HOW SECURE ARE YOUR CLIENTS?
PLANNING FOR DISTRIBUTIONS OF RETIREMENT PLANS AFTER THE SECURE ACT

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The SECURE Act (officially titled Setting Every Community Up for Retirement Enhancement Act or the "SECURE Act" for short), enacted by Congress on December 17, 2019, substantially changed post death distributions from a person's Retirement Plan[1]. Because of this change, the SECURE Act will affect estate planning for these benefits going forward.

I. **OVERVIEW**.

The SECURE Act surgically overlaid the existing post death distribution scheme known as the "5 year rule" found in Internal Revenue Code ("Code") § 401(a)(9)(B)(ii) with a new distribution period now applicable to "Designated Beneficiaries". This new distribution period set out in new § 401(a)(9)(H) of the Code simply substitutes "10 years" for "5 years". Creating the new 10 year distribution period in this fashion, the 10 year distribution period presumably will simply adopt the basic framework of the "5-year" rule found in Code § 401(a)(9)(B)(ii) and the regulations promulgated under § 401(a)(9)(B)(ii). This new "10-year" rule will now apply to ALL Designated Beneficiaries, other than a new category of Designated Beneficiary called an "Eligible Designated Beneficiary" added in new § 401(a)(9)(H)(ii) of the Code. This new 10-year rule requires Designated Beneficiaries to take distribution of the Owner's[2] entire interest in the Retirement Plan "within 10 years after the death of such employee."

Life expectancy distributions found in § 401(a)(9)(B)(iii) of the Code will still apply for an Eligible Designated Beneficiary (see below for a discussion of the categories identified as Eligible Designated Beneficiaries), but on the death of an Eligible Designated Beneficiary before the interest is entirely distributed, new § 401(a)(9)(H)(iii) provides that life expectancy distributions "shall not apply to any beneficiary of such eligible designated beneficiary and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary."

These changes apply to Retirement Plans of decedents who die after 12/31/2019. Section 401(b)(5) of the SECURE Act, also applies the provisions of the Act to the Designated Beneficiaries of Owners who died prior to 12/31/2019 when such Designated Beneficiary dies after 12/31/2019. On such post effective date death, the life expectancy of such Designated Beneficiary is changed to the 10-year distribution period.

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[1] "Retirement Plan" is used throughout to refer both to a qualified plan and an IRA, as the rules generally apply to both.
[2] Owner is used to refer to the owner of a qualified plan, referred to in the statute as the "employee", and to the owner of an IRA.

In addition to the changes to post death distributions, the SECURE Act surgically changed the required beginning date, simply by changing "age 70½" to "age 72" wherever it appeared in the provisions for determining required distributions. The required beginning date is still April 1, but it is now April 1 of the year following the year in which the Owner turns age 72. This change applies to Owners who attain age 70½ after 12/31/2019.

The SECURE Act also eliminated §°219(d)(1) of the Code that had previously prevented contributions to traditional IRAs after an owner attained age 70½. As of 2020, any person who has received earned income may contribute such earned income to a traditional IRA (up to the contribution limit) regardless of age.

However, the SECURE Act did not change the age at which a person can make a qualified charitable contribution (QCD)[3]. In order to eliminate game playing that could occur with the change in the contribution rules, the SECURE Act made one change to the QCD rules. That is, if a person makes a tax-deductible contribution to a traditional IRA after turning age 70½ and that person later makes a QCD, then the amount of that person's QCDs that can be excluded from income under § 408(d)(8)(A) of the Code will be reduced dollar for dollar by the amount of any such tax-deductible contribution to the traditional IRA. That QCD reduction occurs once for each dollar of tax-deductible IRA contribution until the amount of the tax-deductible IRA contribution is used up in offsetting QCDs. For example, if Jerry, who turned age 70½ in 2019, has income of $25,000 in 2020 and makes a tax-deductible contribution to his traditional IRA in 2020 of $7,000. Then, in 2021 Jerry transfers $10,000 directly from his IRA to his favorite charity. Jerry's QCD in 2021 is limited to $3,000 and $7,000 of his direct transfer from his IRA to charity will be included in his taxable income for 2021. If Jerry itemizes his deductions for 2021, he can take a $7,000 deduction for the transfer to charity from his IRA, but to itemize his deductions he has to give up his $12,000 standard deduction. If Jerry makes no further contributions to his IRA and makes an additional direct transfer of $10,000 from his IRA to his favorite charity in 2022, Jerry's QCD for 2022 will be the full $10,000. If Jerry makes a further tax-deductible contribution to his IRA in 2022 of an additional $7,000, Jerry's QCD for 2022 will again be $3,000 and the additional $7,000 of his direct transfer from his IRA to charity will again be included in his taxable income for 2022. Since Jerry's practice is to use QCDs for charitable gifts, Jerry would be better off not making any tax-deductible contributions to his traditional IRA. Instead, he should make any contributions after age 70½ to a Roth IRA or to a SEP IRA.

II. DESPITE THE SECURE ACT, MUCH HAS REMAINED THE SAME.

- "Designated Beneficiary", as defined in Reg. § 1.401(a)(9)-4, is still an individual (Q&A-1). A Designated Beneficiary must still have been designated as beneficiary under the plan or named as beneficiary by the Owner as of the death of the Owner. Entities, such as charity, an estate or a trust that is not a "See-Through" trust, are still not Designated Beneficiaries (Q&A-3).

[3] A qualified charitable distribution is a direct distribution from an IRA after age 70½ to a public charity that then does not have to be included in the owner's taxable income for the year made.

- The requirements to be treated as a "See-Through" Trust remain the same and are set out in Reg. § 1.401(a)(9)-4, Q&A-5(b).
    - The trust must be valid under state law
    - The trust must be irrevocable as of the death of the deceased Owner.
    - All countable beneficiaries must be individuals who are identifiable (although not by name) under the terms of the trust.
    - A copy of "trust documentation" must be provided to the IRA custodian or plan administrator by October 31 of the year following the year of the Owner's death.

  If the requirements for a trust to be treated as a "See Through" trust are met, the beneficiaries of such trust (and not the trust itself) will be treated as having been designated as the Designated Beneficiaries. Reg. § 1.401(a)(9)-4, Q&A-5(a).

- Since all of the requirements for making a trust a "See-Through" trust remain the same, drafting for a "See-Through" Trust remains the same as well. Basically, a trust can still qualify as a "See Through" trust either as a conduit trust or as an accumulation trust.
    - A Conduit Trust is the name given to a trust described in Reg. § 1.401(a)(9)-5, Q&A-5(c)(3), Example 2, which provides that if all distributions from the Retirement Plan to the trust are to be distributed immediately to the beneficiary during the life of the beneficiary, that beneficiary will be treated as the sole Designated Beneficiary of the Trust for purposes of determining the required minimum distributions.
    - An Accumulation Trust is the name given to a trust described in Reg. § 1.401(a)(9)-5, Q&A-5(c)(3), Example 1, which does not provide for immediate distribution of Retirement Plan benefits to a beneficiary but instead allows accumulation of such distributions within the trust. All of the beneficiaries of an Accumulation Trust are countable and must be individuals who are identifiable at least as a class.

- The required distribution rules if there is no Designated Beneficiary remain the same.
    - If the Owner died prior to the required beginning date, Code § 401(a)(9)(B)(ii) and Reg § 1.401(a)(9)-5, Q&A-5(b), which provide the distribution rules when the beneficiary is not a Designated Beneficiary, still provide that the deceased Owner's entire interest in the retirement Plan must be distributed "within 5 years after the death of the employee." Reg. § 1.401(a)(9)-3, Q&A-2 provides that this means "the entire interest must be distributed by the end of the calendar year containing the fifth anniversary of the date of the employee's death."
    - § 401(a)(9)(B)(i) of the Code likewise was not changed and still provides that, if the decedent died after his or her required beginning date, the remaining portion

of the decedent's interest must be distributed "at least as rapidly" as the method used by the decedent. If there is no Designated Beneficiary, Reg. § 1.401(a)(9)-5, Q&A-5(a)(2) states that this distribution would be over the decedent's remaining life expectancy determined using the age of the decedent as of the decedent's birthday in the year of the decedent's death reduced by one each year after the decedent's death. This is sometimes referred to as the Owner's ghost life expectancy. If the Owner has a Designated Beneficiary, Reg. § 1.401(a)(9)-5, Q&A-5(a)(1) still provides that the Designated Beneficiary is to take distributions over the longer of the Owner's ghost life expectancy and the Designated Beneficiary's life expectancy.

- There are quite a few additional rules that remain the same – all of those that do not deal with the post death required distribution rules.
    - Spousal Rollover Rules
    - Spousal Rights Rules
    - Prohibited Transaction Rules
    - UBIT Rules

III. SECURE ACT CHANGES TO POST DEATH REQUIRED DISTRIBUTIONS.

Before the SECURE Act, any Designated Beneficiary of Retirement Plan benefits could "stretch out" the required minimum distributions ("RMDs") over his or her life expectancy determined under the Single Life Table published by the IRS[4]. This allowed the IRA to grow, tax-free, for a long period of time, especially for a younger Designated Beneficiary. This stretched out distribution period increased the overall amount the Designated Beneficiary would ultimately receive from the inherited IRA.

Following the SECURE Act, most Designated Beneficiaries (with an exception of those called "Eligible Designated Beneficiaries" discussed below) are required to withdraw 100% of the Retirement Plan assets "within 10 years after the death of such employee." Because the new 10 year rule is overlaid onto the old "5 year" rule, it is assumed that Reg. § 401(a)(9)-3, Q&A-2, which provides such distribution would need to be completed by December 31st of the year containing the 5th anniversary of the deceased Owner's death, would now apply this same timeline to this new "10 year" distribution period. Assuming this regulation as to the operation of the "5 year" rule will apply to the operation of the new "10 year" rule, distributions under the 10 year rule will be able to be taken out in any manner and in any amounts, so long as the entire interest in the Owner's Retirement Plan is completely distributed prior to this December 31st date. So the distributions could be taken in tenths, in thirds, or a withdrawal of the entire sum at the end of 10 years, as long as it has been fully withdrawn by that 10 year date.

[4] The IRS has proposed new life expectancy tables last November that would in essence extend the life expectancy distributions about 2 years on average beginning in 2021.

It is expected that Treasury will be providing published guidance as to the operation of this new 10 year rule and whether it will operate exactly the same as the 5 year rule. Recently, Treasury reissued Publication 590B, Distributions from Individual Retirement Arrangements (IRAs), for use in preparing 2020 returns. The changes to Publication 590B give some hint as to Treasury's thinking and what might be coming in the way of guidance later this year as to the workings of the 10-year rule. Initially, much furor was raised about the example on page 12 of the Publication, adopted verbatim from the prior version of the Publication (changing only the date). The implication taken from the example was that a designated beneficiary must take life expectancy distributions during the 10-year distribution period. However, this example made no mention of the 10-year rule, and such a distribution is not supported by any language in the SECURE Act. Indeed, this concept is contradicted by the very language contained elsewhere in the updated Publication 590B. At the bottom of page 12 of the Publication, under the heading "Which Table Do you Use", provides that the beneficiary is NOT to "use any of the tables if either the 5-year rule or the 10-year rule (discussed earlier) applies." This example was simply erroneous. The Service has now corrected this example by converting this example to an example dealing with an EDB – a beneficiary that is not more than 10 years younger. The life expectancy distribution reflected in the example is correct for such an EDB.

The Publication is also unfortunately sloppy in the various ways it describes the end of the 10-year rule. Beginning at the top of page 10, the time when the beneficiary's interest must be fully distributed is variously described as (i) ". . .within 10 years after the beneficiary's death, or in some cases within 10 years of the owner's death;" (ii) ". . . by the end of the 10th year following the year of the owner's death;" (iii) . . . the 10-year period ends on the 10th anniversary of the beneficiary's death or the child's attainment of majority;" (iv) ". . . (or December 31 of the year containing the 5th anniversary (or the 10th anniversary for the 10-year rule) of the owner's death . . ."; (v) "by the 10th anniversary of the owner's death under the 10-year rule". Perhaps the clearest description of the 10-year rule is under the cautionary note on page 11, which states "If the 10-year rule applies, the amount remaining in the IRA, if any, after December 31 of the year containing the 10th anniversary of the owner's death is subject to the 50% excise tax." Given this sloppiness in Publication 590B, we won't really know for certain when the 10 year period ends, until Treasury issues guidance.

This Publication does, however, clear up some uncertainties created by the SECURE Act.

1. The 10-year rule will generally work the same way as the 5-year rule in that no distributions will be required until the end of the term (whenever that is).
2. An EDB can elect to have the 10-year rule apply if the Owner dies prior to the Required Beginning Date.
3. If the Owner dies on or after the Required Beginning Date, the distribution period for an EDB is the LONGER of the EDB's life expectancy or the "ghost" life expectancy of the Owner, and the EDB will not be able to elect the 10-year rule.

But when can we expect Treasury to issue guidance? Treasury officials have informally stated that the proposed regulations have been prepared and are currently in the final review process. It is our understanding that the proposed regulations will contain a lot more addressed to trusts and that these proposed regulations already consist of over 250 pages. ACTEC provided comments to Treasury in July of 2020 suggesting areas in need of guidance with respect to the 10-year rule[5] Given the anticipated length of these proposed regulations, we are hoping that many of the issues raised in ACTEC's comments will be addressed.

In addition to creating a new 10-year rule, the SECURE Act created a new category of Designated Beneficiary, the Eligible Designated Beneficiary (referred to as an EDB), who will qualify for a "modified version" of the life expectancy payout period. Amended § 401(a)(9)(E) of the Code, the section that defines "Designated Beneficiary," was expanded to provide for five different "Eligible Designated Beneficiaries: (1) the surviving spouse, (2) a child of the Owner who has "not reached majority (within the meaning of subparagraph (F))", (3) a disabled person "(within the meaning of section 72(m)(7))", (4) a chronically ill individual "within the meaning of section 7702B(c)(2))", and (5) an individual who is not more than 10 years younger than the Owner. It also creates a new type of trust, called an "Applicable Multi-Beneficiary Trust," held for the benefit of disabled or chronically ill beneficiaries.

As stated above, new § 401(a)(9)(H)(iii) provides that life expectancy distributions for Eligible Designated Beneficiaries "shall not apply to any beneficiary of such eligible designated beneficiary and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary." Once an Eligible Designated Beneficiary dies, the life expectancy distribution, which would have continued for the successor beneficiaries under the rules prior to the SECURE Act, will now convert to a 10 year distribution period. If the EDB had not yet taken out the RMD for the year of death, it is assumed that such RMD would still be required to be taken by the end of the year in which the EDB dies, since that is the rule applicable when a Owner dies and that the 10 year distribution period would commence the year after the death of the EDB. However, this will have to be clarified by Treasury in published guidance.

Similarly, it is not clear whether this conversion to a 10 year distribution period would apply if the successor beneficiary was also an EDB, or if the successor EDB will continue the life expectancy distribution set in place by the initial EDB. Finally, it is assumed that the conversion to the 10 year distribution period would mean that the entire interest in the Retirement Plan would need to be completely distributed by December 31st of the year containing the 10th anniversary of the EDBs death, again assuming that the operation of this particular 10 year period would be the same as the IRS has set out for the operation of the 5 year rule. Each of these assumptions will need to be confirmed by the IRS in published guidance.

IV. **PLANNING FOR THE ELIGIBLE DESIGNATED BENEFICIARY.**

A. The Owner's **<u>Surviving Spouse</u>**, is an Eligible Designated Beneficiary, and can still take distributions over life expectancy from an inherited IRA so long as the surviving spouse is the sole beneficiary of the Retirement Plan. And the surviving spouse can still roll over Retirement Plan benefits into the surviving spouse's own IRA. This makes the spouse the most appropriate primary beneficiary of the Retirement Plan.

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5 A copy of the ACTEC comments is attached to these materials.

However, if this is not the Owner's first marriage and there are children by a prior marriage, naming the spouse as the sole primary beneficiary likely is not what the Owner wants. John is now married to Suzy and has two grown children by his first marriage. John's single largest asset is his Retirement Plan. John wants to benefit Suzy during her lifetime, but wants to preserve a significant portion of John's assets for ultimate distribution to John's family. Planning in this instance depends on John's primary concerns.

- If the John's primary concern is to provide for Suzy during her life while at the same time making sure that whatever is left after Suzy's death will pass to John's two children and not to those beneficiaries Suzy might name, John could name a Conduit Trust for Suzy's sole benefit during her lifetime as the primary beneficiary of the Retirement Plan. As the sole beneficiary of the Conduit Trust, Suzy would be the "sole beneficiary" of the Retirement Plan and would qualify as the EDB so that the Conduit Trust could arrange for distribution over Suzy's life expectancy.

    - The Trust would have to require the trustee to distribute every distribution made from the IRA to the Trust to be paid immediately to Suzy, outright.

    - The Trust should also provide direction to the Trustee that the Trustee should not take any greater distributions from the inherited IRA than the RMDs unless Suzy needs more funds distributed to her from the trust and there are no other assets available to satisfy those needs, or unless the trust is to qualify for the marital deduction and there is more income earned by the inherited IRA than is distributed in the RMD.

    - If John had not yet reached his required beginning date (April 1 of the year after John turns age 72) ("RBD"), the Conduit Trust for Suzy would enable the Trustee to wait until John would have reach the RBD before having to start taking distributions over Suzy's life expectancy, and the Trustee would be able to redetermine Suzy's life expectancy annually using the Single Life Table. Therefore, while distributions to the surviving spouse will be accelerated over what the RMDs would have been using the Uniform Table if the spouse would have been able to roll over the Retirement Plan benefits to his/her own IRA, the surviving spouse will generally not outlive the assets in the Retirement Plan payable to such a trust.

    - This Conduit Trust can be drafted to qualify for the marital deduction as a QTIP Conduit Trust by requiring the greater of the income earned by the Retirement Plan or the annual distributions from the Retirement Plan to be paid over immediately from the Trust to Suzy.

    - Then at Suzy's death, whatever remains in John's Retirement Plan will be held for the benefit of his two children as beneficiaries of the Conduit Trust, and the Trustee of the Conduit Trust would have to withdraw the remaining balance in the

Retirement Plan no later than December 31st of the year containing the 10th anniversary of Suzy's death.

- The issue with the use of a Conduit Trust for the surviving spouse in a second marriage is that the Owner may want to preserve more of the Retirement Plan for his/her family than just what is left in the Retirement Plan after the death of the surviving spouse.

- Also, if John dies after the Required Beginning Date and Suzy is older that age 80, the distribution period would be better if a Conduit Trust were not used to make Suzy an EDB. If the Suzy is an EDB, in this case, the Trustee would have to take distributions over a life expectancy that is shorter than 10 years, such distributions would have to start the year after the John's death, and the Trustee would have to distribute all of these accelerated distributions promptly to the Suzy free from trust.

- If, instead, John is concerned more about leaving as much as possible for his family than about obtaining a life expectancy distribution during Suzy's life, John should use an Accumulation Trust as beneficiary of the Retirement Plan.

    - An Accumulation Trust is not deemed to be for the "sole benefit" of the surviving spouse within the meaning of what is required to use the life expectancy of the surviving spouse, even if the spouse is the only current beneficiary of the trust during life. Such an Accumulation Trust will not qualify for life expectancy distributions. Instead, the entire interest remaining in the Retirement Plan will have to be distributed to the Trust no later than the end of 10 year period.

    - The Plan value as of the Settlor's death will be trust principal but will be taxable income when distributed to the trust. Trustee will need to be given guidance in the trust instrument as to the Settlor's intentions concerning (1) the timing of distributions from the Plan (should distributions be deferred as long as possible); and (2) the extent to whether the taxable income distributed from the Plan to the trust should be distributed outright to the spouse. The Settlor should specifically state in the trust his/her intention that it is more important that the principal value of the Retirement Plan (the value of the Retirement Plan at the time of death plus appreciation) be preserved in the Trust for ultimate distribution to his/her family than that income tax be minimized.

    - See the discussion below as to use of a withdrawal right to make the beneficiary be taxable on the IRA distributions even though not actually distributed. But use of such a withdrawal right would have the same result as a Conduit Trust, as the spouse could withdraw all of the distributions to the Trust during the 10 year period.

    - Even though the surviving spouse would not be an EDB in this instance and would not be entitled to life expectancy distributions when an Accumulation Trust is the named beneficiary of the Retirement Plan, this Trust can still qualify for the marital deduction. To qualify for the marital deduction, all of the trust accounting income (as opposed to the taxable income) from the Trust and from the Retirement Plan must be required to be distributed to the surviving spouse no less frequently than annually, or the surviving spouse can be given the right to compel the Trustee to make this distribution.

  - If Suzy is older that age 80, the 10 year distribution period will be longer than Suzy's life expectancy, and these distributions do not have to be made until the end of the 10 year period.

- In determining the best plan for the surviving spouse, age and health is a consideration, even in long term marriages. If Suzy is in her 80s or 90s, an Accumulation Trust would be better in any event because the life expectancy distribution period would be shorter than the 10 year period and all of the distributions would be able to stay in the trust to be invested for ultimate distribution to John's family. On the other hand, if Suzy is young, life expectancy distribution period would be much longer with a Conduit Trust, so greater consideration should be given to setting up the trust as a Conduit Trust, all other things being equal.

B. The SECURE Act provides special rules for EDB who are **Disabled or Chronically Ill.**

- In order to qualify as a Disabled EDB or as a Chronically Ill EDB, the person must have been "disabled" or "chronically ill" as of the date of the Owner's death.

- § 401(a)(9)(E) of the Code tells us that a person is "Disabled" if the person meets the definition found in section 72(m)(7) of the Code. Section 72(m)(7) provides that a person is "considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration." This is essentially the definition of "disabled" found in the Social Security Act, 42 U.S. Code § 1382c(a)(3), for purposes of Supplemental Security Income for aged, blind and disabled.

- Section 401(a)(9)(E) of the Code tells us that an individual is "Chronically Ill" if the individual meets the definition found in § 7702B(c)(2)(A) of the Code. Section 7702B of the Code deals with qualified long-term care insurance and § 7702B(c)(2)(A) defines a "chronically ill individual" as "any individual who has been certified by a licensed health care practitioner as a person who is "unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to loss of functional capacity." In other words, the individual would be able to receive benefits under a long term care contract (2 out of 6 activities of daily living). The term "licensed health care practitioner" is defined in § 7702B(c)(4) to mean "any physician and any registered professional nurse, licensed social worker, or other individual who meets such requirements as may be prescribed by the Secretary."

- In addition to meeting this definition of a "chronically ill individual", § 401(a)(9)(E) of the Code imposes an additional requirement in order to be a Chronically Ill individual and qualify as an EDB. The fact that the Designated Beneficiary is Chronically Ill must be certified by the licensed health care practitioner not only as meeting that definition as of the Owner's date of death, but also that the licensed health care practitioner expects the chronic illness to continue for an indefinite and lengthy period of time.

- Within this exception for EDBs who are Disabled or Chronically Ill, new § 401(a)(9)(H)(iv) of the Code provides special rules for certain trusts for Disabled or Chronically Ill EDBs, which are referred to as "Applicable Multi-Beneficiary Trusts".

- An Applicable Multi-Beneficiary Trust would be an Accumulation Trust with discretionary distributions authorized for the Disabled or Chronically Ill EDB. In order to be considered an Applicable Multi-Beneficiary Trust, the terms of the trust instrument must provide

  - that the trust is to be divided immediately on the Owner's death into separate subtrusts for each beneficiary; and

  - with respect to the subtrust for any Disabled or Chronically Ill EDB, that no other individual other than the Disabled or Chronically Ill EDB has any right to the Retirement Plan during the lifetime of the Disabled or Chronically Ill EDB, other than as a remainder beneficiary after the death of the Disabled or Chronically Ill EDB.

  - There likely can't be any provision for an alternate payee who is not Disabled or Chronically Ill in the subtrust for the Disabled or Chronically Ill beneficiary during that EDB's lifetime even if the subtrust otherwise would interfere with such beneficiary's qualification for public assistance. However, published guidance may soften this requirement.

Pursuant to § 401(a)(9)(H)(iv), the separate account rule is expressly made to apply to each such subtrust created under an Applicable Multi-Beneficiary Trust for a Disabled or Chronically Ill beneficiary, overruling the regulations that state the separate account rule does not apply to trusts. This means the separate life expectancy of the Disabled or Chronically Ill EDB will be used, and the life expectancy of a different but older beneficiary will likely not apply.

Once the Disabled or Chronically Ill EDB dies, the life expectancy distribution will be converted to a 10 year distribution period so that the Retirement Plan assets would then need to be taken out the end of the 10 year period following the death of the Disabled or Chronically Ill person. It is uncertain what this means if there is more than one such EDB who is a beneficiary of the subtrust. Will the conversion to the 10 year distribution period occur on the death of the EDB that is the measuring life, or on the death of all of the EDBs who are beneficiaries of the subtrust.

For example, Joe is single and has 3 children, Joey age 40, Billy age 37 and Sammy age 35. Billy is Disabled. Joe's trust provides that on his death, his trust that is the beneficiary of his Retirement Plan is to divide into three separate discretionary Accumulation Trusts, one for each of his three children for their respective lifetimes. Billy's Accumulation Trust is a Special Needs Trust. Joe dies at age 75, and the Trustee sets up the three separate Accumulation Trusts. The Trustee must take distributions from the Retirement Plan in Joey's and Sammy's separate discretionary Accumulation Trusts no later than the end of the 10 year distribution period following Joe's death. The Trustee of Billy's Trust will take distributions from the Retirement Plan over Billy's life expectancy, as the Separate Account Rule applies so that the remainder interests of Joey and Sammy in Billy's Special Needs Trust are disregarded. On Billy's death, his Trust will be added half to Joey's Trust and half to Sammy's Trust, and the Trustee of those Trusts will have until the end of the 10 year period following Billy's death to complete the distributions from the Retirement Plan that came to those Trusts as a result of Billy's death.

- If the subtrust is a discretionary pot trust for the benefit of more than one Disabled or Chronically Ill EDBs, the multiple beneficiary rule would apply so that the distribution from the Retirement Plan would be over the life expectancy of oldest Disabled or Chronically Ill person.

    - The requirements for an Applicable Multi-Beneficiary Trust described in the SECURE Act are essentially the same as a Qualified Disability Trust described in § 642(b) of the Code in permitting a deduction for personal exemption for such a trust of a minimum of $4,150 adjusted for inflation after 2018.

    - An example of how this Applicable Multi-Beneficiary Trust works would be as follows. Duncan designates his residuary trust for his 4 children as the beneficiary of his Retirement Plan. Under the provisions of Duncan's trust, the residuary trust is to divide into subtrusts on Duncan's death, one such trust for each child who is not Disabled or Chronically Ill, and one discretionary pot trust for his Disabled and Chronically Ill children. At the time of Duncan's death, his youngest son David is Disabled and his middle son Ed is Chronically Ill. Duncan's Residuary Trust for David and Ed is a special needs trust for David and Ed for their lifetimes, and on the death of the survivor of David and Ed, the trust is to be divided among the 2 additional subtrusts for Duncan's two other children. The subtrusts for the 2 other children are discretionary trusts as well and qualify as Accumulation Trusts. The Retirement Plan is directed to be distributed outright to the last living descendant of the Owner. The one-half portion of the Retirement Plan that is in the Special Needs Trust will be distributed over Ed's life expectancy as he is the oldest of David and Ed and will be the measuring life under the old multiple beneficiary rule. The one-fourth portion of the Retirement Plan in each of the other 2 subtrusts for Duncan's other children will be required to be distributed in full no later than the end of the 10 year distribution period following Duncan's death. It is not clear when the 10 year distribution period will kick in for the Applicable Multi-Beneficiary Trust for David and Ed. It could kick in on Ed's death, but likely will not kick in until both David and Ed have died. At that time, each of the two other subtrusts will have an additional 10 years following the death of the survivor of Ed and David within which to withdraw the entire interest in the portion of the Retirement Plan initially distributable to the Special Needs Trust for Ed and David.

C. The SECURE Act provides that a **Child** of the deceased Owner who is the sole Designated Beneficiary of the Retirement Plan and "who has **not reached majority** (within the meaning of subparagraph (F))" is also an EDB.

- Only a child of the Owner, and not a grandchild, a step child or any other any person who just has not yet reached majority, would fit within this category of EDB. If the child is adopted or was conceived using Artificial Reproductive Technology, the child will likely be treated for this purpose as a child of the Owner if the child is treated under applicable state law as the child of the Owner.

- The life expectancy distribution for an Owner's child who has not yet reached majority only lasts until the child reaches majority or dies prior to majority.

- § 401(a)(9)(H)(iii) provides that the child will "cease to be an eligible designated beneficiary as of the date the individual reaches majority and any remainder of the portion of the individual's interest [being distributed over the life expectancy of the child] shall be distributed within 10 years after such date." It is uncertain whether this 10 year distribution period expires in exactly 10 years from the date the child reaches majority or on December 31st of the year containing the 10th anniversary of the child reaching majority or at some other time within the 10 year distribution period.

- It is also uncertain what "who has not reached majority (within the meaning of subparagraph (F))" means. Section 401(a)(9)(F) to which this refers is a provision that is unrelated to required distributions from Retirement Plans. However, Reg. §1.401(a)(9)-6. Q&A-15 provides a regulatory explanation of the meaning of § 401(a)(9)(F), and states "a child may be treated as not having reached the age of majority if the child has not completed a specified course of education and is under the age of 26." Therefore, the age of majority could simply be based on each particular state's definition of majority (age 18 or 21), or could be determined under this regulatory explanation of § 401(a)(9)(F), extending to completing some "specified course of education" or reaching age 26. If a particular state definition of majority were to be applied to this determination, there could be a change if the minor child moved from a state defining majority as age 21 to a state defining majority as age 18. There would be more consistency in the application of the rules if the more generic "specified course of education" and reaching age 26 were the rule. In fact, it would be simplest for the IRS if there was an age certain, such as age 26, that would apply in all cases, because it is uncertain what documentation would be required to substantiate being enrolled in a "specified course of education."

- In order for the child to qualify for the life expectancy distribution period prior to reaching majority, the child needs to be the sole Designated Beneficiary.

- This could be as an outright beneficiary of the Retirement Plan but that would likely require a conservatorship for the minor. And if distributions were paid to the legal representative of the minor, would that qualify for life expectancy distributions?

- This could also be through a Conduit Trust for the sole benefit of the child during life. On the one hand, in order to optimize the distribution period, by using a Conduit Trust, the distributions, even though initially quite small distributions over life expectancy, will need to begin the year following the year of the Owner's death, and all such distributions will need to be distributed to the child immediately. Or could these distributions be made to a legal representative of the child or to the child's parent or simply just used for the child's benefit? So with a Conduit Trust for the child, life expectancy distribution will be able to be used for a short period, but once the child reaches majority, the 10 year period will kick in and the child will receive distribution of the entire Retirement Plan by the time the child is age 36 at the latest.

- If the child is the sole beneficiary of an Accumulation Trust for life, the trustee would not be able to use the child's life expectancy as the distribution period prior to majority. If an Accumulation Trust is used to preserve as much as possible after tax in the control of the trustee until the child is much older, the 10 year distribution period would apply from the date of the Owner's death.

- It is not clear whether the plan could call for a Conduit Trust during minority and conversion to an Accumulation Trust on the child reaching majority.

- Therefore, the Owner must make the hard choice between giving control of the Retirement Plan to the child at a very young age to optimize the distribution period, or preserving control over the Retirement Plan assets until the child is much older.

- For example, Sharon has one daughter, Lauren, who is 6 years old. Sharon would like to use Lauren's life expectancy as the distribution period, but does not like the idea of a required conservatorship for Lauren after her death. For this reason, she does not want to name Lauren as the beneficiary of Sharon's Retirement Plan. Instead, Sharon wants to name a trust for Lauren as the beneficiary. Sharon has decided to use a Conduit Trust for Lauren. The Trustee will be able to take relatively small distributions from the Retirement Plan until Lauren reaches the age of majority (which we are hoping will be age 26) and then the Trustee can stop distributions until the end of the 10 year period following Lauren reaching the age of majority.

- Sharon's sister Cynthia has a daughter Joan who is age 19, and although in college has been struggling with school. Cynthia is concerned about Joan's ability to handle money and believes that she will withdraw any funds from her Retirement Plan she can get her hands on. Cynthia has decided to use an

Accumulation Trust for Joan because a Conduit Trust won't add much in the way of additional time to the distribution of her Retirement Plan. In addition, Cynthia believes that she needs to control as much of the Retirement Plan as she can to protect Joan.

- It is unknown how the child as EDB rule would work if the trust were a discretionary pot Conduit Trust for the benefit of multiple children who had not reached majority. First, there is no authority as to whether there can be a Conduit Trust for more than one beneficiary. Second, even if there could be a Conduit Trust for more than one child, it is unclear how the termination of the life expectancy status would work. Would it flip to the 10 year payout when the oldest child reaches majority or only when all have reached the age of majority? Would the life expectancy distributions be based on the life expectancy of the oldest minor child?

D. The final category of EDB is the person who is **Not More Than 10 Years Younger** than the Owner. Someone who is an EDB in this category can also use life expectancy distributions. Again, after the death of the Not More Than 10 Years Younger individual, the Retirement Plan benefits must be taken out completely no later than the end of the 10 year distribution period following such individual's death. The issues here to consider are the following.

- It is unclear how we should calculate "10 years younger". Is that determined on the basis of the number of days between the birthdate of the beneficiary and the birthdate of the Owner, with the number of days divided by 365 days of the year? Or is that determined by subtracting the actual age of the beneficiary at the time of the Owner's death from the actual age of the Owner as of death? Or is that determined by the age of the Owner on the Owner's birthday in the year of death and the age of the beneficiary on the beneficiary's birthday in the year of the Owner's death? It would be possible to come up with a different result using each of these methods.

- The Owner may or may not have a beneficiary who is no more than 10 years younger, and even if there is such a beneficiary, the Owner may or may not want to leave the Retirement Plan to such no more than 10 years younger person just to be able to use that person's life expectancy as the distribution period. This may be especially true if the Owner wants to make sure that whatever remains after the death of the no more than 10 years younger person goes to the rest of the Owner's family members.

    - Instead of designating the no more than 10 years younger person as the direct beneficiary, the Owner could designate a Conduit Trust for the benefit of the no more than 10 years younger person, so that whatever remains after that person's death would pass to the Owners other beneficiaries.

- Having said this, whether the Owner should name a person who is no more than 10 years younger depends on a number of things.

    - Does the Owner otherwise want to provide for the no more than 10 years younger person?

- Is that person in good health and likely to live a while, or in poor health and likely to die within a short period of the Owner.

- What is the age of the person who is no more than 10 years younger than the Owner? What is that person's life expectancy under the Single Life Table? If the person is in his 80s, life expectancy may actually be less than 10 years, so that no additional distribution time would be added, and distribution would have to begin the year following the Owner's death. In planning, it is important to determine the maximum additional distribution period that would be available if that person were an EDB.

- Does that person have creditor issues, such that the Retirement Plan would be subject to the claims of that person's creditors? If the answer to this is yes, then if that person is to be a beneficiary of the Retirement Plan at all, An Accumulation Trust may be a better plan.

- If after analysis, the Owner wants to provide the Retirement Plan for his no more than 10 years younger family member, it may be best to do so with a Conduit Trust, making the family member the sole beneficiary.

- An Accumulation Trust will not result in the use of a life expectancy distribution for the no more than 10 years younger beneficiary.

V. EFFECTIVE DATE ISSUES

- Section 401(b) of the SECURE Act contains the effective date provisions. As stated in that provision, the SECURE Act applies to all Owners who die after 12/31/2019.

    - If the Owner's surviving spouse rolled over the Retirement Plan into the spouse's own IRA, the surviving spouse becomes the Owner under this effective date rule, and the SECURE Act applies if the surviving spouse dies after 12/31/2019.

- But this is not the whole story. The SECURE Act also applies on the death of a Designated Beneficiary even if the Owner died prior to 12/31/2019.

    - Under the pre-SECURE Act rules, on the death of the Designated Beneficiary, the inherited IRA would continue to be distributed over the remaining life expectancy of the Designated Beneficiary, subtracting one each year.

    - However, even if the Owner died prior to 12/31/2019, the effective date provisions apply the SECURE Act 10-year rule on the death of the Owner's Designated Beneficiary after 12/31/2019 to "any beneficiary of such designated beneficiary" as if the Owner's designated beneficiary who dies after 12/31/2019 was an eligible designated beneficiary.

- Thus, on the post 12/31/2019 death of a Designated Beneficiary of an Owner who died before 12/31/2019, the distribution period will then flip from the life expectancy of the Designated Beneficiary to the 10 year distribution period.

- For example, Jeff died in 2017, naming Jeff's sister, Amelia, as the Designated Beneficiary of his Retirement Plan. Amelia began taking distributions from the inherited IRA she received from Jeff over her life expectancy. Amelia died in January of 2020. The remaining assets in her inherited IRA must be distributed to her named beneficiary no later than the end of the 10 year period following Amelia's death.

- On the other hand, Tom designated his discretionary pot trust for his three children as beneficiary of his Retirement Plan. This trust was to last until the death of the survivor of his three children, at which time it would divide into separate trusts. Tom died in 2017 and the Trustee began taking distributions from the inherited IRA over the life expectancy of Andy, his oldest child. Andy died in January of 2020 survived by his two sisters. When does the life expectancy distribution flip to the 10 year distribution period?

    - Published guidance will need to provide whether this rule applies to a trust that was a beneficiary of the Retirement Plan on the death of the trust beneficiary who was the measuring life for purposes of determining the required minimum distributions, or on the death of all of the beneficiaries of the trust .

    - What if Tom's trust split right away into 3 separate trusts with distributions over Andy's life expectancy? When Andy dies in 2020, does the life expectancy distribution period for just the one-third interest in Tom's Retirement Plan owned by Andy's Trust flip to the 10 year distribution period when Andy dies? Or does it flip to the 10 year distribution period for all three of the trusts?

- Also, will this effective date provision apply on the death of the Designated Beneficiary if the Owner's life expectancy was being used for determining the RMDs under the "at least as rapidly" rule of Reg. § 1.401(a)(9)-5, Q&A-5? If the Owner's ghost life expectancy would apply, does the Designated Beneficiary have a choice to use the 10 year distribution period if desired?

- And does this effective date rule require a new determination of whether the beneficiary, who succeeds to the interest of the Designated Beneficiary who dies after 12/31/2019, is a designated beneficiary, an eligible designated beneficiary, or a non-designated beneficiary.

- If the Owner's Designated Beneficiary also died prior to 12/31/2019, when the successor beneficiary dies after 12/31/2019, does the life expectancy of the

Designated Beneficiary being used by the successor beneficiary flip on the death of the successor beneficiary to the 10 year distribution period?

- Finally, if the Owner died prior to the 12/31/2019 and prior to reaching the RBD, and the Owner's surviving spouse was the sole beneficiary so that the surviving spouse could wait until the Owner would have reached age 70 ½, can the surviving spouse wait until the Owner would have reached age 72 to start taking RMDs?

VI. PLANNING OPTIONS FOR THE DESIGNATED BENEFICIARY WHO IS NOT AN ELIGIBLE DESIGNATED BENEFICIARY.

1. <u>Accelerating Distributions.</u> The Owner could accelerate distribution of the Retirement Plan, using those funds and saving non-Retirement Plan assets. This may be desirable right before death if the Owner is in a low tax bracket at the time. The funds could be used to make annual exclusion gifts.

2. <u>Roth Conversions.</u> Instead of just withdrawing Retirement Plan funds, if the Owner is in a relatively low tax bracket, the Owner could utilize the rest of that tax bracket to convert traditional IRA assets to a Roth IRA. The Owner may want to do this if the Owner wants to retain the ability to grow the funds in a tax exempt environment. This will facilitate distributions to an Accumulation Trust without unduly raising the tax cost to the trust.

3. <u>Continue the Prior Plan.</u> The Owner could just ignore the change in the distribution rules, if there are no desirable beneficiaries who would be EDBs. If the beneficiaries would leave the funds in the Retirement Plan the entire 10 years, the tax free build up may be sufficiently beneficial.

    - But most individual beneficiaries withdraw the funds sooner than required in any event, so a longer distribution period may be irrelevant

    - If the plan is to provide for a continuing trust for the beneficiaries for asset protection reasons, an Accumulation Trust would be best in all events.

    - A Conduit Trust will protect the Retirement Plan for at least the 10 year distribution period from the trust beneficiary's creditors, will ensure that the longest tax free build up is attained, and will deal directly with an untimely death of a beneficiary, providing for the descendants of the named trust beneficiary.

    - Adequate instructions will need to be given to the Trustee to indicate that it is the Owner's desire to leave the assets in the Retirement Plan as long as possible.

    - Unless there are charities as remainder beneficiaries, or unless the plan was to distribute trust assets at certain ages, there is no reason to use a Conduit Trust for Designated Beneficiaries who are not EDBs.

4. Use an Accumulation Trust. The Owner could name his Accumulation Trust as the beneficiary of the Retirement Plan. This would preserve the tax free buildup of these benefits for the beneficiaries in an asset protected environment and ensure that the trustee would make appropriate elections to maximize the tax free earnings of the Retirement Plan. In doing so, the Accumulation Trust will need to provide adequate direction to the trustee as to how to deal with the Retirement Plan and the Owner's desires in dealing with Retirement Plan.

    - Since the trust will be taxed at the highest rates, does the Owner want the trustee to distribute the IRA distributions immediately to the beneficiaries? If so, consider using a Conduit Trust instead, or simply advise the Trustee in precatory language as to this desire to save income taxes. Or is it more important to provide asset protection for the benefits even though keeping the benefits in the trust may cause the benefits to be taxed at the highest tax rate? Provide guidance to the Trustee as to the Owner's desires concerning retention of distributions in trust.

    - The beneficiary could be given the power to withdraw any distribution from the Retirement Plan, with this power lapsing 30 days after the expiration of the tax year. This power should be coupled with a special power to appoint the Retirement Plan – or the entire trust – to individuals to avoid the lapse of the withdrawal right resulting in taxable gifts. This withdrawal power will cause the beneficiary to be taxed on the distribution from the Retirement Plan whether or not the Retirement Plan distribution is actually distributed to the beneficiary. This power should be eliminated once the 10 year distribution period expires. There should be adequate direction in the trust instrument as to the manner in which the Settlor intends the Trustee to take distributions from the Retirement Plan. This power would make the Accumulation Trust similar to a Conduit Trust if the beneficiary will likely withdraw the funds, and may interfere with asset protection.

    - If the Owner has converted traditional IRA assets to a Roth IRA to the extent the Owner is in a lower tax bracket, the distributions to the Accumulations Trust would not have adverse income tax consequences.

5. Charitable Remainder Trust.

    - This may be an attractive option now for the Owner with any charitable intent

    - The Owner could name a charitable remainder unitrust (CRUT) as the beneficiary of the Retirement Plan. On the death of the Owner, the Retirement Plan would be distributed income tax free to the CRUT, which will then pay a fixed percentage of the value of the trust each year to the individual beneficiary for his or her lifetime. The distributions from the CRUT will be taxable to the noncharitable beneficiary as ordinary income until all of the income from the Retirement Plan has been paid out to the noncharitable beneficiary.

- In comparing the distributions paid to a noncharitable beneficiary under the 10 year distribution rule with the use of a CRUT, we have determined that the actual distributions to a young noncharitable beneficiary over the lifetime of the beneficiary would be slightly greater than if the CRUT were not used and the distributions were over the 10 year period. The cross over in favor of the CRUT occurs about 35 years out. So if the beneficiary is relatively young and lives out his/her life expectancy, the CRUT performs well for the noncharitable beneficiary.

- However, with a CRUT, there was a significant portion of the Retirement Plan that would go to charity.

- The actual income tax paid on the distributions from the CRUT would be less than under the 10 year distribution period option.

- However, in the early years, significantly more funds would flow to the noncharitable beneficiary with the 10 year distribution period option than with the use of a CRUT, so if the noncharitable beneficiary dies early, less goes to the family of the Owner.

6. <u>Use of Life Insurance</u>.

    - If the Owner were to purchase life insurance payable to the beneficiary of the Retirement Plan, the life insurance proceeds could replace the accelerated income tax paid as a result of the 10 year distribution of the Retirement Plan to the beneficiary.

    - If the noncharitable beneficiary of a CRUT were to purchase life insurance on his/her own life with a portion of the CRUT distributions, the family of the noncharitable beneficiary would receive more in the event of the early death of the noncharitable beneficiary.

7. <u>Use of a Gift to Charity as Beneficiary in conjunction with a Charitable Gift Annuity.</u> If the individual the Owner would like to benefit with distributions from the Retirement Plan is over age 60, the typical minimum age that many charities set for entering into a charitable gift annuity, and if the Owner has a desire to make some charitable gifts, consideration should be given to entering into a charitable gift annuity contract with one or more target charities. This agreement would specify that the charity agrees to provide an annuity to the person the Owner wants to designate, upon receiving a distribution from the Owner's Retirement Plan after the Owner dies. This agreement would provide for the maximum permitted annuity while still providing the charity with at least 10% of the value of the gift. It may be possible for the annuitant to receive the annuity amount without having to include in income the IRD from the Retirement Plan paid to the charity for the annuity.

8. <u>Use a Discretionary Pot Trust as Beneficiary.</u> The Owner could create a Pot Trust for the benefit of multiple beneficiaries and name this Pot Trust as the beneficiary of the

Retirement Plan. This would enable the Trustee to use discretion as to when to take distributions from the Retirement Plan and to whom such distributions should be given, based on tax brackets and need. The Owner will need to provide guidance in the Pot trust to the Trustee as to what the Owner has in mind as to the Trustee's exercise of discretion. This structure assumes that the minimization of income tax rather than who is to receive the funds is of primary importance to the Owner.

9. Use an Equalization Trust. If the Owner wants to minimize the income tax paid on the Retirement Plan to the greatest extent possible and opts for making a pot trust the beneficiary of the Retirement Plan, but also wants to treat the beneficiaries of the Retirement Plan Pot Trust as equally as possible overall, the Owner could name the Retirement Plan Pot Trust the beneficiary of the Retirement Plan and create an Equalization Trust for all of the Owner's other property. The Equalization Trust would provide for distributions to be made from that trust to equalize the distributions among the beneficiaries from the Retirement Plan Pot Trust.

10. Trusteed IRA. The Owner could create a Trusteed IRA – that is the IRA itself is in the form of a trust – with a professional Trustee knowledgeable about how to maximize the benefits of the IRA and minimize the payment of income taxes. If the beneficiary of the Trusteed IRA is not an Eligible Designated Beneficiary, the Trusteed IRA would have to be paid out to the beneficiary in the 10 year distribution period. The Owner would be relying on the Trustee of the Trusteed IRA to determine the timing and amount of the distributions from the Trusteed IRA within the 10 year period.

    - The advantage of the Trusteed IRA rather than a simple traditional IRA with an individual named as the beneficiary is that the beneficiary would not be free to withdraw the funds from the Trusteed IRA. Instead, distributions from the Trusteed IRA would be up to the discretion of the Trustee. This would operate much like a Conduit Trust.

    - The cost of the Trusteed IRA would be about the same as the cost of a Conduit Trust with a corporate Trustee.

VII PRACTITIONER'S "TO DO" LIST

1. Identify all Trusts that contain Conduit Trust provisions and contact the client to discuss changing the trust.

2. Contact clients who have large Retirement Plans concerning the new distribution rules under the SECURE Act and urge them to review their beneficiary designations.