for year of Employee's death	Annual distributions required in succeeding years	Outer Limit Year (100% distribution required in this year)
EDB: Employee's surviving spouse (S/S)	Yes if not taken by employee (Note 3)	Annual distributions over longer of spouse's life expectancy or decedent's ("ghost") life expectancy (Notes 1, 2, 4).	Earliest of: Year that contains 10th anniversary of S/S's death, final year of S/S's life expectancy; or final year of ghost life expectancy. (Notes 5, 6, 7)
EDB: Minor child of employee	Yes if not taken by employee (Note 3)	Annual distributions over beneficiary's life expectancy (Note 2)	Year that contains the 10th anniversary of the earlier of the EDB's death or the EDB's 21st birthday. (Note 9)
EDB: Disabled, Chronically ill, or not more than 10 years younger individual	Yes if not taken by employee (Note 3)	Annual distributions over longer of EDB's life expectancy or decedent's ("ghost") life expectancy (Note 2).	Earliest of: Year that contains 10th anniversary of EDB's death; final year of EDB's life expectancy; or final year of ghost life expectancy. (Notes 5, 7)
PODB	Yes if not taken by employee (Note 3)	Annual distributions over the beneficiary's life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). See Note 8.	The earlier of: (1) The year that contains the 10th anniversary of the employee's death or (2) the final year of the beneficiary's life expectancy. (Notes 2, 8)
Non-DB (employee's estate)	Yes if not taken by employee (Note 3)	Annual distributions over ghost life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(iii).	Final year of ghost life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(iii).

Notes to Chart II:

1. RMDs to the S/S are based on the longer of S/S's life expectancy or the employee's life expectancy (sometimes called the "ghost life expectancy"). Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). The S/S's life expectancy is recalculated annually; the employee's is not. Prop. Reg. § 1.401(a)(9)-5(d)(3)(ii), (iv). [What happens if they cross? Not covered here...]

2. Life-expectancy RMDs to a beneficiary continue through the year of the beneficiary's death (if the account was not fully distributed earlier). Prop. Reg. § 1.401(a)(9)-5(d)(1)(i). When are such distributions required to commence? Presumably the year after the year of the employee's death; it appears that the limitation "in the case of an employee who dies before the required beginning date" should be removed from the definition of "First distribution calendar year for beneficiary" in Prop. Reg. § 1.401(a)(9)-5(a)(2)(iii), since the rule presumably applies regardless of whether death was before or after the RBD. Life expectancy of a nonspouse EDB is not recalculated annually. Prop. Reg. § 1.401(a)(9)-5(d)(3)(iii).

3. If the decedent had not taken the full RMD for the calendar year of his death, the beneficiary must withdraw whatever portion the decedent failed to take by December 31 of the year of the employee's death. Prop. Reg. § 1.401(a)(9)-5(c)(1), last two sentences. If the beneficiary misses that deadline, then, "Unless the Commissioner determines otherwise" (???), there is an automatic waiver of the 50% excise tax normally assessed on a missed RMD (§ 4974(a)) if the beneficiary satisfies the year-of-death distribution requirement by taking the distribution "no later than the tax filing deadline (including extensions thereof) for the taxable year of that beneficiary that begins with or within that calendar year." Prop. Reg. § 54.4974-1(g)(3).

4. The S/S also has the option to "roll over" distributions from the decedent's account into the S/S's own retirement account. Prop. Reg. § 1.402(c)-2(j)(1). Following such rollover, the S/S's RMDs will be calculated using the Uniform Lifetime Table, not the Single Life Table applicable to beneficiaries. This rollover option is not part of the minimum distribution rules of § 401(a)(9). It does not apply to any distribution to the S/S that is a Required Minimum Distribution. Prop. Reg. § 1.402(c)-2(j)(3).

5. Prop. Reg. § 1.401(a)(9)-5(e)(1), (3).

6. According to the *Preamble* to the Proposed Regulations, recalculation of S/S's life expectancy ends with year of S/S's death. Thereafter annual RMDs continue based on that year-of-death remaining life expectancy minus one each year, until S/S's life expectancy runs out. I could not find this rule in the Proposed Regulations. See Prop. Reg. § 1.401(a)(9)-5(d)(3)(iv); compare (3)(ii). This rule does not actually appear in the Proposed Regs.

7. The "Shorter of" Rule: If the EDB was older than the decedent, then the ghost life expectancy will be longer than the EDB's life expectancy. The Proposed Regulations provide

that in cases of death after the RBD, the Outer Limit Year for the EDB's "life expectancy payout" is the final year of the ghost life expectancy or of the EDB's life expectancy *whichever comes first*. Prop. Reg. § 1.401(a)(9)-5(e)(5). As the Proposed Regulation puts it, the Outer Limit Year will be the year the beneficiary's remaining life expectancy becomes "less than or equal to one," if that happens before the final year of a payout based on the ghost life expectancy (and before the 10-year limit). This "shorter of" rule applies even if, prior to such year, the EDB was enjoying the longer payout period of the ghost life expectancy under the "longer of" rule! The shorter-of rule applies only to EDBs who were older than the employee, not to PODBs or Non-DBs. The shorter-of deadline is presumably complicated to calculate if the EDB is/was the S/S, because the surviving spouse's life expectancy is recalculated annually until the year of his/her death so it's a moving target. The "shorter of" rule wins the first annual award for Nastiest Most Mean-Spirited Proposed Regulation of the Year. It "attacks" only elderly surviving spouses, disabled or chronically ill, and other individual beneficiaries who by definition are older than age 73 and therefore have at most a 15-year payout to look forward to (though a surviving spouse's life expectancy payout could stretch to age 120, due to recalculation). Is it really necessary to force the 85-year old sibling of the deceased 80-year old employee to withdraw the entire balance within 8 (approximately) years rather than (approximately) 11 years?

8. The rule for PODBs in case of employee's death after the RBD is the 10-year rule limit, unless the payout ends earlier under the "longer of" (PODB's or employee's life expectancy) rule. I believe the longer-of rule could not apply to an individual PODB: If the PODB had a same-as-or-shorter life expectancy than the employee, the PODB would be an EDB! ("Not more than 10 years younger..."). So for practical purposes, in case of employee's death after the RBD leaving benefits to one individual PODB, the beneficiary must take the balance of decedent's year of death RMD (if not taken by the decedent), then take annual RMDs based on the *beneficiary's* life expectancy. If the PODB is over age 81, this will result in the account being fully distributed before the end of the 10-year rule period since the beneficiary's life expectancy would be less than 10 years. If the PODB's life expectancy is more than 10 years, he would take RMDs based on his life expectancy for the first nine years after the participant's death, then withdraw 100% of the account in year 10. The "longer of" rule might somehow come into play for a PODB if the beneficiary is a see-through accumulation trust with multiple designated beneficiaries; this Chart does not cover trusts or multiple beneficiary situations.

9. The "shorter of" rule normally applicable to an EDB under Prop. Reg. § 401(a)(9)-5(e)(5) (see Note 7) cannot come into play for benefits left to a minor-child EDB because (I'm pretty sure) the decedent cannot have been younger than his/her own child.

10. The Proposed Regulation calls for annual distributions over the greater of the beneficiary's life expectancy or the ghost life expectancy. 1.401(a)(9)-5(d)(1)(ii). The ghost LE would be longer than the DB's LE only if the DB is older than the participant, but in that case the DB would be an EDB not a PODB.

Chart III: RMDs to a Trust Named as Beneficiary of a Retirement Account ...if Participant Died BEFORE the Required Beginning Date

Type of trust that inherited the account	Annual distributions required beginning year after Participant's death	Outer Limit Year (100% distribution required in this year)
Trust that does not qualify as a DBT; a Non-DB.	None	Year that contains the 5th anniversary of participant's death. Prop. Reg. § 1.401(a)(9)-3(c)(2).
Conduit trust for one beneficiary who is a PODB or EDB	Same RMD "deal" as would apply to that PODB or EDB if named directly as beneficiary. See Chart I. See Note 1.	Same as would apply if that PODB or EDB were named directly as beneficiary. See Chart I. See Note 1.
Type II AMBT	Annual distributions over life expectancy of oldest countable D/CI beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(1)(ii). See Note 1	Year that contains the 10th anniversary of the death of the last D/CI beneficiary of the trust. Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii). See Note 1
DBT which has at least one countable minor-child-EDB	Annual distributions over life expectancy of the oldest countable beneficiary of the trust (NOT just the oldest minor-child EDB; may be a mere PODB). Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). See Note 1	Year that contains the 10th anniversary of the oldest minor-child-EDB's 21st birthday or earlier death. Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii). See Note 1
DBT which is none of the above, but all countable beneficiaries of which are EDBs	Annual distributions over the life expectancy of the oldest countable beneficiary of the trust (Notes 1, 2). Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). See Note 1	Year that contains the 10th anniversary of death of oldest countable beneficiary of the trust. Prop. Reg. § 1.401(a)(9)-5(e)(1), (f)(2)(i). See Note 1
DBT trust which is none of the above	10-year rule applies; no annual distributions.	Year that contains the 10th anniversary of the participant's death. Prop. Reg. § 1.401(a)(9)-5(e)(2), (f)(2)(i)

NOTE 1: If participant died before RBD, the retirement plan may require that the 10-year rule "will apply" to some or all EDBs in place of the life expectancy payout; OR allow EDB to elect 10-year rule instead of life expectancy payout; OR allow the employee to elect that 10-year rule shall apply to the EDB instead of life expectancy payout. Prop. Reg. § 1.401(a)(9)-3(c)(5)(ii), (iii).

Chart IV: RMDs to a Trust: if Participant Died AFTER RBD

In all cases, the trust must also take the RMD for the year of the participant's death to the extent it had not been distributed to the participant prior to death. Also, see "The Note!" at bottom of chart.

Type of trust that inherited the account	Annual distributions required beginning year after Participant's death	Outer Limit Year (100% distribution required in this year)
Trust that does not qualify as a DBT; a Non-DB.	Annual distributions over ghost life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(iii).	Final year of ghost life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(iii).
Conduit trust for one beneficiary who is a PODB or EDB	Same RMD "deal" as would apply to that PODB or EDB if named directly as beneficiary. See Chart II.	Same as would apply if that PODB or EDB were named directly as beneficiary. See Chart II.
Type II AMBT	Annual distributions over life expectancy of oldest countable D/CI beneficiary (or, if longer, over the ghost life expectancy). Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii).	Year that contains the 10th anniversary of the death of the last D/CI beneficiary of the trust Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii). But see The Note!
DBT which has at least one countable minor-child-EDB	Annual distributions over life expectancy of the oldest countable beneficiary of the trust (or, if longer, over the ghost life expectancy). Prop. Reg. § 1.401(a)(9)-5(d)(ii), (f)(1)(i).	Year that contains the 10th anniversary of the oldest minor-child-EDB's 21st birthday or earlier death. Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii). But see The Note!
DBT which is none of the above, but all countable beneficiaries of which are EDBs	Annual distributions over the life expectancy of the oldest countable beneficiary of the trust (or, if longer, over the ghost life expectancy). Prop. Reg. § 1.401(a)(9)-5(d)(ii), (f)(1)(i).	Year that contains the 10th anniversary of the death of the oldest countable beneficiary of the trust. Prop. Reg. § 1.401(a)(9)-5(e)(1), (f)(2)(i). But see The Note!
DBT trust which is none of the above	Annual distributions over life expectancy of oldest countable beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i).	Year that contains the 10th anniversary of the participant's death. Prop. Reg. § 1.401(a)(9)-5(e)(2), (f)(2)(i)

The Note: Weird effects happen if the ghost life expectancy applies but the oldest EDB dies more than 10 years prior to the end of the ghost life expectancy. See "**Weird effects**" in the Outline.

Appendix C: The New Life Expectancy Tables

Effective for 2002 and later years.

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		