LEAVING IRAs TO A TRUST

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I. INTRODUCTION

When we prepare estate plans for our clients, we plan differently for their IRAs, 401(k)s and other retirement accounts. These accounts have different tax treatment from probate assets, and we must take care in the manner in which they are left to the children.

This paper will discuss the basic rules for naming a trust for children as a beneficiary of IRAs and 401(k)s, including Designated Beneficiary and Stretch IRA rules. We'll explore the requirements and impact of various trust options, including see-through, conduit, accumulation and special needs trusts.

We will first go over the rules prior to the SECURE Act, and then go over how the new SECURE Act affects the way clients can leave retirement plans to children.

A. Terms

The concepts in this paper generally apply to IRAs and qualified retirement plans such as 401(k)s and 403(b)s. For simplicity's sake, in this paper I'll usually refer to these retirement plans as **IRAs.** IRAs are administered by custodians, and qualified plans are administered by plan administrators. I'll usually refer to them as the **plan administrator**. 401(k)s are established by an employee and IRAs are created by a plan participant. I will refer to the person establishing and contributing to the IRA or 401(k) as the **participant**.

The following acronyms are used in this paper:

IRA—Individual Retirement Account
DB—Designated Beneficiary
EDB—Eligible Designated Beneficiary
Non-DB—Non-Designated Beneficiary
RBD—Required Beginning Date
RMD—Required Minimum Distribution

The date that the plan participant must take distributions from a traditional IRA or qualified retirement plan is called the Required Beginning Date (RBD). For participants who die before

January 1, 2020, that date is April 1 of the year following the year in which the participant reached the age of 70 ½.[1] According to the SECURE Act, for participants who die after December 31, 2019, the RBD is 72. Roth IRAs have no required beginning date.

B. Basic Rules

IRAs are distributed upon the death of the participant to the beneficiary designated by the participant in the proper form. It is not distributed according to the participant's will. If the participant fails to properly name a beneficiary, the terms of the IRA contract govern who will inherit the IRA.

Typically, the participant names a primary beneficiary, and a contingent beneficiary if the primary beneficiary predeceases. If no beneficiaries are named on the form, or if all beneficiaries predecease the participant, the plan documents state who the default beneficiary is. The default may be the estate, which could result in a loss of tax benefits.

Our goal in planning has often been to stretch out the payout of IRAs to the beneficiary as long as possible, to increase the wealth transferring to the next generation. We try to minimize taxes and maximize deferral. Some of these options have been eliminated by the SECURE Act.

II. THE PROBLEM

For illustration purposes, let's assume that Marilyn Morte is married to Henry, and they have two children, Annie and Ben. Annie is 27 and, due to her disability, is receiving SSI/Medicaid and other benefits based on financial need. Ben is 21 and a college senior. Marilyn has a traditional IRA of $1 million and anticipates that upon her death it will still be worth $1M. She would like to leave the IRA to her husband Henry, but if he is deceased, then to Annie and Ben. She would like to use a large portion of it to fund Annie's special needs trust, as Annie will not be self-supporting and will require public benefits for her lifetime. Marilyn would like to maximize the tax-deferred growth that her children receive.

Henry has predeceased Marilyn, and Marilyn has designated her IRA beneficiaries as follows:

75% to Annie
25% to Ben

If Marilyn dies before 2020, and Annie inherits 75% of the IRA outright, Annie has two options. One, she can cash it out within 5 years and pay income tax on the whole amount. Two, she can transfer it into an inherited IRA. With the inherited IRA, she would receive tax-deferred growth, but must take Required Minimum Distributions ("RMDs") each year. The amount of each distribution will be calculated based on Annie's life expectancy according to the IRS single life chart. Annie can take additional distributions as well.

[1] Treas Reg. Sec. 1.401(a)(9)-5, A-1(c); 1.408-8, A-3

If Annie cashes out the IRA at once, it may be subject to the highest personal income tax rate of 37%. $750,000 x .37 = $277,500 in income tax Annie would have to pay, leaving her with $472,500. This does not accomplish Marilyn's goal of maximizing the IRA tax benefits.

The option which maximizes the funds for Annie's care is the inherited or Stretch IRA. Annie receives a stretch-out of tax-deferred growth. The funds earn income, but she does not pay income tax on that income until a distribution is made from the IRA. With tax-deferred compounding, the inherited IRA can grow substantially.

Two problems immediately appear. First, Annie is incapacitated and under guardianship. She does not have legal capacity to own these assets outright or manage them. If she is named as an outright beneficiary, the court may have to appoint a guardian of the estate or someone may have to apply to the court for a 1301 management trust in order for her to receive the IRA.

Second, the IRA could disqualify Annie from her government benefits. If Annie cashes out the IRA, she has excessive resources and may lose her government benefits. If she chooses the Stretch IRA option, the annual required distributions will at some point exceed the income limits and she will lose her benefits. If she doesn't spend the distributions timely, she may exceed the resource limit as well.

Ben has the same options of cashing out the IRA or putting it into an inherited IRA. Ben, however, is not mature at 21 and if he cashes it out he may use the money unwisely and it may be gone after a short time. He may not have the wisdom to choose an inherited IRA, and loses the tax benefits. Further, if he cashes it out, the funds are not protected from creditors or divorce.

Fortunately, with proper planning, these problems may be alleviated by creating a properly drafted trust.

III. STRETCH IRAs

An inherited IRA is one acquired due to the death of the original owner. When someone is named as the beneficiary of a decedent's IRA, the beneficiary can cash it out within 5 years and pay income tax on the entire amount.

If the beneficiary meets the definition of a "Designated Beneficiary" (see below), he or she can also put it into an inherited IRA, or Stretch IRA. Distributions from the Stretch IRA are made annually over the lifetime of the beneficiary. These distributions do not start at the retirement age of the beneficiary, but begin in the year following the year of the participant's death. This allows the account to grow tax deferred for the beneficiary's lifetime, usually resulting in a larger payout.

A qualified retirement plan is not required to allow a stretch of payments for the beneficiary's lifetime. In fact, the plan may require a lump sum payment upon the death of the participant. Read your client's plan documents to determine if the stretch is available. If it's not, the client may want to consult with their financial advisor to determine whether they should roll the plan into an IRA, as most IRAs allow the stretch.

A. Designated Beneficiaries

The stretch out of tax-deferred growth and lifetime RMDs is only available to "Designated Beneficiaries." Just because a beneficiary is named on a beneficiary designation form does not mean they are a "Designated Beneficiary."

To be a "Designated Beneficiary," the beneficiary must be:

1. A human individual designated by the participant (not an estate or charity), or
2. A trust that qualifies as a "See-Through Trust" (described below).

If multiple beneficiaries are named, all of them must be individuals in order for any to qualify as a Designated Beneficiary.[2] If one is not an individual, there is no Designated Beneficiary.

Please note that "Non-Designated Beneficiary" does not mean that the participant did not name a beneficiary. It means that the beneficiary named does not meet the definition of Designated Beneficiary. If a participant names their estate or a charity as a beneficiary, for example, it is a Non-Designated Beneficiary (Non-DB).

B. Distributions for Designated Beneficiaries

The Designated Beneficiary must take the first distribution by December 31 of the year after the year of the participant's death. A distribution must be taken every year until the beneficiary dies or the account is depleted, whichever occurs first.

To compute the RMD for the Designated Beneficiary, use the IRS Single Life Table to determine the life expectancy of the beneficiary. A copy of the IRS table is attached to this paper as Exhibit A. For example, if Annie is 28 at the time of distribution, her life expectancy according to the chart is 55.3 years. The first distribution is based on the account balance divided by 55.3. Each year one is deducted from the divisor, so the following year the balance is divided by 54.3, and so on. Annie's required distribution in 2020 will be $750,000/55.3 or $13,562. She can take additional distributions and will pay personal income tax on all distributions.

I went to the Schwab website Beneficiary RMD Calculator for a non-spouse, entered in the information from our scenario and it computed the payouts to our hypothetical Annie. I've attached a copy of the printout for illustration purposes as Exhibit B. Distributions increase each year if the account is increasing in value through investments. The distribution to Annie at age 50 could be $50,312, and at age 60 could be $91,973. According to this chart, if the account earns 6% per year, it could grow to over $2 million, doubling the value of the IRA. Contrast this with the $472,500 Annie would have received had she cashed out the IRA.

Clearly the stretch IRA results in a much larger payout to Annie, which accomplishes Marilyn's goal.

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[2] Reg. Sec. 1.401(a)(9)-4, A-3, third sentence

Designated Beneficiary	Non-Designated Beneficiary
• Human individual • See-through trust	• Estate or charity • Multiple beneficiaries and one is not a DB • Non-see through trust
Lifetime Stretch	5-year or Ghost Rule

C. Distributions for Non-Designated Beneficiaries

If the beneficiary named is a Non-Designated Beneficiary, the distributions will depend upon the age of the participant on the date of death. If the participant dies before the RBD, the 5-year rule applies and a stretch is not available.[3] All of the account must be distributed by December 31 of the year of the fifth anniversary of the participant's death.[4] There are no RMDs, and the payments can be spread out or taken on the last day. Some plans allow a Designated Beneficiary to choose the 5-year rule if the participant died before the RBD.

If the participant dies on or after his or her RBD, the distributions will be based on the life expectancy chart for the deceased beneficiary.[5] Some call this the "Ghost Rule." A trust that is a non-DB trust falls under these rules.

D. Multiple Beneficiaries

Generally, the payout of the RMDs for multiple beneficiaries will be based on the life expectancy of the oldest beneficiary.[6] If multiple beneficiaries inherit through an estate or single trust, they can create separate accounts but the RMDs will still be based on the life expectancy of the oldest beneficiary.

An exception to this rule that applies in some cases is the Separate Accounts Rule. If the multiple named beneficiaries, before the end of the year after the year of the participant's death, divide the inherited IRA into separate accounts, each beneficiary's RMDs will be based on the life expectancy of that beneficiary.

[3] Sec. 401(a)(9)(B)(ii); Reg. Sec. 1.401(a)(9)-3, A-4(a)(2)
[4] Reg. Sec. 1.401(a)(9)-3, A-1(a); Sec. 54.4974-2, A-3(c)
[5] Reg. 1.401(a)(9)-5, A-5(a)(2)
[6] Reg. Sec. 1.401(a)(9)-5, A-7(a)(1)

E. Disclaimers

A beneficiary of an IRA or trust can file a qualified disclaimer by September 30 of the year following the year of the participant's death. This removes that beneficiary as a Designated Beneficiary.[7] For example, when Marilyn dies, if Ben would rather that his 25% of the IRA go to Annie for her care, he can disclaim and 100% of the IRA will go to Annie or her trust.

In addition, the surviving spouse can disclaim, and the IRA will go to the contingent beneficiaries. If Henry was living when Marilyn died, and he wants her IRA to be used for their children, he can file a qualified disclaimer and the IRA will pass according to the contingent beneficiary designation. He would have no tax consequences if done properly.

Keep in mind that a person on SSI/Medicaid cannot disclaim. If they do, it could be considered an available resource or a transfer for less than fair market value, and could disqualify them from benefits.

IV. LEAVING IRAs TO A TRUST

The optimal financial result for the child, in many situations, would be a Stretch IRA. The account can grow tax-deferred for the child's lifetime, and the child will receive annual RMDs based on the child's life expectancy. In order to receive the stretch, remember that the beneficiary must be a "Designated Beneficiary" ("DB").

For a trust to qualify as a DB, it must meet the requirements of a See-Through Trust. If it does, the IRS looks though the trust and treats the trust beneficiary as the Designated Beneficiary.

A. See-Through Trust

In order to qualify as a See-Through Trust, the trust must meet these requirements:

1. The trust is valid under state law[8] at the date of death of the participant. It may be an inter-vivos or testamentary trust.
2. The trust must be irrevocable or will become irrevocable upon the death of the participant.[9]
3. The beneficiaries of the trust must be identifiable from the trust instrument.[10]
4. The trustee must supply certain documents to the plan administrator by October 31 of the year following the year of the death of the participant,[11] including a final list of beneficiaries and a copy of the trust instrument.[12]

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[7] Reg. Sec. 1.401(a)(9)-4, A-4(a)

[8] Reg. Sec. 1.401(a)(9)-4, A-5(b)(1); see also Reg. Sec. 1.401(a)(9)-5, A-7(c)(30, Examples 1 and 2

[9] Reg. Sec. 1.401(a)(9)-4, A-5(b)(2)

[10] Reg. Sec. 1.401(a)(9)-4, A-5(b)(3)

[11] Reg. Sec. 1.401(a)(9)-4, A-6(b

[12] Reg. Sec. 1.401(a)(9)-4, A-5(b)(4)

5. All beneficiaries must be "Designated Beneficiaries," or human individuals. If a beneficiary is the estate or a charity, the trust does not qualify as a See-Through Trust.

In order for the beneficiary to be identifiable they may be named in the trust, or they may be part of a class if it's possible to identify the member of the class with the shortest life expectancy,[13] or in other words, the oldest member. If the trust names "all of my descendants" as the beneficiary, this would suffice if at least one descendant is living when the participant dies, since it's possible to determine the oldest of the descendants at the time of the participant's death.

B. Non-See-Through Trusts

If the trust does not qualify as a See-Through Trust, the IRA is distributed as if there is no "Designated Beneficiary." If the participant died before the date he or she was required to take distributions, the trustee must distribute all of the trust to the beneficiary within 5 years after the death of the participant.[14] If the participant died after his or her RBD, the trustee will make distributions to the beneficiary in accordance with the ghost rule, over what would have been the life expectancy of the participant.[15]

C. Two Types of Retirement Trusts

A **conduit trust** provides that distributions from the trust must be paid immediately to the beneficiary. Distributions, which include RMDs as well as discretionary distributions, cannot be retained or accumulated in the trust. RMDs for a conduit trust are calculated based on the life expectancy of the primary beneficiary.[16] The remainder beneficiaries of the trust are not considered, even if they are an older person, a charity or an estate. A conduit trust will qualify as a See-Through Trust.

An **accumulation trust** allows the trustee to accumulate distributions in the trust—they do not have to be paid out immediately to the beneficiary. The remainder beneficiaries are not ignored. The IRS will use the life expectancy of the oldest of the primary beneficiary *and* the remainder beneficiaries in determining the RMD payout.[17]

An accumulation trust may or may not qualify as a See-Through Trust. The IRS looks at who, under the terms of the trust, is entitled to the trust property immediately and outright when the primary beneficiary dies. If these are individuals, the trust is a See-Through Trust. If the remainder beneficiaries are a charity or estate, it is not a See-Through Trust. This determination is made at the time of the participant's death, and who actually ultimately inherits the IRA is irrelevant.

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[13] Reg. Sec. 1.401(a)(9)-4, A-1

[14] Reg. Sec. 1.401(a)(9)-3, A-2

[15] Reg. Sec. 1.401(a)(9)-5, A-5(a)(2)

[16] I.R.C. Sec. 409(a)(9)-5, A-7((c)(3), example 2

[17] Reg. Sec. 1.401(a)(9)-5, A-7(c)(1)

Since the IRS looks at the primary and the remainder beneficiaries in determining who is the oldest beneficiary for the accumulation trust, it is important to draft the trust so that the remainder beneficiary is younger than or near to the age of the primary beneficiary. You usually will not want to name the grantor's or beneficiary's heirs at law as the remainder beneficiary, since the heirs could be significantly older than the primary beneficiary. Similarly, if an estate or charity is named as the remainder beneficiary, the trust does not qualify as a See-Through Trust.

The best practice may be to name specific people as the contingent beneficiaries. It is important to look closely at a power of appointment, as it may result in the beneficiary not being identifiable or may result in an older person being the DB. Naming the beneficiary's estate as a remainder beneficiary could also cause the trust to fail as a See-Through Trust.

The advantages of an accumulation trust are that it allows for tax-deferred growth and lifetime payout, while providing the protections of a trust (creditor/spouse/bloodline protection). If the beneficiary does not need the distribution in a given year, it can be retained in the trust to grow for the next generation. The disadvantage is that it is more complex and could result in higher taxes.

Conduit Trust	Accumulation Trust
RMDs paid out to beneficiary immediately	RMDs can be accumulated and not paid out immediately to beneficiary
RMDs based on life expectancy of primary beneficiary	RMDs based on life expectancy of oldest of primary and contingent beneficiaries
Is a See-Through Trust	Is a See-Through Trust only if primary and contingent beneficiaries are individuals

D. <u>Special Needs Trusts</u>

If the trust beneficiary is a person with disabilities who may rely on government benefits based on financial need, the trust should be drafted as a third-party Special Needs Trust. If done properly, the trust will not be considered a resource to the beneficiary. If the trust is drafted as a conduit trust, all distributions must be paid to or on behalf of the beneficiary, and could be considered income for SSI/Medicaid eligibility purposes. Conduit trusts are generally not used for special needs beneficiaries.

An accumulation trust may be the best option for a beneficiary with disabilities who needs to qualify for public benefits. You may draft the trust as a discretionary supplemental needs trust. Be very careful in naming the contingent beneficiaries, since their life expectancy will be considered in determining whose life on which to base the RMDs. The IRS will look at the primary beneficiary and the remainder beneficiaries who will inherit when the primary beneficiary dies, and will use the life expectancy of the oldest. If the beneficiary has siblings near in age, they are often the best choice for remainder beneficiaries.

Do not name a charity or the beneficiary's estate as a contingent beneficiary of the accumulation SNT. Since the charity or estate is not a DB, the trust will not qualify as a See-Through Trust. The trust must then be distributed to the beneficiary according to the 5-Year Rule or the Ghost Rule.

E. If an SNT is Not Named as a Beneficiary

If the participant dies and has named a beneficiary with disabilities outright, and the beneficiary needs to qualify for government benefits, the beneficiary could transfer the IRA to a first party self-settled SNT.[18] If necessary, the individual's parent or guardian could apply to the court to create the SNT. The benefits will be paid out over the life expectancy of the beneficiary, since the outright beneficiary is a Designated Beneficiary. This trust does not need to be a See-Through Trust (since the trust is not the named beneficiary). Remember that first-party SNTs are limited by statute and require a Medicaid payback provision.

For SSI/Medicaid purposes, the inherited IRA would be considered income in the month received, and a resource if retained into the next calendar month. Therefore, it's important to have the SNT drafted and ready to fund as soon as the distribution is made. You may request that the plan administrator not make a distribution until the SNT is executed. The beneficiary may lose their SSI/Medicaid benefits in the month the inherited IRA is received.

If a beneficiary is named outright, rather in trust, and a first-party SNT is created to hold the proceeds, can the plan administrator write the check out to the trustee of the SNT instead of to the beneficiary? If so, perhaps the beneficiary would not lose benefits in the month of the distribution. In the author's experience, most plan administrators would not issue the check in the name of the SNT. At least one attorney in Lubbock County has successfully petitioned the court to modify the beneficiary designation language (after the death of the participant) to name an SNT as a beneficiary instead of outright. The court order directs the plan administrator to cut the check to the trustee of the SNT. It is not known whether other counties would rule the same. The IRS may not honor such a state court order, either.

F. Multiple Trust Beneficiaries

If a single retirement trust is named as a beneficiary, and it states that upon the participant's death the trust is divided into separate trusts for multiple beneficiaries, the life expectancy of the oldest is used for all beneficiaries.

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[18] PLRs 2006-20025, 2011-16005

For example, if Marilyn's beneficiary designation names the "Marilyn Morte Trust" as the beneficiary, and the trust specifies that subtrusts for Annie and Ben will be created, the life expectancy of the oldest beneficiary applies to both subtrusts. The same result would occur of Marilyn's trust had a pot trust for the children.

The best practice is to name the children's subtrusts separately as beneficiaries on the beneficiary designation form itself.[19] That way, only the life expectancy of the beneficiary of the subtrust will be used to determine the RMDs of that particular subtrust.[20]

The beneficiary designation could state:

> 75% to the Annie Trust, as a separate share under the Marilyn Morte Trust
> 25% to the Ben Trust, as a separate share under the Marilyn Morte Trust

The distributions from Ben's subtrust will be based on Ben's longer life expectancy, resulting in a larger growth. Annie's trust could name Ben as the contingent beneficiary, and since he is younger, the RMDs for Annie's trust will be based on her life expectancy.

G. Court Reformation

If the trust named as a beneficiary of a retirement account is not a See-Through Trust, can you apply to court to have it modified to qualify as a See-Through Trust? Even though state law allows parties to apply to court to have a will or trust modified post-death, the IRS probably would not recognize the modification. [21]

H. Using a Standalone Trust

Some attorneys create a stand-alone retirement plan trust. If the retirement provisions are in a will or revocable living trust, they believe that having specific provisions that apply to only certain assets (IRAs) and not others would complicate a testamentary or revocable trust. If the trust is amended by another attorney, they may not notice these specific provisions. Also, a pot trust for all of the children would affect the RMD distributions. RMDs must be taken by a certain date, and the trustee of a regular trust may not notice to do this, or the trustee may comingle IRA assets with other trust assets. Adding retirement trust language to a will or trust could complicate it and make it longer.

Using a separate retirement trust may avoid the confusion and complication, and alert those involved of its unique nature. Its different provisions don't need to be mixed in with the will or RLT language. A standalone trust could cost more in legal fees and tax preparation fees, however.

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[19] Reg. Sec. 1.401(a)(9)-4, A-5(c)
[20] PLRs 2005-37044, 2006-07031
[21] Frances v. Sloan, IRS, in PLR 2010-21038

Some attorneys believe that adding retirement plan trust language to the revocable living or testamentary trust is simpler for smaller IRAs. If the client is creating subtrusts for multiple children or grandchildren, it may be easier to use a separate retirement plan trust.

If you include retirement trust language in a regular trust or will, you may want to carve out the power of appointment and other trust terms that affect the life expectancy rule.

I. Income Taxation of a Retirement Trust

After the participant's death, distributions from the retirement account to a trust are considered gross income to the trust. Trust tax rates are generally higher than personal income tax rates, but trusts are allowed to take some exemptions that individuals are not.

The general rules are that if income is accumulated in the trust, the income is taxed to the trust. If income is distributed, the trust receives an income tax deduction and the beneficiary reports it as income.

In 2020, trust income of over $12,950 is taxed at the highest trust tax rate of 37%. For a Qualified Disability Trust, remember, the trust receives an exemption of $4,125. However, the trust may take an income tax deduction for distributable net income ("DNI") paid out to the beneficiary. This distribution is considered gross income to the beneficiary. IRA distributions to the trust are considered DNI.[22] They may be deductible to the trust and are included in the beneficiary's gross income.[23] There are certain requirements in order for the trust to carry out the DNI.

The trust may also be subject to the 3.8% Net Investment Income Tax and the Medicare surcharge of .9%. Some qualified retirement plan trusts are exempt from NIIT under I.R.C. Sec. 501. Further, distributions from the inherited IRA generate Income in Respect of a Decedent, so IRD rules should be consulted if the estate is subject to estate tax. The rules regarding taxation of trusts are complex, and the practitioner or client may want to consult with a tax expert regarding the trust taxation.

If income is accumulated in the trust and not distributed, the income is subject to trust tax rates. If income is distributed for the beneficiary, the trust gets a deduction and the beneficiary pays taxes on the distribution at their lower income tax rate.

Conduit trusts generally do not produce much tax at the trust tax rate, since the distributions are immediately paid out to the beneficiary. Accumulation trusts, however, could be subject to significant taxation at the trust level since the RMDs can be accumulated.

It should be noted that income tax accounting is different than fiduciary accounting. For those of you who are trustees, remember that fiduciary accounting determines the type of income and the amount that is distributed to the beneficiary, and the trust instrument and state law govern. Fiduciary accounting determines what is principal and what is income. Tax accounting determines who is taxed on the income and is governed by federal law.

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[22] I.R.C. Sec. 643(a); Reg. Sec. 1.663(c)-5, Examples 6, 9 and 10; CCA 2006-44016

[23] I.R.C. Sec. 661(a); 662(a); Reg. Sec. 1.662(a)-3

J. Qualified Disability Trust

If the trust meets the IRS requirements of a Qualified Disability Trust (and usually would), the trust may enjoy some income tax benefits. A QDT may be entitled to a $4,125 personal exemption (in 2019).[24] The income is considered earned income to the beneficiary, rather than unearned income, which could be subject to the kiddie tax.

V. THE SECURE ACT

Setting Every Community Up for Retirement Enhancement ("SECURE Act"), H.R. 1865, was signed into law on December 20, 2019 and was effective January 1, 2020. I've attached a copy of the Act as Exhibit C. You may also find it here: https://www.congress.gov/116/bills/hr1865/BILLS-116hr1865enr.pdf. The SECURE Act begins on page 604, and the provisions regarding Eligible Designated Beneficiaries are found in Section 401, which begins on page 643. A copy of this section is attached as Exhibit D. The Act modifies I.R.C. Sec. 401(a)(9) to add a new subparagraph (H), and modifies definitions in I.R.C. Sec. 401(a)(9)(E). The Act applies to qualified retirement plans as well as to IRAs.[25] We should expect the IRS to issue regulations clarifying the SECURE Act within the next 6-12 months. The change in RMDs is expected to generate $15.7 million in revenue for the U.S. government over the next 10 years.

The SECURE Act changes the payout of inherited IRAs. The new general rule for participants who die on or after January 1, 2020, is that the Designated Beneficiary must take all distributions within 10 years, which we will call the **10-Year Rule**.

The definitions of a Designated Beneficiary or of a See-Through Trust are not changed. A new category is created—**Eligible Designated Beneficiary** (EDB), and a stretch or modified stretch is available only to EDBs.

The new RMD rules apply only to beneficiaries of participants who die after December 31, 2019. Be aware that even if the participant dies before that date, part of the SECURE Act still applies—the part that states that upon the primary beneficiary's death, the remainder beneficiary must take distributions within 10 years.

The SECURE Act completely changes estate planning for individuals with retirement accounts. For most beneficiaries, the Stretch IRA is gone, and they must take distributions within 10 years. Fortunately, an exception was carved out for beneficiaries with disabilities.

[24] I.R.C. Sec. 642(b)(2)(C)

[25] Reg. Sec. 1.408-8A-1(b)

A. 10-Year Rule

For beneficiaries subject to the 10-Year Rule, the retirement account must be distributed by December 31 of the year that contains the 10th anniversary of the death of the participant.[26]

B. Non-Designated Beneficiaries

Non-designated Beneficiaries (such as an estate, charity or non-See-Through Trust) are still bound by the 5-Year Rule and the Ghost Rule. This wasn't changed by the Act.

C. Non-Eligible Designated Beneficiaries

Designated Beneficiaries who are not Eligible Designated Beneficiaries are subject to the new 10-Year Rule.

D. Eligible Designated Beneficiaries Exceptions

The 10-Year Rule does not apply to "Eligible Designated Beneficiaries" ("EDB"). These are exceptions to the 10-Year Rule. Distributions to these beneficiaries are for their lifetime (with some modifications for minors). Whether someone is an EDB is determined on the date of the participant's death. The Act defines an EDB as:

- Surviving spouse of the participant[27]
- Minor child of the participant[28]
- Disabled person as defined by I.R.C. Sec. 72(m)(7)
- Chronically ill individual as defined by Sec. 7702B(c)(2)
- An individual who is less than 10 years younger than the participant

Minor children's distributions are based on their life expectancy until they reach majority (potentially up to age 26) and then the 10-Year Rule applies.[29] Note that only a child of the participant is an EDB—stepchildren, grandchildren and other children do not qualify. A child is a minor if they have not reached majority per state law (18 in Texas), or is under 26 and hasn't completed a "specified course of education.[30] So the rule for minor children is RMDs based on life expectancy until they reach majority, then the 10-Year Rule applies. When planning for minors, remember that if the child is under 24, kiddie tax may cause the distribution to be taxed at the parent's rate.

A person who is disabled will be able to stretch the distributions over his or her life expectancy. A person is considered to be disabled by the IRS if he or she "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 (sic) furnishes proof of the existence thereof in

[26] See Reg. 1.401(a)(9)-3,A-2; new Sec. 401(a)(9)(H) substitutes 5 years for 10 years
[27] I.R.C. Sec. 409(a)(9)(E)(ii)(I)
[28] I.R.C. Sec. 409(a)(9)(E)(ii)(II)
[29] I.R.C. Sec, 401(a)(9)(E)(iii)
[30] I.R.C. Sec. 409(a)(9)(F) and accompanying regulations

such form and manner as the Secretary may require."[31] It is not clear what proof the IRS will require.

A chronically ill person can also stretch their RMDs for their lifetime. They must be unable to perform at least two daily activities of daily living for at least 90 days, or they must require "substantial supervision to protect such individual from threats to health and safety due to cognitive impairment."[32] A medical professional must certify that the inability is indefinite and "reasonably expected to be lengthy in nature."[33]

Eligible Designated Beneficiary	Non-Eligible Designated Beneficiary	Non-Designated Beneficiary
• Surviving spouse • Minor child • Disabled person • Chronically ill person • < 10 years younger	• Human individual that is not EDB • See-through trust and beneficiary is not EDB	• Estate or charity • Multiple beneficiaries and one is not a DB • Non-see through trust
• Minor child: stretch until majority, then 10-Year rule • All others: Lifetime Stretch	10-Year Rule	5-year or Ghost Rule

VI. TRUSTS AFTER THE SECURE ACT

A. Conduit Trusts

Conduit trusts are still See-Through Trusts,[34] and require that RMDs be distributed to the beneficiary. If the primary beneficiary is an Eligible Designated Beneficiary (EDB), then the conduit trust will make distributions for the lifetime of the beneficiary (or modified for minors). If the beneficiary is a Non-EDB, then the trust would have to distribute all of the retirement benefits to the beneficiary within 10 years.

For example, a conduit trust for a minor would pay out RMDs to the child based on the child's life expectancy until the child reaches majority. At that time the conduit trust would distribute out the rest either in annual installments, or wait and distribute the balance at the end of year 10.

[31] I.R.C. Sec. 72(m)(7)
[32] I.R.C. Sec. 7702B(c)(2)
[33] Sec. 401(a)(9)(E)(ii)(IV)
[34] I.R.C. Sec. 409(a)(9)-5, A-7(c)(3), example 2

A conduit trust for a beneficiary who is disabled or chronically ill would pay RMDs for the life expectancy of the beneficiary. The problem is that the distributions could disqualify the beneficiary from government benefits. Conduit trusts are rarely used for beneficiaries with disabilities.

Clients with conduit trusts may not achieve the results they were expecting. The trust was drafted so that the lifetime RMDs would be paid out to the beneficiary, and the payments would be smaller in the beginning and allow for tax-deferred growth. With the 10-Year Rule, requiring payouts within 10 years could subject the child to higher income taxes on the larger distributions, and the tax-free compounding would be limited. If the client did not want large distributions to their child (spendthrifts, etc.) at an early age, that goal may be thwarted. Some clients may want to amend their trust to be an accumulation trust instead, after considering the tax consequences.

For example, if the parents left a $1 million IRA in a conduit trust for a 13-year old, they anticipated that RMDs would be paid annually for their child's life. The child would not get a large lump sum that could potentially be harmful to the child. Under the SECURE Act, the child would get RMDs until the child reaches majority. Then, let's say at age 21, the child could be receiving more than $100,000 per year for 10 years, or a lump sum of $1 million at the age of 31. As Natalie Choate mentions, the taxation is accelerated, and the child's control of the money is accelerated. This may not be what the parents intended.

B. Accumulation Trusts

An accumulation trust for a non-disabled beneficiary is subject to the 10-Year Rule, even if the beneficiary is an EDB. Remember that for an accumulation trust, the IRS looks at the life expectancy of the primary beneficiary and the contingent beneficiary in determining the payout period. This trust cannot have an EDB beneficiary since the primary beneficiary (a minor, for example) is not the sole beneficiary.[35] This is a major change to prior law.

C. Special Needs Trusts

Two special rules apply to trusts for beneficiaries who are disabled or chronically ill. First, an accumulation trust for a disabled beneficiary counts as an EDB as a sole beneficiary, regardless of who the remainder beneficiary is. The disabled beneficiary just has to be the life beneficiary.[36] The accumulation trust can be distributed for the beneficiary's lifetime (not the 10-Year Rule), and RMDs are based on the life expectancy of the primary beneficiary. This is different from other EDBs, who are not considered the sole beneficiary of an accumulation (since their remainder beneficiary life expectancy is considered).

Second, if the IRA is left to a trust with multiple beneficiaries who are DBs, and at least one is disabled or chronically ill, and if the trust provides that it is divided into separate trusts for each beneficiary upon the death of the participant, the RMD rules will apply separately for each subtrust

[35] Reg. 1.401(a)(9)-5, A-7(c)(1)
[36] Sec. 401(a)(9)(H)(iv)(II), (v)

for a disabled or chronically ill beneficiary.[37] If the beneficiary were not disabled, naming a single trust as the beneficiary of the IRA would not result in separate RMDs for each beneficiary.

This is great news for our clients. We can still draft accumulation trusts for children with disabilities, and the child will receive lifetime payouts and tax-deferred growth. It is preferable to draft the SNT so that no other beneficiaries can benefit from the trust of the disabled person during his or her lifetime.

RMDs that are accumulated rather than distributed out are subject to the compressed trust tax rates. However, a trustee who is aware of this could try to make distributions when appropriate and minimize the taxes. The trustee could also consider different investment strategies to limit income taxation.

Experts are telling us that you no longer have to draft the accumulation SNT with remainder beneficiaries who are younger or near the same age as the primary beneficiary. You still will not want a charity or estate to be the remainder beneficiary.

Conduit Trust	Accumulation Trust
EDB: Lifetime Stretch	Disabled Beneficiary: Lifetime Stretch
Non-EDB: 10-Year Rule	Non-Disabled Beneficiary: 10-Year Rule

D. Trusts for Roth IRAs

Roth IRAs may be better for accumulation trusts and SNTs, because the growth and distributions are not taxed to the beneficiary (the income tax was already paid by the participant). Then the higher trust rate does not cause as much of a problem. Roths are also beneficial because the participant does not have to take out RMDs over their lifetime, so the account can grow tax-free for his or her lifetime.

The growth of the Roth IRA and distributions from the IRA are not taxed. If the distribution from the Roth is not paid out to the beneficiary but retained by the trustee, it becomes trust principal. Income on that retained principal is taxable to the trust if it is not distributed to the beneficiary. If the trustee is careful, the earnings on that principal can be distributed to the beneficiary to eliminate

[37] Sec. 401(a)(9)(H)(iv)(I), (v)

trust tax. The beneficiary will pay tax on what is distributed to him or her. If the trustee distributes the principal to the beneficiary, the principal is not subject to income tax. Thus, the taxation of an inherited Roth in an accumulation trust can be significantly lower than that of a traditional IRA.

E. Separate Share Rule

If the participant names a single trust for multiple beneficiaries as a beneficiary of their IRA (and does not name the separate subtrusts on the beneficiary form), after the participant's death the beneficiaries cannot create separate shares with separate life expectancies as they may have been able to do prior to SECURE. Distributions will be based on the life of the oldest beneficiary. The one exception is that a separate share can be created for a person who is disabled or chronically ill.[38]

F. Distribution Upon Death of EDB

After the lifetime distributions to the EDB, upon their death the 10-Year Rule applies to their remainder beneficiary.[39] It is not clear if this applies to the remainder beneficiary of a trust, as opposed to a beneficiary named by the EDB.

If you are planning for parents who have a child with a disability, beware of leaving the spouse's share to them in trust. If the spouse is named outright, the surviving spouse can roll the IRA over into their own IRA, and name the trust for the child with disabilities as the beneficiary. The child's trust would enjoy lifetime growth and distributions for the child. If the parent leaves the IRA to the spouse in a conduit trust, however, upon the death of the surviving spouse, the remainder beneficiary (child) must take the distributions within 10 years.

G. Trusts for Non-Disabled Beneficiaries Under SECURE

What if the client does not want outright distributions of the IRA to their children who are not disabled? What if the client wants to protect it from the child's creditors (if the child is a doctor, for example), or outright distributions could be harmful to the child (spendthrift or child with addiction)? You may want to discuss with them whether they want to amend, reform or decant from a conduit trust into an accumulation trust. Consider using a totally discretionary distribution standard and an independent trustee.

The problem with an accumulation trust is it is trapping income inside the trust. This income is taxed at the higher trust tax rate. If the participant is alive, they could consider Roth conversions.

H. Charitable Remainder Trust

A charitably minded participant could name a Charitable Remainder Trust ("CRT") as a beneficiary of the retirement account. The CRT does not pay income tax on the IRA, and the unitrust or annuity payments could be paid to a first party special needs trust for the lifetime of the beneficiary. The SNT must meet the requirements of a (d)(4)(a) trust, including a Medicaid

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[38] I.R.C. Sec. 401(a)(9)(H)(IV)

[39] Sec. 401(a)(9)(H)(iii)

payback provision. Keep in mind that a CRT is irrevocable and does not provide flexible distributions for the beneficiary. Also, the child will pay tax on the distribution, and the taxation of these distributions is based on a complex tier system, depending upon the type of assets producing the income.

VII. PLANNING OPTIONS FOR SPECIAL NEEDS BENEFICIARIES POST-SECURE ACT

A. Name Beneficiary Outright

The client can choose to name the beneficiary as an outright beneficiary of their IRA, and hope that the beneficiary or someone on behalf of the beneficiary will create a first-party SNT. Distributions will be for the lifetime of the child, but the Medicaid payback may be an issue. Also, the child may lose benefits in the month the IRA was received. If the SNT is not executed quickly enough, and the IRA funds are held into the next month, it could be considered a resource and the child may be disqualified from benefits.

The client could name the child as a beneficiary outright, and when the client dies the beneficiary could immediately cash out the IRA, pay income tax on the entire amount, and then put the remaining funds in a first-party SNT. Again, the beneficiary would lose benefits for at least one month, and maybe longer if the cash-out and trust funding are not done in the same month. Also, if the beneficiary is incapacitated, they may need a guardian of the estate or a 1301 management trust.

B. Accumulation Trust

The client can instead sign a third-party accumulation SNT and name it as the beneficiary of that child's portion of the IRA. The trust would get the benefits of the stretch, but if the trust does not make distributions in a given year, the trust may pay high taxes. The beneficiary does not lose government benefits since it's not considered income or a resource.

C. Roth Conversions

To minimize the high trust taxes, the client may want to speak with their financial advisor about converting traditional IRAs to Roth IRAs. Roths can significantly reduce the trust taxation as well as taxation to the beneficiary.

D. Two Trusts

Some attorneys do two trusts—one for Roth and one for regular retirement accounts. That way there are annual withdrawals from regular IRAs and one for Roths. It may seem like overkill, but could be an option when the IRAs are very large.

E. Shift Tax to Parents

Another option is to shift the income tax to the parents and away from the accumulation trust. Once the parents are over 59 ½ (and the account has been open at least 5 years), they could withdraw as much as they want from their IRAs, and after their RBD they could take larger distributions than required. They would pay income tax at their personal tax rate but no penalty. A financial professional could help determine if this makes more sense tax-wise than allowing an accumulation trust to pay compressed tax rates. Once the parents take the distributions, that money is part of their regular estate and can be left to the regular (non-retirement) third-party SNT that is not subject to mandatory distributions that are taxed.

F. Life Insurance to Pay Taxes

If the parents are receiving RMDs and they don't need those RMDs for their living expenses, they could use the RMD to purchase life insurance for the benefit of the child with disabilities. This could allow a larger inheritance for the child and offset taxes paid by the accumulation trust.

For children who are not disabled, it's not possible to reduce the income taxes they will pay on the inherited IRAs, so the parents may want to consider how to leave money to pay those taxes, using life insurance, for example.

G. Spouse Planning

If the surviving spouse does need the deceased spouse's IRA, he or she could disclaim (assuming an SNT is a contingent beneficiary) and allow it to go to the child's SNT. Before SECURE, the spousal rollover was almost always the option chosen, but it may not necessarily be the best in these cases.

H. Grandparent Planning

Grandparent planning is another option. Unlike the exception for a minor (that the minor be the participant's child), there is no requirement that a disabled beneficiary be the child of the participant in order for the beneficiary to be an EDP. Therefore, the participant could name an accumulation trust for a grandchild with disabilities as a beneficiary.

VIII. CONCLUSION

It is vital that retirement accounts be considered when preparing an estate plan for a family with children. Beneficiary designation forms must be completed as part of the overall plan. It is fortunate that Congress carved out exceptions for individuals with disabilities, so that SNTs for inherited IRAs are still an option. Income tax management is more important after SECURE.

It may be a good time to meet with clients with large IRAs for whom you prepared previous estate planning and review them to consider if the plan needs to be modified.

Final words of caution: Do not allow an estate planning client to fail to name a beneficiary or to name their estate as a beneficiary. If there are multiple beneficiaries of a retirement trust, make sure the separate shares are set out on the beneficiary form.

Attachments:

Exhibit A	IRS Single Life Table
Exhibit B	Beneficiary RMD Calculator
Exhibit C	SECURE Act text
Exhibit D	SECURE Act Designated Beneficiaries text

Resources:

Life and Death Planning for Retirement Benefits, by Natalie Choate, https://www.ataxplan.com/life-and-death-planning-for-retirement-benefits/