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Natalie Choate: The SECURE Act

"Signed into law December 20, 2019, SECURE has radically changed the estate planning landscape for clients' retirement benefits. Except for a few types of beneficiaries, the life expectancy payout is gone with the wind, replaced by a maximum 10-year post-death payout period for most retirement benefits. Here is what estate planners need to know about the new RMD regime, including what we don't yet know, and what to do about it all."

Natalie Choate provides members with her analysis of the SECURE Act. Members will find her commentary most helpful as it contains a "Practitioner to Do List" as well as commentary that examines what advisors need to do now given the radically new landscape we now operate in.

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Here is Natalie's commentary:

EXECUTIVE SUMMARY:

For over 30 years, the go-to estate plan for the owners of tax-favored retirement plans has been the "stretch IRA": Make your IRA or other retirement plan payable to a "designated beneficiary" (or see-through trust) and the designated beneficiary (or trust) could leave the plan in its tax-deferred status for years or decades after your death, withdrawing the benefits only gradually by taking annual distributions over his or her life expectancy. With the life expectancy of a 50-year-old son or daughter being 34.2 years, or that of a grandchild or great-grandchild being potentially as long as 80 years, this estate plan was understandably popular.

SECURE has swept that option away for most people. The definition of designated beneficiary hasn't changed. The definition of see-through trust hasn't changed. What has changed is the payout period for those beneficiaries: With the exception of five particular types of beneficiaries ("eligible designated beneficiaries") (EDB), the life expectancy payout has been replaced by a 10-year payout rule. So, the 50-year old son or daughter who inherits Mom's IRA will now have to withdraw the entire account within 10 years after Mom's death instead of over the 34.2-year life expectancy payout period that would have applied if Mom had died before 2020.

But even pre-2020 deaths are not totally spared by SECURE; they get only a partial exemption from the 10-year payout rule. See "*SECURE Effective Date; Pre-2020 Deaths,*" below. The rest of this newsletter will examine the new SECURE regime, how it works, who it applies to, which beneficiaries are exempt, what we still don't know, and what estate planners need to do about all this.

COMMENT:

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Meet SECURE; Where to Find the Law; Terminology

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

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

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

The Old Rules, Still Partially in Effect

To see how the SECURE changes fit into the Internal Revenue Code (“Code”), you have to first be familiar with the “old rules.” The minimum

distribution rules for retirement plan death benefits, until now, were entirely contained in Code section 401(a)(9)(B). As substantially enhanced and embroidered by Treasury Regulations, these pre-2020 rules were:

1. Upon the death of a retirement plan participant, the balance of his/her retirement account had to be distributed in annual instalments over the life expectancy of his/her designated beneficiary, or (if elected by the DB or required by the plan) under the paragraph #2 method, or more rapidly.

2. If the benefits were not left to a designated beneficiary, the inheritor had to withdraw the benefits within 5 years after the participant’s death if the participant died before his/her required beginning date or (otherwise) in annual instalments over what would have been the remaining life expectancy of the participant if he/she had not died.

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

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

SECURE Sits on Top of the Old Rules

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

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

Do all of SECURE's provisions fit perfectly and neatly into the existing Code and regulatory RMD rules? No. There are some rough edges the IRS will have to sand down with regulations; some of these are mentioned in this article.

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

To summarize: Pre-SECURE, there were two categories of beneficiaries, one of which was divided into two subcategories:

- **Beneficiary who is not a designated beneficiary** (the participant's estate, a charity, or a trust that does not qualify as a see-through trust) ("non-DB"): 5-year rule for benefits of participant who died before his RBD, participant's remaining life expectancy if participant died on or after RBD).

- **Designated beneficiary** (individual(s) or see-through trust): Entitled to life expectancy payout (or to use the non-DB rules if more favorable). A designated beneficiary could be either the surviving spouse (one set of rules) or a nonspouse beneficiary (another set of rules).

With SECURE, there are now three categories of beneficiaries, one of which has five subcategories:

- **Beneficiary who is not a designated beneficiary** (the participant's estate, a charity, or a trust that does not qualify as a see-through trust) ("non-DB"): 5-year rule for benefits of participant who died before his RBD, participant's remaining life expectancy if participant died on or after RBD). NOTE THAT THE RULES FOR NON-DB BENEFICIARIES WERE NOT CHANGED BY SECURE.

- **Designated beneficiary** (individual(s) or see-through trust): Unless "eligible" (see next category), must withdraw benefits within 10 years after the participant's death. See "The 10-year Rule" below. The general distribution rule for designated beneficiaries is now the 10-year rule—but there is an exception (allowing use of the life expectancy payout) for certain beneficiaries:

- **Eligible designated beneficiary**: These designated beneficiaries are still entitled to (a modified version of) the life expectancy payout method:

    A. **The surviving spouse.** § 401(a)(9)(E)(ii)(I). The surviving spouse can still use the life expectancy payout. However on her death the exception ceases to apply and a 10-year payout applies. See "Planning for the Surviving Spouse," below.

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

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

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

E. **Less than 10 years younger beneficiary**. The life expectancy payout applies to an individual who is not more than 10 years younger than the participant; upon his or her death, the 10 payout rule kicks in. See “*Planning for Less-than-10-years-younger Beneficiary*,” below.

Conduit trust. Vs. Accumulation Trust

Under the existing pre-SECURE rules, two types of trusts could qualify as see-through trusts, “conduit trusts” and “accumulation trusts.” The exact same types of trusts defined in exactly the same way can still qualify as see-through trusts under the new RMD regime created by SECURE. So understanding the tests and definitions discussed here is critically important to estate planning post-SECURE.

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

With an **accumulation trust**, the trustee can "accumulate" retirement plan distributions in the trust for possible later distribution to another beneficiary.

All beneficiaries who might ever be entitled to receive such accumulations are "counted" as beneficiaries for purposes of applying the minimum distribution rules, except that a beneficiary who is a "mere potential successor" to another beneficiary is disregarded. An accumulation trust qualifies as a see-through trust only if all of the countable beneficiaries are identifiable individuals. Reg. § 1.401(a)(9)-5, A-7(c)(1).

Here is what happens to these trusts under SECURE:

- If the primary beneficiary of the trust is an "eligible designated beneficiary," see the discussion of his or her category of EDB below as to whether a trust for his or her benefit qualifies for the favorable treatment granted to the EDB individually. Generally only a conduit trust for an EDB will get the life expectancy payout granted to the EDB individually. However, one type of accumulation trust for the benefit of a disabled or chronically ill individual can also qualify for the life expectancy payout.

- If the beneficiary of a conduit trust is not an EDB, then the conduit beneficiary will receive outright distribution of 100% of the retirement

- benefits within 10 years after the participant's death.

- With the exception of certain trusts for the sole life benefit of disabled or chronically ill beneficiaries, an accumulation trust must take distribution of the entire plan balance within 10 years after the participant's death.

The 10-year Rule

Since SECURE operates by "borrowing" the longstanding "5-year rule" of § 401(a)(9)(B)(ii) to create the 10-year rule, the 10-year rule presumably operates in the same manner as the longstanding (and still extant) 5-year rule: All amounts must be distributed by December 31 of the year that contains the 10th anniversary of the date of death; and in the interim, no distributions are required, as long as funds are out of the plan by that deadline. See Reg. 1.401(a)(9)-3, A-2.

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

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

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

Parsing this out, we find that for a beneficiary who is not a designated beneficiary, the rules don't change, but for every designated beneficiary the NEW rule is: "A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest is completed (regardless of whether distribution had begun prior to death), the entire interest of the employee will be distributed within 10 years after the death of such employee."

Code section 401(a)(9)(B)(iii) provides that there is an exception to the 5-year (now 10-year) rule: benefits payable to a designated beneficiary can be paid in annual instalments over such beneficiary's life expectancy in accordance with regulations. The new § 401(a)(9)(H) overrides this: This life expectancy payout shall apply ONLY in the case of an "*eligible* designated beneficiary."

Since the "10-year" rule is simply a replacement of the number 5 by the number 10 in the 5-year rule, we can presume that the IRS will interpret it the same way via regulations as assumed above, meaning that:

> The payout deadline would be December 31 of the year that contains the 10th anniversary of the date of death, not literally the 10th anniversary of the death. Either way, the actual payout period could extend over 11 taxable years of the beneficiary.
>
> Unlike with the life expectancy payout, there is no requirement of annual distributions. The distributions can be made at any time or times during the 10-year period as long as the plan is totally distributed by the end of the period.

Having seen how the 10-year payout works, let's turn to the different treatment granted to eligible designated beneficiaries (EDBs).

Planning for the Surviving Spouse

The "surviving spouse of the" participant is an EDB. The options for leaving benefits to the surviving spouse are little changed.

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

A conduit trust for the surviving spouse will be entitled to all the minimum distribution benefits of the surviving spouse under the IRS's rule that the conduit beneficiary is considered the sole beneficiary of the plan. Thus:

> The trust does not have to commence taking RMDs until the end of the year in which the deceased participant would have reached age 72. See § 401(a)(9)(B)(iv)(I), as amended by SECURE.
>
> The spouse's life expectancy, recalculated annually, will be the Applicable Distribution Period.
>
> The 10-year rule will not apply during the spouse's life.

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

A see-through accumulation trust for the surviving spouse will not be eligible for the life expectancy payout, even if the spouse is sole life beneficiary—for example, an "income only" marital trust. This type of trust would have to cash out all the benefits within 10 years after the participant's death.

Planning for Minor Children

As under existing rules, leaving retirement benefits for the benefit of minor children is difficult without either accelerating the taxation of the benefits or accelerating the children's control.

A conduit trust for a minor child is entitled to the same treatment the minor child, as an EDB, would have, namely, the life expectancy payout, because, as conduit beneficiary, the child is considered the "sole designated beneficiary" of the retirement plan.

However, this entitlement does not last for the child's entire life—only until he/she reaches majority, at which point the trust becomes subject to the 10-year rule. § 401(a)(9)(E)(iii). Thus, all benefits would have to be distributed outright to the minor within 10 years after he/she attained majority, which may or may not be what the parents would want. Some parents are content to have their children receive their inheritances outright at a young age, other are not. Here are important points, and questions, about this EDB category:

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

- The exception ceases to apply once the child "reaches majority (within the meaning of subparagraph [§ 401(a)(9)] (F)." (§ 401(a)(9)(F) is an otherwise unrelated provision that deals with payments made to a minor child being treated as paid to the surviving spouse.) Presumably the child reaches majority when he or she attains the age of majority applicable in his or her state (typically 18 or 21), unless this regulatory exception (under § 401(a)(9)(F)) applies: "... a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26. In addition, a child who is disabled within the meaning of section 72(m)(7) when the child reaches the age of majority may be treated as having not reached the age of majority so long as the child continues to be disabled." Reg. § 1.401(a)(9)-6, A-15.

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

This exception seems straightforward enough, subject to possible difficulties in determining "majority" status based on education status, which hopefully someone other than I will figure out.

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

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

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

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

Planning for Disabled and Chronically Ill

A designated beneficiary who is "disabled (within the meaning of section 72(m)(7))" is an EDB. § 401(a)(9)(E)((ii)(III). § 72(m)(7) provides that "an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require."

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

On the death of the disabled or chronically ill individual, as with other EDBs, the life expectancy payout period terminates and the 10-year rule kicks in.

Trusts for disabled and/or chronically ill EDBs are given two special break not granted to trusts for surviving spouses, minor children, and less-than-10-years-younger beneficiaries. If retirement benefits are left to a trust that has multiple beneficiaries, all of whom qualify as designated beneficiaries, and least one of the designated beneficiaries is an EDB by virtue of being disabled or chronically ill, then:

- If the trust is required by the terms of the trust instrument to be divided immediately upon the death of the employee into separate trusts for each beneficiary, the payout rules will apply separately to the separate trust so created for the disabled or chronically ill beneficiary. § 401(a)(9)(H)(iv)(I), (v).

- If under the terms of the trust [or subtrust created as provided in the preceding paragraph] "no individual other than [a disabled or chronically ill EDB] has any right to the employee's interest in the plan until the death of all such [EDBs] with respect to the trust," then the life expectancy exception "shall apply to the distribution of the employee's interest and any beneficiary who is not such an [EDB] shall be treated as a beneficiary of the [EDB] upon the death of such" EDB. § 401(a)(9)(H)(iv)(II), (v).

How is this treatment different than for other EDBs? For one thing, this special rule is saying the disabled or chronically ill EDB does not have to be the "sole" beneficiary of the trust—just the life beneficiary. Thus an accumulation trust for the disabled beneficiary, for example, could get the life expectancy payout treatment, even though (under the regulations) the disabled beneficiary is not considered the sole trust beneficiary. In the case of the surviving spouse, minor child, or less-than-10-years-younger individual, the trust would get the EDB's life expectancy payout treatment only if it were a conduit trust, since that is the only way the EDB would be considered the sole beneficiary.

Also, this special rule "overrules" the IRS's normal rule that, when retirement benefits are left to a single trust, which then immediately divides into separate subtrusts for separate beneficiaries, such division does not create separate accounts for purposes of determining the applicable distribution period unless the separate subtrusts were each named separately as beneficiary in the beneficiary designation form. Under SECURE's special rule in § 401(a)(9)(H)(iv)(I), separate subtrusts can be treated as separate accounts even if not so separately named in the beneficiary designation form.

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

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

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

Patty Example: Patty never married. Now age 75, she wishes to leave her $3 million IRA to her three siblings, all of whom are older than age 65. Each sibling, as an EDB, will be able to withdraw his or her share of the inherited IRA over his or her life expectancy (assuming they divide the inherited IRA into separate accounts by 12/31 of the year after the year of Patty's death). This is exactly what Patty wanted to achieve in her estate plan, and it still works under the new rules. The only difference is, as each sibling dies, his or her inherited IRA will become subject to the 10-year rule. While that is not a welcome modification, the family can deal with it. For example, Sibling #1 might decide to name the surviving siblings as her successor beneficiaries, knowing that they could use and might welcome the additional money, and name a charity as contingent beneficiary, giving the surviving siblings the option to disclaim the IRA to the charity if it turns out they don't need the money.

What Happens on Death of the EDB?

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

Presumably this simply means that the 10-year rule kicks in at that time. So if (for example) a surviving spouse who is life beneficiary of a conduit trust established by the deceased participant later dies while there is still something left in the retirement plan, the RMD schedule after her death would be as follows:

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

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

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

New Planning Landscape: Now What Do We Do?

The good news is, most clients’ estate plans will still “work” in the sense that their designated beneficiary is still the designated beneficiary and the see-through trust is still a see-through trust. The bad news is, most plans will not work the way they were expected to work. With the 10-year rule destroying the life expectancy payout, these will be the main considerations for most estate plans where retirement benefits are intended to benefit individuals:

As discussed above, if the client's chosen beneficiary is the surviving spouse, a disabled or chronically ill individual, or a less-than-10-years younger person, the client's existing plan will probably still continue to work, with some tweaks possibly being required to accommodate

SECURE (such as, for example, eliminating other discretionary beneficiaries from benefitting from a trust for a disabled person during the disabled person's lifetime). But for other beneficiaries:
Conduit trusts could prove disastrous in some cases. Specifically, if the client strongly wanted a gradual payout over the beneficiary's lifetime, and instead is face with a 10-year payout rule, the client will have to switch to an accumulation trust, despite the accelerated taxes at high trust rates, or consider a charitable remainder trust (see below).

Accumulation trusts will still work—but the trustee will be faced with a substantially accelerated tax bill, since all benefits must be distributed from the plan to the trust within 10 years. There are very limited options to avoid that tax bill, so figuring out how to pay it might be more fruitful.

Most of the concerns discussed here pertain to traditional retirement plans and IRAs, where taxes are going to be substantially accelerated (and therefore probably also be in higher brackets) than under previous law. With a Roth IRA, acceleration does not increase taxes, since the distributions are tax-free—the acceleration just means loss of future tax-free growth. Thus, one response to SECURE will presumably be increased Roth conversions during life by IRA owners, especially if the IRA owner is in a lower tax bracket than he expects his beneficiary to be (often correctly if the beneficiary is a trust).

A client who simply leaves his IRA outright to various individuals (e.g. his adult children) may have nothing to change. The children will have to pay taxes sooner than was previously expected, and that in turn may mean the taxes will be higher than if more spread out, but other than finding a new funding source for the taxes, or converting to a Roth IRA now if the client is in a lower bracket than his beneficiaries, there is not much that can be done about this.

Charitable remainder trusts may have more appeal now for a client who has charitable intent and a desire to leave a lifetime income stream to the beneficiary rather than a 10-year payout taxed at high rates. Traditional retirement benefits can be paid income tax-free into the CRT, which then pays a lifetime stream of fixed dollar or fixed percentage payouts (taxable) to the human beneficiary.

Trusteed IRAs should come into their own. Estate planning lawyers may decide to give up the struggle to create valid “see-through trusts” when such a trust will last only 10 years instead of several decades. A trusteed IRA is already guaranteed to provide the longest payout period the law allows (because it’s an IRS-approved prototype IRA), and the expert IRA trustee (if it is doing its job) should have the knowledge, will, and skill to manage payouts over the applicable distribution period in a way to maximize the benefit to the beneficiaries and minimize taxes. As someone who has been paid to write and endorse trusteed IRAs, perhaps I am biased—but one reason I’ve been hired to do those jobs is because I am a fan of trusteed IRAs.

SECURE Effective Date; Pre-2020 Deaths

§ 401(b) of SECURE is entitled “effective dates,” which it does provide, but this section also provides various exceptions to the new regime.

First, the amendments made by SECURE “shall apply to distributions with respect to employees who die after December 31, 2019.” However, pre-2020 deaths are not totally spared. SECURE attempts to impose the new regime if the original designated beneficiary dies prior to the end of his/her life expectancy.

Example: Suppose Mom had died before 2020, and Son was withdrawing from the IRA inherited from her over his 34.2-year life expectancy. Son then dies in (say) year 15, causing the IRA to pass to his designated successor beneficiary, Grandson, age 35. Under the old rules, Grandson would simply step into the shoes of the deceased designated beneficiary and take distributions over the remaining 19.2 years of Son's life expectancy. Under SECURE, the new rules will apply to the designated beneficiary of the original designated beneficiary—meaning (apparently)

Grandson is subject to a 10-year payout rule.

More precisely, here is what SECURE says about this situation, with commentary: If the participant died before the general 1/1/2020 effective date of the law, "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 [the one who died? Or the designated beneficiary of the one who died?] shall be treated as an eligible designated beneficiary [but which kind of EDB? Minor? Disabled???] for purposes of" § 401(a)(9)(H)(ii).

I will not attempt here to figure out what this means. Under current law, there is no way for a nonspouse designated beneficiary to name another "designated beneficiary." He/she can name a "successor beneficiary," and that's all. And how would this apply to a see-through trust which is taking RMDs over the life expectancy of the oldest beneficiary of a pre-2020 decedent, where the oldest trust beneficiary dies within his/her life expectancy? I will leave it to other wise authors and practitioners and the IRS regulatory skill to figure this one out.

Practitioner to Do List

First, check all estates your firm is currently administering. If still within the deadline for qualified disclaimers (generally nine months from the date of death), consider whether a qualified disclaimer could improve RMD results for any pre-2020 decedent's heirs.

Example: Dad died in November 2019, leaving his $1 million IRA to Mom as primary beneficiary with their three nondisabled adult children as contingent beneficiaries. If Mom accepts the IRA, rolls it over to her own IRA, and dies after 2019 leaving it to the children [the typically recommended scenario pre-SECURE] , the best payout period the children will get is 10 years. If she doesn't need the money, she could consider disclaiming the IRA and allowing it to pass to the children as Dad's contingent beneficiaries. As beneficiaries of a pre-2020 decedent, the children would be entitled to a life expectancy payout.

Then, contact all clients for whom retirement benefits are a significant part of their estate plan, explain what has happened and urge a review of the plan. Perhaps review, on your own motion without charge, recently completed estate plans, so you can suggest possible changes. Review the new landscape of planning choices (above) and when the client chooses one, implement the plan.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Natalie B. Choate

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the responsibility of the authors and do not represent an opinion on the part of the officers or staff of **LISI**.

CITES:

Further Consolidated Appropriations Act, 2020, (see pages 1640-1652 for the SECURE Act); House Ways and Means Committee summary of the SECURE Act.