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**EXAMPLE 2-G:** ADDITION OF BENEFICIARY PRIOR TO BFD VIA DECANTING OR REFORMATION: Trust says "After my death, pay income in equal shares to my beloved nephews Arthur, Bill, Charlie, David, Fred, and George, or the surviving member(s) of said group, as long as they live, then distribute the principal to their then-living issue per stirpes." After the participant's death, the trust is reformed in accordance with applicable state law to correct a scrivener's error which eliminated one of the intended nephews (Edward) from the beneficiary list. The reformation is completed properly under applicable state law before the BFD. Edward is added to the list of potential trust beneficiaries, according to Prop. Reg. § 1.401(a)(9)-4(f)(5)(iii)(C).

Note that the Proposed Regulations make no allowance for a post-death reformation of the *beneficiary designation form*—only a trust reformation will be recognized for RMD purposes apparently.

Congratulations! You've completed Step TWO and have your list of "potential" trust beneficiaries. You are now are ready for....

## 9. STEP 3: Divide the potential beneficiaries into first and second tiers

Now that you have your list of "potential" beneficiaries from Step Two, it's time to divide that list into two tiers. Once we have our tiers, we can apply the next set of "disregard rules" and determine who, among the possibly long list of potential beneficiaries achieved in Step 2, are the "countable" beneficiaries, and which potential beneficiaries are "disregarded." The countable beneficiaries will determine the distribution period for the trust (STEP 5).

A first tier beneficiary is any beneficiary who either MUST or MIGHT receive benefits from the trust following the death of the participant, without having to wait for some other beneficiary to die: "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 who did not predecease (and is not treated as having predeceased) the employee." Prop. Reg. § 1.401(a)(9)-4(f)(3)(i)(A). The Proposed Regulations call these "beneficiaries described in paragraph 1.401(a)(9)-4(f)(3)(i)(A)." This Outline calls them "first tier beneficiaries."

A second tier beneficiary is "Any beneficiary...that could receive amounts in the trust representing the employee's interest in the plan that were not distributed to" first tier beneficiaries.

First tier beneficiaries are always countable. Some or all second tier beneficiaries are disregardable in some cases.

**EXAMPLE 3-A**: Isabelle's trust says "Pay all income to my husband Oliver for life, and upon his death pay the principal to my son Angier if living otherwise to Hillsdale College." Both Oliver and Angier survive Isabelle. Oliver is a first tier beneficiary because he gets benefits from the trust upon Isabelle's death—he doesn't have to wait until someone else dies. Angier is a second tier beneficiary because he has to wait until Oliver dies before he will get anything. The College is *also* a second tier beneficiary for the same reason. One is tempted to say the College is a "third tier beneficiary" because it won't get anything unless BOTH Oliver and Angier die, <u>but there is no such</u>

<u>thing in this system as a “third-tier beneficiary</u>”...only first and second tiers. The College may be “disregardable” at a later point in the process (see STEP 4-C) but for now it is just a second tier beneficiary, just like Angier.

**EXAMPLE 3-B:** Julia’s trust says “Pay all income to my husband Harold until his death or remarriage. Upon his death or remarriage, pay the principal to my daughter Charlotte if living otherwise to Morgan Memorial.” Both Harold and Charlotte survive Julia. Harold is a first tier beneficiary because he gets benefits from the trust upon Julia’s death—he doesn’t have to wait until someone else dies. Charlotte is ALSO a “first tier beneficiary” because she could get benefits without having to wait until Harold dies....she would get the benefits if he remarries. See Preamble to the Proposed Regulations, p. 32. Morgan Memorial is a second tier beneficiary; it cannot get benefits merely because Julia dies, it may get some of the benefits not distributed to Harold after he dies (i.e., if he doesn’t remarry). Preview of coming attractions: None of the disregard rules (see STEP 4) would allow the charity to be disregarded under this trust.

Those are easy....how about this one?

**EXAMPLE Z:** Steve’s trust says “Upon my death, pay income and principal to or for the benefit of such persons as the trustee shall select from the class consisting of my surviving spouse and all my issue living from time to time for their health and support. Upon my spouse’s death, distribute the entire trust to my issue then living by right of representation or if none is then living, to My Favorite Charity.” Steve is survived by his spouse, two children, and five grandchildren. All eight of those individuals are first tier beneficiaries, since all of them are eligible to receive distributions as a result of Steve’s death. They don’t have to wait for someone else to die. The Charity is the only second tier beneficiary. Preview of coming attractions: It appears that none of the disregard rules (see STEP 4) would allow the Charity to be disregarded, so this is probably not an advantageous way to draft the trust. The problem can be cured by naming an individual as the wipeout beneficiary in place of the Charity, or by using a last man standing approach; see the continuation of Example 2-B in Step 4-C below.

## 10. STEP 4: Apply three more disregard rules

Once you have divided all your potential beneficiaries into first and second tiers, you can apply this final set of disregard rules. The result of applying this final round of disregard rules is to whittle down your list of “potential beneficiaries” so you are left with only “countable beneficiaries.”

### A. Conduit trust rule: Disregard all second tier beneficiaries.

**A. Conduit trust rule: Disregard all second tier beneficiaries.** With a conduit trust, only first tier beneficiaries count. All second tier beneficiaries are disregarded. Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(A), (3)(i)(B), (6)(i), Example (1)(B).

**EXAMPLE 4-A:** CONDUIT TRUST: Trust says, “Every time the trustee takes a distribution from my IRA, the trustee shall forthwith distribute such distribution to my husband Larry or apply it for his benefit. On Larry’s death, any amounts remaining in the IRA shall be paid to Baypath

Humane Society." Larry is the first tier beneficiary. The Humane Society is the second tier beneficiary and it is disregarded (not treated as a "countable" beneficiary of the trust) because this is a conduit trust. A conduit trust is a See-through Trust [see STEP 1] 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); see PART 4, #2.

**B. First tier inherits by age 31 rule.** Disregard any second tier beneficiary who will inherit only if a first tier beneficiary who would have inherited the property outright at a certain age (age 31 or younger) [or by end of year after year of participant's death, if later] dies before reaching that age [or such year-end]. Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B).

**EXAMPLE 4-B:** AGE 31 RULE**.** Regina's trust says, "Use income and principal of the trust for the benefit of my niece Sophie, for her health, education, and support, until she reaches age 30, at which time the trust shall terminate and be distributed outright to her. If she dies before reaching that age the trust shall terminate and be distributed to the Salvation Army." The first tier beneficiary is Sophie. The second tier beneficiary is a charity. The charity is disregarded because (1) it is a second-tier beneficiary and (2) it will receive funds from this trust only if a first tier beneficiary who would inherit the funds outright upon reaching age 31 (or any younger age) dies before reaching such age.

Although "age 31" is the same age as the final year of distribution to a minor child of the deceased participant (i.e., a category of eligible designated beneficiary or EDB) (10 years after attaining majority), the age 31-disregard rule applies to ANY first tier beneficiary who is to receive outright distribution at or before that age, even if such beneficiary is not a minor child of the participant.

**C. Disregard the second choice-second tier guy.** Disregard any second tier beneficiary who will inherit only if some *other* second tier beneficiary (who was supposed to inherit outright on death of a first tier beneficiary) fails to survive such first tier beneficiary. This is the Proposed Regulations' version of the old "mere potential successor rule."

This is the hardest rule to grapple with. This rule does not merely require that one person survives another person while someone else fails to survive such person. Both the "first choice guy who failed to survive" and the "second choice guy who actually did survive" must be second tier beneficiaries who inherit the property outright (or *would have* inherited it outright in the case of the guy who didn't survive) upon death of a first tier beneficiary. The survivor-second tier beneficiary must be getting something that the other second tier-beneficiary-guy who DIDN'T make it would have received outright.

Here is how this rule applies to some "vanilla" type trusts we have already looked at:

**EXAMPLE 1, VANILLA TRUST, continued:** Trust says "Pay income to my spouse for life, and on my spouse's death distribute the principal to my issue then living by right of representation, or if none of my issue are then living, to Charity X." Participant is survived by his spouse, three children, and four grandchildren. The potential beneficiaries list is as follows: Spouse, three children, four grandchildren, and Charity X. The first tier beneficiary is spouse. The children, grandchildren, and Charity X are all second tier beneficiaries, who must wait until not only the participant but also the spouse dies before they might inherit something.

Charity X is disregardable because: It is a second tier beneficiary, but it will not receive anything from the trust unless *another* second tier beneficiary (actually a whole bunch of them—the issue) fail to survive the first tier beneficiary (spouse). When the spouse/first tier beneficiary dies, the participant's issue then living will inherit the trust outright. The charity won't get anything if *any* other second tier beneficiary survives the spouse. So the charity gets something only if "the first-choice second tier guys" [the participant's issue] don't survive the first tier beneficiary [the spouse].

Now contrast that with this other example from earlier in this Outline:

**EXAMPLE 2-B: PERPETUAL FAMILY TRUST, continued:** Trust says "The trustee shall pay income and principal to or for the benefit of such persons as the trustee shall select from the then living members of the class consisting of my spouse and my issue living at the time of such payment for their health, education, support, and welfare in such amounts as the trustee deems advisable. If at any time there is no issue of mine living, and my spouse is deceased, the trust shall terminate and be distributed to Charity X." Participant is survived by his spouse, three children, and four grandchildren. The potential beneficiaries list is as follows: Spouse, three children, four grandchildren, and Charity X. Though the trust is *intended* to benefit the participant's present and future issue in perpetuity, you cannot "count" issue who do not exist yet. For purposes of testing this trust, you can look only at people who are actually living when the participant dies.

What are the tiers? The spouse, children, and grandchildren are all first tier beneficiaries because they are all eligible to receive benefits once the participant dies....they don't have to wait until someone else dies.

Charity X is the second tier beneficiary; it only inherits when all the first tier beneficiaries die (actually only when all the first tier beneficiaries and all issue of such first tier beneficiaries die—but we can't count those future unborn issue).

But the Charity is NOT disregardable! There is *no other beneficiary* who will inherit the trust outright upon the deaths of the [currently existing] first tier beneficiaries. *The only beneficiary who inherits outright under this trust is the Charity!* And because the Charity is therefore a countable beneficiary and it is not an individual, this trust flunks. It is a "Non-DB."

If drafting this trust, and wishing to assure that designated beneficiary treatment will apply, there are two ways to cure this problem. One is to use a last man standing provision: If at any time in the future there is only ONE living member of the class consisting of the donor's spouse and the donor's issue of all generations, the trust will terminate and be distributed outright to that one. This eliminates the charity and means all countable beneficiaries are individuals so you have a designated beneficiary. It does not carry out the participant's original charitable intent....but if the participant

really expects the trust to last for 1,000 years for the benefit of his descendants, charitable intent is not a high priority for him.

The other way is to choose some other INDIVIDUAL to be the wipeout beneficiary if all the participant's issue die. Again, this assures that all countable trust beneficiaries will be individuals and the trust can qualify as a designated beneficiary (but eliminates the charitable goal).

### 11. STEP 5: Determine the applicable denominator

Here is your reward for completing the first four steps: You now know who are your countable beneficiaries. Find your countable beneficiaries in the list below and that answer A-E will get you started on finding the distribution period applicable to your trust. Full details on the distribution period for a trust are found in PART 5 of this Outline and in Charts III and IV in Appendix B of this Outline.

A. If any of your countable beneficiaries is a nonindividual (such as the participant's estate or a charity) your trust is a nondesignated beneficiary (Non-DB), UNLESS the trust is a "Type II AMBT. For Type II AMBTs, certain types of charities are considered "designated beneficiaries, at least with respect to trusts of post-2022 decedents"; see PART 5, #2. But for any other type of trust, having a countable nonindividual beneficiary means the trust is a Non-DB. Ditto if the trust flunked Step 1. The distribution period for a Non-DB is the 5-year rule if the participant died before his RBD, otherwise the ghost life expectancy. See PART 5, #1.

B. If the trust is a conduit trust, the distribution period for the trust is exactly the same as it would have been for the conduit beneficiary(ies) if named directly as beneficiaries—e.g., 10-year rule for a plain old designated beneficiary, or life expectancy payout (with life expectancy redetermined annually) in the case of a conduit trust for spouse. See PART 5, #1.

C. If the trust is a Type II "Applicable Multi-Beneficiary Trust" (AMBT), see PART 5, #2.

D. If any countable beneficiary of the trust is a minor child of the participant, see PART 5, #3.

E. If all countable beneficiaries of the trust are EDBs (but none is a minor child-EDB), see PART 5, #4. For example, a conduit trust for the surviving spouse would have only one countable beneficiary (the spouse), who is an EDB.

F. If none of the above applies, the 10-year rule applies. All funds must be distributed no later than the year that contains the 10th anniversary of the participant's death. If the participant died after his RBD, annual distributions are required in years 1-9 based on the life expectancy of the oldest countable designated beneficiary, according to the Proposed Regulations; otherwise no distributions are required in years 1-9. Prop. Reg. § 1.401(a)(9)-5(d)(1)(i) (last sentence), -5(e)(1), (2); §1.401(a)(9)-3(c)(3), § 54.4974-1(c).

"At the end of the day" the new trust-testing rules are almost the same as the old trust-testing rules, with lots more detail filled in: 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 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 Proposed 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; trusts that are Non-DBs

"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 (see PART 5, #2); a trust that has at least one countable beneficiary who is a minor child-EDB (see PART 5, #3); and any trust all "countable" beneficiaries of which are EDBs (see PART 5, #4). "EDB treatment" 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 use the 10-year rule instead of the life expectancy payout if the participant died before his RBD (see PART 3, #4(C)), though this point is not explicitly stated in the Proposed Regulations (and the regulations allowing an EDB to elect the 10-year rule in cases of death before the RBD do not indicate whether such election would be made by the trustee or the EDB when the trust is the named beneficiary).

With one new and significant exception, a trust that has any countable beneficiary (PART 4, #10) that is not an individual (*i.e.*, the participant's estate or a charity), is automatically a Non-DB. (The new and significant exception is that a TYPE II AMBT may have a charity as beneficiary without losing DB status; see PART 5, #2.) The distribution period for a Non-DB (UNCHANGED by SECURE) is the 5-year rule if the participant died before his RBD, otherwise the "ghost life expectancy." See PART 3, #2 for details. Since the ghost life expectancy would be longer than 10 years if the participant died between ages 73 and 80, it is not always bad to be a Non-DB!

If the trust is not a Non-DB, and does not "qualify for EDB treatment," it will be a PODB.

## 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.

A Type II AMBT gets two special breaks under the RMD rules.

First, as a result of "SECURE 2.0" (enacted at the end of 2022), the normal requirement of a designated beneficiary trust that all countable beneficiaries of such trust must be individuals is softened: SECURE 2.0 allows a Type II AMBT to have a charity as a remainder beneficiary while still qualifying as a "designated beneficiary." The new Code language is in § 401(a)(9)(H)(v) (last sentence), added by SECURE 2.0 effective for participants dying after 2022: "any beneficiary which is an organization described in section 408(d)(8)(B)(i) shall be treated as a designated beneficiary described in subclause (II)." The organizations described in 408(d)(8)(B)(i) are all charities OTHER THAN donor-advised funds and supporting organizations. See § 408(d)(8)(B)(i).

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(C).

- 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 any 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. See PART 4, #10(B).

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.

**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, #10(C).

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 goes to 1 year 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 participant's 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 NoMoTTYYs), 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 brother 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 none of the above

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). See PART 3, #3(C).

### 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, with or without annual RMDs required in years 1-9 depending on whether the participant died before or after his RBD. See PART 3, #3.

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 sister 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 sister, so the oldest countable beneficiary is the sister 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 (12.6) 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, as here, 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 DB'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 participant's older sister had been the only countable trust beneficiary, she would have been subject to the "shorter of" outer limit rule. It would not appear logical to allow her more years of payout by "piggybacking" on the EDB status of a now-deceased minor child.

**8. Weird effects, cont.: Type II AMBT, Death after RBD, 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 D/CI beneficiary 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 several 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 it 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. See rulings collected at ¶ 6.3.02(B) of *Life and Death Planning for Retirement Benefits* (8th ed. 2019; www.ataxplan.com.

**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, #4(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 one "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 trusts that have a D/CI beneficiary. In the case of a trust that qualifies as a designated beneficiary, and that is named as beneficiary, and that "is to be divided immediately upon the death of the employee into separate trusts for each beneficiary," each subtrust shall be treated as a separate beneficiary if at least one beneficiary of the funding trust is a D/CI individual. See § 401(a)(9)(H)(iv), added to the Code by SECURE. The Proposed Regulations call this a "TYPE I AMBT." 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 trusts that had at least one D/CI beneficiary. This hope was dashed by the Proposed Regulations. **NOTE:** If any beneficiary of any of the subtrusts is a D/CI individual, ALL of the subtrusts receive separate account treatment—even subtrusts that do not have any D/CI beneficiary!

**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 funding trusts where at least one beneficiary is D/CI, "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, 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:

- 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 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 8, #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; curiously, 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. See PART 4, #8(F, G).

## 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)(5)(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 removed), does not in and of itself cause the trust to have non-identifiable beneficiaries. Prop. Reg. § 1.401(a)(9)-4(f)(5)(ii)(A), (5)(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 "retesting" 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/power holder would have a "power to appoint" trust property to or among some particular class of recipients effective upon the death of the power holder. 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 in a fiduciary capacity 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 views:

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 Regs: Potential appointees don't count (until POA exercised)

Under the Proposed Regulations, the trust does not flunk the identifiable test "merely because an individual (power holder) 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 the power is actually exercised in their favor. 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 benefits 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 may 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. Limitations on post-death modifications

The Proposed Regulations' generous provisions for post-death trust changes unfortunately leave us with strict limits on what other types of corrections can be made after death. For one thing, there is no mention of any ability to modify the *beneficiary designation form*.

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 to the trust. 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 8: SECURE AND PROPOSED REGS: OTHER MATTERS

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

The designated beneficiary(ies) of a pre-2020 decedent are "grandfathered" from the new minimum distribution rules imposed by SECURE (with one limitation discussed below). Prop. Reg. § 1.401(a)(9)-1(b)(2)(i). This means that the DB of a pre-2020 decedent can simply continue taking whatever RMDs are required each year under the ORIGINAL payout regime applicable to him or her with two exceptions:

- The DB's life expectancy must be adjusted for RMDs in 2022 and later years to reflect the IRS's new actuarial tables. See PART 3, #1(E), for how to do this.

- If the "grandfathered" DB dies after 2019 but before having withdrawn the entire account, the successor beneficiary is subject to a 10-year limit on how long he/she can continue to draw down based on the original DB's life expectancy. Prop. Reg. § 1.401(a)(9)-1(b)(2)(iii).

**Clara example:** Mother died in 2018, after her RBD, leaving her IRA to daughter Clara as designated beneficiary. Clara starting taking annual RMDs in 2019 based on Clara's life expectancy as computed in 2019. As the DB of a pre-2020 decedent, Clara is "grandfathered" from SECURE and its 10-year payout limit for DBs. In 2022, Clara adjusted her remaining life expectancy payouts to reflect the IRS's new actuarial tables (see PART 3, #1(E)). She dies in 2023, leaving the inherited IRA to her siblings Jack and Jill. The account is now divided and transferred into inherited IRAs titled "Mother, f/b/o Jack" and "Mother, f/b/o Jill" or ("Jack [or Jill] as successor beneficiary of Mother"). What is the payout period for these "double-inherited" IRAs?

Assume Clara's (adjusted) remaining life expectancy as of 2023 was 18 years. Jack and Jill will take the RMD (1/18th of the account) that Clara would have taken in 2023 (if Clara had not taken it before she died), and continue to take RMD payments based on Clara's remaining life expectancy through 2032: 1/17th in 2024, 1/16th in 2025, etc. However, in 2033, even though Clara's life expectancy would not run out for several more years, Jack and Jill must withdraw 100% of the account. The "original" DB (Clara) is "grandfathered" from SECURE, but if the original DB dies after 2019 the successor beneficiaries are not grandfathered—their ability to continue Clara's life expectancy payout is capped at 10 years. Prop. Reg. § 1.401(a)(9)-1(b)(2)(iii).

Here are variations on the Clara example:

- **If Clara had died in 2020, or 2021, rather than in 2023**, Jack and Jill would actually not have to withdraw RMDs (other than Clara's year-of-death RMD) in 2021 and/or 2022!

Because of confusion about what the rule was, the IRS said it will not enforce RMDs for such successor beneficiaries for those years. See 1C below.

- **If Clara, the original DB, had died in 2019 rather than in 2023**, then Clara (like Mother) would have died before 2020. In that case the 10-year rule never kicks in and Jack and Jill as successors to the 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).

**1B. 10-year limit applicable to successor benes of pre-2020 decedents**

Here is how we get to that 10-year limit on payouts to Jack and Jill as successor beneficiaries to Clara (who was the post-2019-deceased DB of a pre-2020-deceased participant): 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)."

Translating this to English: 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 10$^{th}$ 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) no later than the year that contains the 10$^{th}$ anniversary of the DB's death. (Of course it would end earlier if the DB died less than 10 years before the end of his "life expectancy.")

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 10$^{th}$ 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.

### 1C. Notice 2002-53 eliminates 2 years of RMDS for some successor benes

Because the requirement of annual RMDs in years 1-9 for the successor beneficiaries of a pre-2020 decedent was a surprise to some and/or unclear to many, the IRS issued a Notice that it will NOT enforce the 50% excise tax (§ 4974) against these successor beneficiaries for the years 2021 and 2022. Thus, these successor beneficiaries can just skip those years and start taking RMDs in 2023; there is no need to file Form 5329 to request a penalty waiver and no need to take a catchup distribution. See IRS Notice 2022-53 (October 2022) and PART 3, #1(F).

### 1D. Pre-SECURE deaths, cont.: Multiple DB's; trust as DB

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 for successor beneficiaries? 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"—the trust 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.

**1E. If the DB of pre-2020 decedent elected the 5-year rule**

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)(3)(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 come up 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 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 hefty excise tax 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 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 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). The "beneficiary" could be either a trust or an

individual or even an estate, since every beneficiary of a participant who dies after his RBD is required to take the year-of-death RMD if not taken by the decedent prior to death, regardless of whether such beneficiary is a "DB."

According to what standard will the Commissioner "determine otherwise?"

See Appendix D regarding more new developments concerning the excise tax for missed RMDs (courtesy of SECURE 2.0, 2022).

### C. 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 the Applicable Age (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 year the participant attains the Applicable Age (or retires, whichever is applicable) and accordingly, if distributed in that year, may not be rolled over. Prop. Reg. § 1.402(c)(2)(f)(1). This is as already provided in Reg. § 1.402(c)-2, A-7(a) and § 1.408-8, A-4. See ¶ 2.6..03(A) of *Life and Death Planning for Retirement Benefits* ($8^{th}$ ed. 2019).

### D. Clear statement that rollovers ok before first distribution year

Any amount distributed before the participant's first "distribution year" (the first year for which distributions are required...i.e., the year in which he attains the Applicable Age or retires as the case may be) 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). Again, not a new rule, but clearly stated for the first time.

### 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, further changes in the starting age for RMDs were enacted as part of SECURE 2.0; see Appendix D.

## PART 9: 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 a 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 2023) at just $14,450 of taxable income vs. $578,125 for a single individual taxpayer. PODB's income is much lower than $578,125.

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 2023, PODB would have to withdraw the entire balance by 12/31/2033 (year containing the 10$^{th}$ anniversary of client's death). PODB could withdraw the balances anytime during the years 2023-2033, thus giving him 11 taxable years to "spread out" the distributions.

If client dies AFTER his required beginning date (April 1 of the year after the year he reaches the Applicable Age), the payout period for the Roth IRA wouldn't change—it would still be the 10-year rule as described above. However, according to the Proposed Regulations, 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(C). 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. It was such a surprise, the IRS said it will not enforce the 50% penalty tax on certain PODBs who fail to take RMDs in 2021-2022; see PART 3, #1(F).

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, #2).

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, #7.

Once you clear those hurdles you have a "See-through Trust."

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 definition.

*All* of the trust beneficiaries must be individuals? Well not necessarily ALL: First, there is an exception to this rule for Type II AMBTs; see PART 5, #2. Second, only the *countable* beneficiaries must be individuals—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, #7-#10.

This brings you to a decision point that will have to be faced with many 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, #11) 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 originally requested.

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, #9. If the trust is not a Type II AMBT, all countable beneficiaries (PART 4, #10) 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**. PART 4, #8(B). 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 client 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, and to a designated Roth account if he dies in 2024 or later.

- 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 15 years (if he dies at age 74) 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 after his RBD and between ages 74 and 80! (See Appendix C.)

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 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. 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 "first choice second tier beneficiaries" predecease the "first tier beneficiary." Prop. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)(1); see PART 4, #10(C).

**D. Do this! 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), the participant does not have a designated beneficiary and 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.

- 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 (where the trust could spread distributions over whatever RMD payout period applies) 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 sounds just right to her for this IRA, as long as he does not have to inherit as outright beneficiary in order to get that treatment.

**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= second tier;
BUT charity is disregarded because [1] it is not a first tier beneficiary and [2] it inherits only if all nieces & nephews (the "first choice second tier guys") die prior to SS. See PART 4, #10(C).

However, unless ALL of the nieces and nephews are either disabled or chronically ill or not-more-than-10-years-younger (NoMoTTYY) than Jean, 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 or NoMoTTYY), but that is not the case. See PART 5, #1, #4. If written as client has described it, this trust would only qualify for the 10-year rule (PODB treatment).

One solution is to use 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, or applied for his benefit). It would not be able to take IRA distributions and accumulate them in the trust's taxable account for future use.

Before recommending the conduit trust, 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 trust for the spouse that would qualify for a payout 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 draft a separate article or section of the trust 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 (i.e., the RMD). 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 inside 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 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 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 amounts 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 "second tier" beneficiaries...and because it's a *conduit trust* the second tier beneficiaries are disregarded, and therefore SS is the sole countable beneficiary, and 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 the Applicable Age or year after Jean's death, and life expectancy recalculated annually. [Note: This would not allow the trust to use the "spousal rollover" that SS could use if he were named as outright beneficiary. A trust for the spouse may not use the spousal rollover or election to treat an inherited IRA as the spouse's own IRA even if the surviving spouse is deemed to be the sole beneficiary of the trust for RMD purposes.]

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.

Query: In other sections of the Proposed Regulations, certain events that *could* happen after the participant's death (namely reformation or decanting of the trust, or exercise of a power of appointment) are ignored in "testing" a trust for RMD purposes until the event actually *does* happen. See PART 7,#7. This liberal approach does not apply, apparently, to a contingency dependent on the spouse's remarriage. Effectively the Proposed Regulations assume the surviving spouse WILL remarry so whether or not he actually does, the nieces and nephews move up to being first tier beneficiaries. See Proposed Regulations, "Preamble," p. 7.

### 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. Another possible advantage of a trusteed IRA is (depending on the extent to which the final regulations follow the proposed regulations on this point), the client could specify in the IRA agreement that the 10-year rule would (or would not) apply to the IRA if the client died before (or after) his RBD. See PART 3, #4(C).

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: Mr. & Mrs. Steinmetz: Providing for minor children**

## 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 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 21$^{st}$ birthday under the Proposed Regulations. 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 31$^{st}$ birthday itself). Also note: 100% distribution is required in the year that contains the 10$^{th}$ anniversary of 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 have substantial control of the distributions from the retirement account: The trustee would of course have to withdraw from the account, each year, the RMD for such year...but the RMDs would be small (due to the child's long life expectancy...*e.g.* 69.9 years at age 15–see Appendix C—meaning the RMD for a $500,000 IRA would be $7,153) and the trustee can "apply" that distribution "for the benefit of" the minor (e.g., paying tuition bills diretly from the trust) rather than distributing the cash to the child. The trustee can determine whethrr to take any distributions beyond the RMD (with all such distributions being immediately paid to or for the benefit of the child). control the rate of distributions from the retirement accountuntil 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 it is not necessary to use a conduit trust to get these two advantages—if they are willing to have the money pass outright to the child 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 <u>do not have to use a conduit trust</u> 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). See PART 4, #10(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* minor children-EDBs?

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 ["until there is no child of mine living who is under age 25"], at which point any remaining funds are paid out to the the surviving children equally (and issue of a deceased child, if any).

### C. What are the annual RMDs for this trust?

Before we can draft this trust, 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 our Uncle Oscar 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 trust is entitled to "eligible designated beneficiary" treatment, meaning that the life expectancy payout will apply. Prop.

Reg. § 1.401(a)(9)-4(e)(2)(ii). The life expectancy used will be that of the *oldest countable beneficiary*. Prop. Reg. § 1.401(a)(9)-5(d)(2)(ii), (f)(1)(i).

The oldest potential beneficiary is Uncle Oscar. At age 63, his life expectancy is 24.5 years. The Steinmetz's oldest child is 12; his life expectancy is 72.9 years! Can Uncle Oscar be disregarded? As explained in the "How to Test a Trust" section of this Outline, the Proposed Regulations tell us Uncle Oscar (as a "second tier" beneficiary) can be disregarded if he can only inherit the trust if his inheritance is conditioned on the death of a first-tier 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 would receive the benefits outright by age 31, but Uncle Oscar would inherit the benefits if such child dies before age 31, Uncle Oscar would be disregarded. But under the Steinmetzes' proposed trust Oscar's inheritance is contingent on FOUR first tier beneficiaries' dying before they are *all* over age 25.

By the time the Steinmetzes' youngest child (now age 2) reaches age 25, the oldest child (now age 12) will be age 35—i.e., older than age 31. So 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.

One more note: If the Steinmetzes use a "pot trust" for the children as a group, with the oldest child's life expectancy as the initial payout period for the retirement accounts, are they "wasting" the even longer life expectancy of their youngest child? As one practitioner put it, the youngest child is being "forced to use the life expectancy of the oldest child." 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.

**D. What is the Outer Limit Year for this trust?**

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 Steinmetzes' oldest child is now age 12, the age-based termination will occur19 years from now (when the oldest child turns age 31), at which time the *youngest* child (now age 2) will be age 21. 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: Suppose Mr. and Mrs. Steinmetz 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 will reach age 31). But what if the oldest child dies at age 14? While extremely unlikely, this event is possible. His death would trigger the termination of

EDB status for the entire trust...and the IRA would have to be paid out in just *12 years* after the parents' deaths not 19 years. The youngest child will be only 14 when the IRA is fully distributed to the trust. **That's a big acceleration** and **may force the parents to consider another plan.** (Reminder: The premature death of the oldest minor child-EDB would cause the IRA to be distributable much earlier than was planned—but that fact would not accelerate the termination of the trust itself...the trust would still not terminate until all children were over age 25 (or earlier deceased). The trustee would hold the after-tax proceeds of the IRA in trust until that point, meanwhile using such proceeds for the purposes specified in the trust instrument.)

**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.

Should these clients 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 have to be payable in predetermined shares (*e.g.* equally) 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 want? 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 (and premature death, if it occurs) of the oldest minor child. Though hypothetical tax savings based on using *each minor child's* own life expectancy for his/her share are not normally a significant planning factor, the tax savings from using a younger rather than an older "wipe-out" beneficiary may be...and the risk of unexpected early termination due to premature death of the oldest minor child needs to be considered.

### E. 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? Have the trustee buy term insurance on the oldest child? What if the oldest child is sickly and uninsurable?
- 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, when the death of both parents during the childrens' minority is an unlikely event and the assets are not substantial enough to justiry administration of so many trusts?

### F. 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 second-to-die life insurance on the young parents (very cheap) to cover the gap, rather than trying to increase the pot by squeezing extra post-death 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," 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.

### G. 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 directly 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" and "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 IRAs to their own grantor trusts, but the only IRS mention allowing such transfers by the IRA owner during life was hostile. 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: The Dingles: 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.

WARNING: This case study is about planning for the clients' disabled child. If the participant's intended beneficiary is a D/CI individual who is OLDER than the participant, leaving the benefits outright to such beneficiary will cause a more rapid distribution of the benefits than leaving the benefits to a Type II AMBT (see "C") for such beneficiary's benefit, if the participant dies after his RBD. See PART 3, #4(F).

**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 seek 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 *exclusive life 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, subject to an outer limit requirement: 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 remainder beneficiaries will also be "countable beneficiaries." This in turn NORMALLY means that the remainder beneficiaries must be "individuals" (i.e., people!) who will receive the trust property immediately and outright upon the death of either Daisy herself or some other trust beneficiary. However, under a special dispensation for Type II AMBTs, due to an amendment of the law made by SECURE 2.0, most types of charities could also be named as remainder beneficiaries without causing the trust to lose DB status (at least with respect to participants dying after 2022); see Appendix D.

- Second, the trust must provide that distributions from the retirement account (including proceeds thereof) may not be paid 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 these requirements, 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 (or a permitted charity) at her death. This would make the trust a DBT since Daisy would be the first tier beneficiary and her siblings (or the permitted charity) are the second tier beneficiaries, and they are all individuals or permitted charities so they count as "designated beneficiaries." If Daisy's siblings are the remainder beneficiaries, and there is a contingent or wipeout beneficiary that would inherit at Daisy's death only if her siblings predeceased her, that contingent beneficiary is disregardable. See PART 4, #5-#10.

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 (or a permitted charity).

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), or (if the participant dies after 2022) to a permitted charity, the trust qualifies as a Designated Beneficiary Trust. The applicable distribution period (ADP) for required minimum distributions (RMDs) to this trust under the Proposed Regulations 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 trust tax rates to the extent the retained distribution exceeds the trust's exemption and lower-taxed income brackets. This result is presumably consistent with Congress's goal of benefitting a disabled individual without allowing other family members to piggyback on this disabled individual's status to get tax deferral.

- 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 retirement benefits 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 beneficiary

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. See PART 9, Case #7.

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 with 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 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 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 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 siblings only recently died, at ages 98 (mother) and 102 (father); they were killed when struck by lightening while hiking in Baxter State Park, Maine, with their many siblings. Longevity is a feature on both sides of Beverly's family tree.

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

### B. Three trust choices to get 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 ("second tier") 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 "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 no longer provides a financial cushion. 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 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 and 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 cut 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 nieces and 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: Hiram: Leaving 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 $400,000 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, education, and care into adulthood for minors 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 of the participant, Hilda, age 16, and Harry, age 12, who are EDBs. 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 of the trust. The life expectancy of the oldest MINOR? No...of the oldest countable trust beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). That would be wife Holly, age 46 (assuming Hiram 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 <u>a little better</u> 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 (to 11 years if Hilda is 20 when Hiram dies)...but then it pops back up again to 14 years when Hilda turns 21 because then Harry (four years younger than Hilda) becomes the "oldest minor child-EDB" so the Outer Limit Year becomes when *Harry* turns 21 (or earlier dies). Unless Hiram has some more children, the trust will not "do better" than the 10-year rule once baby Harry (now 12) reaches age 21 (because after that point there will be no more minor child-EDBs).

"Screwy" is how I would describe the above 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 retirement benefits among separate trusts for different beneficiaries. 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:

- Leave some IRA assets to wife Holly, 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 at age 28.

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

- Hiram might consider weighting the Roth IRA to oldest-child 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 slicing and dicing does benefit Hiram's estate plan 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, a child who succeeds to the share of another child due to such other child's death cannot be considered a "second tier" beneficiary because all the children are already in the first tier. *The IRS Proposed Regulations' testing system 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 the charity is a countable second tier beneficiary and (except in a Type II AMBT; see Appendix D) you can't have a nonindividual beneficiary be "countable" because then you don't have a designated beneficiary.

In a semi-normal world, Hiram would then name some relative such as his Uncle Oscar age 73 as the wipeout beneficiary. 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 wife 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 individual as your 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.

**Case #7: Wallace: 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 $600,000 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 administrator 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.

If the charitable gift is made through a trust, additional complexities arise:

**Wallace's Trust:** Wallace dies, leaving $10 million of assets, including $4 million of retirement accounts to a trust. The trust provides that 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 Wallace's two children, Wallace Junior and Lucinda, and another charity. Upon Wallace'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 ten $100,000 "pecuniary" charitable gifts or the $3 million charitable "residuary" gift. The trustee could cash out the $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 the stringent rules of Code § 642(c). For full explanation of those rules see and the ideas discussed below see ¶ 7.4 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...then the trust gets its income tax charitable deduction, no problem. See example in PLR 2016-11002. [Note: It is not recommended to use the phrase "income in respect of a decedent" (IRD) when specifying the source of funds for payments to charity. 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 independent "economic effect." Reg. § 1.642(c)-(3)(b)(2); § 1.643(a)-5(b). Even though IRD has never been defined as a "class of income," there is nothing that says it is NOT a "class of income." A retirement account is an asset, not a "class of income."]

But Wallace is deceased so it is now too late to add these words to the trust. The trustee can "fix the problem" with respect to the *residuary* bequests to charity by transferring the IRAs directly to those charities (rather than withdrawing money from the IRA and giving the money to the charity), but (according to the IRS) not with respect to the *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. This IRS position appears to directly violate the Code's rules for "income in respect of a decedent"; see ¶ 4.6,03 of *Life and Death Planning for Retirement Benefits*. However, the trustee can shift IRA income to the *residuary* charitable beneficiary by transferring a $3 million inherited IRA to the charity intact. See **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.

## 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 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.

Here is a summary of the 7 facts of FIT (Fiduciary Income Tax) "in English." For more detail on these rules, see ¶ 6.5 of *Life and Death Planning for Retirement Benefits* (8th ed. 2019; www.ataxplan.com.

### 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 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. But 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. See Chapter 7 of *Life and Death Planning for Retirement Benefits* for how to do this.

**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, JD

You must read this introduction to understand the charts

These charts summarize the minimum distribution requirements for certain beneficiaries of a retirement-account owner ("participant") **who dies in 2022 or later** according to the proposed Treasury regulations issued in February 2022. Prop. Reg. § 1.401(a)(9)-2. If participant died before 2020, see PART 8, #1A-#1E, instead. Effective date may be later for certain annuities and collectively bargained retirement plans, not covered in this Outline. The rules in these charts were affected for years 2021 and 2022 for some beneficiaries by Notice 2022-53; see PART 3, #1(F). The proposed regulations do not reflect the (very few) changes made by SECURE 2.0 (2022); see Appendix D; the changes regarding the "applicable age" for RMDs have been included in the Charts.

Charts I and II summarize the requirements applicable to one beneficiary. For multiple beneficiaries, see PART 3. Charts III and IV summarize the requirements applicable to a trust named as beneficiary. The regulations are not final, and so may change. 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" was. 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 distributions (required or otherwise).

To use the charts you need the following information; see PART 3 of this Outline for detail::

1. Did the decedent die **before or after** his required beginning date (RBD)? You can NOT figure out any beneficiary's RMDs without knowing whether the decedent died before, or on/after, his RBD with respect to the particular IRA or plan account you are concerned with.

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 (NoMoTTYY) 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) (see Appendix C, "Table 2"). 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*.

**Chart I: RMDs for one individual beneficiary or the estate**
**Participant died after 2019 and 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, 4) unless 10-year rule applies (Note 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. |
| EDB: Minor child of participant | None | Annual distributions over beneficiary's life expectancy (Note 2) unless 10-year rule applies (Note 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 (Note 2) unless 10-year rule applies (Note 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 or other non-individual) | 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; age 73 if born after 1950 [see Appendix D]). 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 to the successor beneficiary as if the S/S "were the employee." § 401(a)(9)(B)(iv)(II); Prop. Reg. § 1.401(a)(9)-4(d). For 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 or 73 if applicable), whichever is later (regardless of when distributions actually commence). Prop. Reg. § 1.401(a)(9)-3(d). Any distribution to 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.

2. Life-expectancy RMDs to a non-spouse EDB commence year after year of participant's death. Prop. Regs. § 1.401(a)(9)-3(c)(4), § 1.401(a)(9)-5(a)(2)(iii). [Rule appears 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 participant 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). If the 10-year rule applies under these provisions, see "PODB" instead of S/S or EDB. The ability of the participant or EDB to elect for use of the 10-year rule instead of the life expectancy payout for EDB applies *only* if participant died before RBD; compare CHART II. However, this limitation does not seem to apply to a PLAN PROVISION mandating use of the 10-year rule for some or all EDBs—that can apply in cases of death both before and after the RBD.

4. The S/S also has the option to "roll over" distributions to him or her 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)(i)(A).

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 Participant Died after 2019 and ON OR AFTER his/her Required Beginning Date**

| 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 (S/S) | Yes if not taken by participant (Note 3) | Annual distributions over longer of spouse's life expectancy or decedent's ("ghost") life expectancy (Notes 1, 2, 4). | Earlier of year that contains 10th anniversary of S/S's death or final year of S/S's life expectancy. (Notes 5, 6, 7) |
| EDB: Minor child of participant | Yes if not taken by participant (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 participant (Note 3) | Annual distributions over longer of EDB's life expectancy or decedent's ("ghost") life expectancy (Note 2). | Earlier of: Year that contains 10th anniversary of EDB's death or final year of EDB's life expectancy. (Notes 5, 7) |
| PODB | Yes if not taken by participant (Note 3) | Annual distributions over the PODB's life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). See Notes 8, 10. | Earlier of: (1) year that contains the 10th anniversary of the participant's death or (2) final year of the beneficiary's life expectancy. (Notes 2, 8) |
| Non-DB (participant's estate) | Yes if not taken by participant (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 participant'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 participant'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 year of 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 participant'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 participant'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)(i)(A).

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. 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. 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 participant, 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 participant to withdraw the entire balance within 8 (approximately) years rather than (approximately) 11 years?

8. The rule for PODBs in case of participant's death after the RBD is the 10-year rule limit, unless the payout ends earlier under the "longer of" (PODB's or participant'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 participant, the PODB would be an EDB! ("Not more than 10 years younger..."). So for practical purposes, in case of participant'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 fact that annual life-expectancy payouts are required even when the 10-year rule applies (in cases of death after the RBD—based on the IRS's interpretation of the "at least as rapidly" rule of § 401(a)(9)(B)(i)) was a shocker when it first appeared in the Proposed Regulations.] 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 II does not cover trusts or multiple beneficiary situations.

9. The "shorter of" rule normally applicable to an EDB under Prop. Reg. § 1.401(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. No penalty for missing the RMDs for 2021-2022 however. See Notice 2022-53 and PART 3, #1(F).

**Chart III: RMDs to a Trust Named as Beneficiary of a Retirement Account ...if Participant Died after 2019 and BEFORE RBD**

NOTES FOR THIS CHART APPEAR AFTER CHART IV

SEE NOTE 1 FOLLOWING CHART IV BEFORE ATTEMPTING TO USE THIS 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. | None | Year that contains 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. | Same as would apply if that PODB or EDB were named directly as beneficiary. See Chart I. |
| Type II AMBT | Annual distributions over life expectancy of oldest countable D/CI beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(1)(ii). 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). |
| 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). 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). |
| DBT which is none of the above, but all beneficiaries of which are EDBs | Annual distributions over the life expectancy of the oldest countable beneficiary of the trust. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). See NOTE 1. | Year of 10th anniversary of death of oldest countable beneficiary. Prop. Reg. § 1.401(a)(9)-5(e)(1), (3), (f)(2)(i). |
| DBT trust which is none of the above | 10-year rule applies; no annual distributions. | Year containing 10th anniversary of the participant's death. Prop. Reg. § 1.401(a)(9)-5(e)(2). |

## Chart IV: RMDs to a Trust: if Participant Died after 2019 and AFTER RBD

In all cases, the trust must 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, in addition to RMDs indicated below.

SEE NOTE 1 ON NEXT PAGE BEFORE ATTEMPTING TO USE THIS 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. Note 4. For a PODB, Note 5. | Same as would apply if that PODB or EDB were named directly as beneficiary. See Chart II. Note 3. |
| Type II AMBT | Annual distributions over life expectancy of oldest countable D/CI beneficiary (or, if longer, ghost life expectancy). Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). Note 4. | 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). Note 3. |
| DBT which has at least one countable minor-child-EDB | Annual distributions over life expectancy of oldest countable trust beneficiary or ghost life expectancy if longer. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii), (f)(1)(i). Note 4. | 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). Note 3. |
| DBT which is none of the above, but all countable beneficiaries of which are EDBs | Annual distributions over life expectancy of oldest countable beneficiary of the trust or ghost life expectancy if longer. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii), (f)(1)(i). Note 4. | Year that contains 10th anniversary of death of the oldest countable beneficiary of the trust. Prop. Reg. § 1.401(a)(9)-5(e)(1), (3); (f)(2)(i). Note 3. |
| DBT trust which is none of the above | Annual distributions over life expectancy of oldest countable trust beneficiary or ghost life expectancy if longer. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii), (f)(1)(i). Note 5. | Year that contains the 10th anniversary of the participant's death. Prop. Reg. § 1.401(a)(9)-5(e)(2). |

## NOTES TO CHARTS III and IV

### NOTE 1: APPLICABLE TO BOTH CHARTS:

Charts III and IV summarize the information provided in PART 5 of this Outline, "HOW TO DETERMINE THE APPLICABLE DENOMINATOR FOR A TRUST." To use Charts III and IV, you must FIRST determine who are the "countable beneficiaries" of the trust you are testing; see PART 4. You cannot use Charts III and IV unless you have first read and understood PART 4 of the Outline, "NEW RMD RULES FOR TRUSTS; HOW TO TEST A TRUST." To determine the countable beneficiaries, you will also need to learn along the way the difference between a designated beneficiary trust (DBT) and a trust that does not qualify as a designated beneficiary and the difference between a conduit trust and an accumulation trust. *See PART 4!!!!*

### NOTE 2: APPLICABLE TO CHART III WHERE INDICATED:

If the participant died before his 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 an EDB to elect the 10-year rule instead of life expectancy payout; OR allow the participant to elect that the 10-year rule shall apply to the EDB instead of life expectancy payout. Prop. Reg. § 1.401(a)(9)-3(c)(5)(ii), (iii). If the beneficiary is a trust with EDB beneficiary(ies) it is not known whether the trustee or the EDB individual or neither could make the election; the Proposed Regulations do not cover this point.

### NOTE 3: APPLICABLE TO CHART IV WHERE INDICATED:

Results in this box MAY NOT APPLY if the EDB is older than participant so ghost life expectancy applies. See "**Weird effects**" in the Outline (PART 5, #7 [minors], #8 [D/CI individual]).

### NOTE 4: APPLICABLE TO CHART IV WHERE INDICATED:

The retirement plan may require that the 10-year rule "will apply" to some or all EDBs in place of the life expectancy. Prop. Reg. § 1.401(a)(9)-3(c)(5)(ii). Unlike in the case of participant death BEFORE the RBD, the Proposed Regulations do not specify that the participant or EDB could elect the 10-year rule instead of the life expectancy payout (compare Prop. Reg. § 1.401(a)(9)-3(c)(5)(iii)).

### NOTE 5: APPLICABLE TO CHART IV WHERE INDICATED

For a PODB (but not an EDB), RMDs for the years 2021 and 2022 may be "skipped" without consequence in this case; see discussion of Notice 2022-53, PART 3, #1(F).

# Appendix C: The New (2022) Life Expectancy Tables

Effective for 2022 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. For how to apply this table to determine RMDs for the nonspouse designated beneficiary of a pre-2021 decedent, see PART 3, #1(E), of this Outline.

## 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 | 42.9 |
| 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**

See preceding page for how to apply to nonspouse designated beneficiary of a pre-2021 decedent.

## 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 | | |

## Appendix D: Estate Planner's Guide to SECURE 2.0

Unlike "SECURE 1.0" (2019), SECURE 2.0 (2022) did not upend the world of estate planning for retirement benefits. It made only one narrow change in the RMD rules for inherited retirement benefits (allowing "Type II AMBTs" to have charity(ies) as remainder beneficiary(ies); see 337 below), a slight change in the age for lifetime RMDs (see 107), and a minor change in clients' transfer options for retirement accounts (allowing charitable "split interest" donations of up to $50,000 from an IRA; see 307).

Almost all of SECURE 2.0 is aimed at increasing retirement savings among lower-income workers, for example by increasing automatic enrollments and encouraging portability. There are numerous changes to the pre-age-59½ distribution rules, along the lines of allowing more such distributions, on more generous terms. Along the way to those goals, the law made several changes that are likely to impact lifetime planning for clients' retirement accounts, by increasing some plan contribution limits and increasing Roth availability...as well as changes that will affect clients who get in trouble with their retirement accounts (shortening the statute of limitations for some IRS actions on IRA mistakes; reducing the penalty for missed RMDs). Here is my **quick guide** to the SECURE 2.0 provisions that will affect (at least some) of our estate planning clients. The number at the beginning of each paragraph is the section of SECURE 2.0 that contains the change:

**107: Raising age for start of lifetime RMDs**. Amending § 401(a)(9)(C)(i)(I): RMD age changed from 72 to 73 for 1951 (and later) babies, effective 2023. The RMD age is to be called the "applicable age." The "applicable age" will increase to 75 in 10 years.

Some planners seek to include a "toggle" in their trust instruments whereby a trust will be changed from "designated beneficiary" (DB) status to Non-DB status if the "ghost life expectancy" payout would be more favorable than the 10-year rule. Some propose doing this by including a clause that would trigger the toggle "If I die between the ages of X and Y." But with the starting age for RMDs now a moving target, toggles based on dying at a particular age are not recommended.

**108 and others: Increasing some plan contribution limits.** These provisions indirectly affect estate planning by increasing plan contribution limits and Roth contribution opportunities, *e.g.*: amending § 219(b)(5) "catchup contributions" to IRAs (now stuck at $1000) to increase for inflation *(i.e.*, adding a "cost of living adjustment" or "COLA" to the base number); higher catchup contributions for certain ages; and permitting more Roth accounts inside employer plans (*e.g.* for matching contributions).

See Mike Harris LISI article "Have We been Looking at RMDs from Inherited Retirement Accounts Wrong for Decades?" (*Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter* - Archive Message #798, 1/23/23) re creative estate planning idea: use "10 year rule" distributions from an inherited IRA to (*e.g.*) a grandchild of deceased participant to permit the beneficiary to maximize his/her own Roth plan contributions—like an inter-generational rollover.

**201: Adds § 401(a)(9)(J):** Affirms that a defined contribution plan account can purchase a commercial annuity with various features such as COLA (less than 5%/year), commutation feature, and death benefit equal to purchase price minus payouts. Effective 2023. Note that the COLA must be *less than* 5% per year! So max is....4.99999% per year? The purpose is to bless certain routine annuity contract features that might otherwise run afoul of IRA etc. rules, thereby easing the path of purchasing an annuity inside a retirement account.

**202: Amends rules for QLACs.** Effective 2023, repeals the 25%-of-account limit for purchase of a "qualified longevity annuity contract" for IRAs and increases the dollar limit to $200,000 (with COLA). This change is especially important for planning for a disabled client needing to shelter IRA assets in an annuity to qualify for Medicaid. Stephen Silverberg, Esq., has written most thoroughly about this change; see article published in *Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter* in February 2023.

**204: Allows aggregating "annuitized" and "non-annuitized" portions of account for satisfying RMD.** Under existing law, created by Regulation § 1.401(a)(9)-6, an individual can purchase an annuity contract inside his IRA or other defined contribution retirement plan account, provided the contract meets RMD requirements established in the regulation (*e.g.*, it must be for a period no longer than the life of the participant or the joint lives of participant and his spouse, etc.). If an individual "annuitized" a portion of his account (that is, used some of the account to purchase a permitted annuity "inside" the account), the IRS's regulations required that the two portions of the account (annuitized and non-) be treated as two separate accounts for RMD purposes, starting the year after the year of the purchase: Distributions from the annuity would be treated as "RMDs" from the annuitized portion of the account, and RMDs from the non-annuitized portion would be computed in the usual way (but excluding the value of the annuity contract from the "year end account value" into which the applicable life expectancy number is divided). SECURE 2.0 requires the IRS to amend this regulation to allow the participant the option of combining the two portions of his account for RMD purposes, and then compute RMDs in the usual "defined contribution" way: so the value of the annuity contract will be included as part of the total account value, and the distributions under the contract made in that year will count towards the RMD for such year. Effective immediately upon enactment! And since the IRS obviously could not turn around its regulations in time for 2022 RMDs to be computed differently, the taxpayer's good faith interpretation of this provision may be relied upon to satisfy his RMD obligation! There must be some Senator who was really aggrieved about not being able to count his annuity contract payout as part of the RMD from his IRA. Note: SECURE 2.0 talks about buying an annuity "in the account." Usually if an IRA purchases an annuity contract there is actually a separate IRA set up that contains only the annuity. Since a person's own IRAs are "aggregated" for minimum distribution purposes, there should be no problem with using separate IRAs for annuity and nonannuity assets.

**302: Significant changes to "penalty" structure for missed RMDs, effective 2023.** The 50% excise tax (often referred to as a "penalty") on missed RMDs is reduced to 25%. § 4793(a). Although the Code provision allowing the IRS to waive the penalty when the RMD-miss was due to "reasonable error" and "reasonable steps" are being taken to remedy the shortfall, is

unchanged, an additional procedure is introduced (§ 4974(e)) whereby a self-reporting RMD-misser can report the missed RMD, take it late, pay a 10% penalty, and get off with that.

At first the change appears beneficial (less harsh on RMD-missers) but since the IRS ALWAYS granted waiver of the 50% tax for reasonable cause, and there is no known case where someone did NOT have reasonable cause for missing his RMD, it's not clear who is going to opt for the 10% middle ground. Some speculate that the IRS is going to regard 10% as a minimum penalty, with no (or less easily granted) waivers for "reasonable cause." See also 313, below.

**307: QCDs to split-interest "entities" allowed. New Code subsection 408(d)(8)*(F)*.** An individual over 70½ can already give up to $100,000 via direct transfer from his IRA to a charity (other than a DAF or supporting organization). SECURE 2.0 now permits that IRA owner to make a ONE TIME transfer of up to $50,000 to a charitable remainder trust or to a charity in exchange for a charitable gift annuity. The $50K comes out of the $100K per year limit; it does not increase the limit to $150K. SECURE 2.0 adds a COLA to the $100K and $50K limits starting in 2024. There are several restrictions on these "split interest" donations: the life income payout must: be only to the IRA owner (and/or spouse) be nonassignable, commence within a year, and be at least 5%. All distributions received under the trust or annuity will be treated as ordinary income with zero basis. No other contributions may be made to the entity and the IRA owner's (and spouse's) interest(s) must be nonassignable.

Two experts are very unenamored of this new planning option and consider it a bad deal for most/all clients, at least with respect to transfers to a charitable remainder trust. See Ed Morrow, Esq., "New Qualified Charitable Distribution (QCD) Provisions in SECURE Act 2.0" (*Steve Leimberg's Charitable Planning Newsletter* - Archive Message #375, 2/6/23) and Paul Hood, Esq., "Extending the Use of Regular IRA QCDs to Fund Split-Interest Vehicles: Where's the Beef?" (*Steve Leimberg's Charitable Planning Newsletter* - Archive Message #327, 2/8/23).

**313: New statute of limitations on imposition of excise tax on excess IRA contributions and missed RMDs, and new definition of "return" for these taxes.** Effective immediately (i.e. for year end 12/31/22), the "return" that must be filed to start that statute of limitations running for these errors is the 1040, NOT (as the IRS policy has been until now) Form 5329...and the statute will be 6 years not 3. The "return" change does not apply for cases of an IRA acquiring property at less than FMV.

While at first this appears as a great improvement (since most taxpayers do not file form 5329 routinely with their 1040's), the fact that it applies (apparently) only to RMDs missed in (and excess contributions made in) 2022 and later years means that the "unlimited" statute of limitations applicable to people who did not file form 5329 for pre-2022 years will continue.

**322: Prohibited transaction rules apply only to the IRA in which the PT occurs.** The punishment for having prohibited transaction in your IRA is that the entire IRA is disqualified...it ceases to be an IRA and is treated as if the entire account were distributed to

the IRA owner. Effective for 2023 and later years SECURE 2.0 “clarifies” that this disqualification applies only to the IRA in which the transaction occurred. The existing regulation on the subject (Reg. § 1.408-4(d)(1)) already seems to provide that. Since the committee report describes this change in the statute as a clarification, one wonders why they made it effective prospectively only.

**325: 402A amended to eliminate lifetime RMD requirement for “designated Roth accounts” (DRACs).** Effective starting in 2024. DRACs will now be like Roth IRAs—no lifetime RMDs. See new subsection 402A(d)**(5)**. What will be the effect of this change? It will be both good and bad. Good in that, until 2024 rolls around, the employee who has a DRAC and is approaching RMD age (73 as of this morning) had to roll his DRAC over into a Roth IRA to avoid getting hit with RMDs from the DRAC. Presumably there are/were DRAC-owning employees who didn’t know about this requirement and got stuck with some lifetime RMDs. Now that won’t happen anymore. But bad for trusts that are beneficiaries for such employees because now if that worker dies at (say) age 75 leaving both his DRAC and his “regular” (traditional) 401(k) account to a trust, his death will be “before the RBD” for the DRAC and “after the RBD” for the rest of the account. Good luck trustees in figuring this out!

**327: Amends § 401(a)(9)(B)(iv) regarding election of surviving spouse to be “treated as the employee.”** The dreaded § 401(a)(9)(B)(iv) rule, whereby a surviving spouse named as sole beneficiary of a participant who dies before his RBD, can elect (or be deemed to have elected) to treat the inherited account as the surviving spouse’s own account has long caused problems, primarily where a surviving spouse didn’t act, was “deemed” into ownership, and then died without having designated a beneficiary. See ¶ 1.5.07(C), ¶ 1.6.04, and ¶ 1.6.05 of *Life and Death Planning for Retirement Benefits*. Whether the SECURE 2.0’s changes to this process are intended to solve those problems or create new ones I have not determined. I will study this section eventually. In the meantime, see Ed Morrow’s article, “Secure 2.0 Offers Longer Stretch for Conduit Trusts, but Contains Traps for Surviving Spouses,” Steve Leimberg's Estate Planning Email Newsletter - Archive Message #3010, 1/24/23.

**337: Amends § 401 to allow a “Type II AMBT” to have a charitable remainder beneficiary.** § 401(a)(9)(H)(v) of the Code provides that if a trust qualifies as a designated beneficiary, and provides that the retirement benefits may not be paid to or for the benefit of anyone other than a disabled or chronically ill (D/CI) “EDB” during his/her lifetime, the trust will qualify for EDB treatment, i.e., a life expectancy payout. In order for a trust to qualify as a designated beneficiary all its “countable” beneficiaries must be individuals, so (prior to SECURE 2.0) a would-be AMBT that had a charity as remainder beneficiary would not qualify for AMBT/EDB treatment because it did not clear the “designated beneficiary” hurdle. Effective for 2023 and later years, for this type of trust, “any beneficiary which is an organization described in section 408(d)(8)(B)(i) shall be treated as a designated beneficiary...” The permitted organizations are the same as for qualified charitable donations from an IRA, i.e., any public charity other than a donor advised fund or a supporting organization.