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Southern Arizona Estate Planning Council

Estate Planning for Retirement Accounts

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Sarah has worked for over twenty years helping clients solve complex technical IRA questions. She has been a contributing writer for many IRA texts, articles and training manuals and has been quoted in national financial and tax publications such as *USA Today, The Wall Street Journal, The Philadelphia Inquirer,* and *CCH IRA Guide.*

She is an experienced speaker who has educated thousands of professionals in the financial industry including attorneys, CPAs, bankers, financial advisors, and brokers on retirement plan rules. Sarah has won praise for her ability to communicate complex laws in an easy-to-understand way and provide practical strategies for clients.

Sarah is a contributing writer and editor for *Ed Slott's IRA Advisor* newsletter, distributed to thousands of financial advisors nationwide, and writes for several areas of the company's website, www.irahelp.com. Sarah also serves as a valuable resource for the members of Ed Slott's Elite IRA Advisor Group™, a 400+ member organization of some of the country's top financial advisors who are dedicated to becoming experts in IRA distribution planning.

Sarah is a graduate of Smith College and Villanova School of Law. She is a member of the Pennsylvania Bar. She practiced law with a concentration in elder law for several years and for fifteen years was a senior consultant with PMC, Pension Management Company, an independent IRA consulting firm for financial organizations nationwide.

Estate Planning for Retirement Accounts

Navigating the SECURE Act

Naming IRA Beneficiaries and Setting up Inherited Accounts.

Trusts as Beneficiaries After the SECURE Act and SECURE 2.0

2023 Retirement Plan Contribution Limits

Phase-Out Ranges for IRA Deductibility

This chart is only for those who are covered by a company retirement plan.

Year	Married/Joint	Single or Head of Household
2021	105,000 - 125,000	66,000 - 76,000
2022	109,000 - 129,000	68,000 - 78,000
2023	116,000 - 136,000	73,000 - 83,000

If not covered by a company plan but the spouse is, the phase-out range for 2022 is $204,000 - $214,000 and for 2023 is $218,000 - $228,000. If filing married-separate, the phase-out range is $0 - $10,000.

IRA and Roth IRA Contribution Limits

Year	Maximum Contribution	Catch-Up Contribution*	Total Contribution w/Catch-Up
2021	6,000	1,000	7,000
2022	6,000	1,000	7,000
2023	6,500	1,000	7,500

A 2022 IRA or Roth IRA contribution can be made up to the tax filing due date, April 18, 2023. There is no extension beyond that date, regardless of whether an extension is filed for the tax return.

*Those who are 50 or older by year end can contribute an additional $1,000.

Roth IRA Phase-Out Limits for Contributions

Year	Married/Joint	Single or Head of Household
2021	198,000 - 208,000	125,000 - 140,000
2022	204,000 - 214,000	129,000 - 144,000
2023	218,000 - 228,000	138,000 - 153,000

If filing married-separate, the phase-out range is $0 - $10,000.

Employee Salary Deferral Limits for 401(k)s & 403(b)s

Year	Maximum Contribution	Catch-Up Contribution*	Total Contribution w/Catch-Up
2022	20,500	6,500	27,000
2023	22,500	7,500	30,000

Limits are per person; **not** per plan.

*Those who are 50 or older at year end can contribute an additional $7,500. The catch-up contributions are also eligible for employer matching contributions if allowed by the plan.

SEP IRA Contribution Limits (Simplified Employee Pensions)

2022 The SEP limit for 2022 is 25% of up to $305,000 of compensation, limited to a maximum annual contribution of $61,000. This limit also applies to Keoghs and profit-sharing plans.

2023 The SEP limit for 2023 is 25% of up to $330,000 of compensation, limited to a maximum annual contribution of $66,000. This limit also applies to Keoghs and profit-sharing plans.

Catch-up contributions do **not** apply to SEP IRAs. They still apply to old SARSEPs in effect before 1997. No new SARSEPs were allowed after 1996.

SEP contributions can be made up to the due date of the tax return, including extensions. For example, a 2022 SEP contribution can be made up to April 18, 2023 or up to October 16, 2023 if a valid extension has been filed.

SIMPLE IRA Contribution Limits
Contribution Limits for Salary Deferrals

Year	Maximum Contribution	Catch-Up Contribution*	Total Contribution w/Catch-Up
2022	14,000	3,000	17,000
2023	15,500	3,500	19,000

*Those who are 50 or older by year end can contribute an additional $3,500. The catch-up contributions are also eligible for employer matching contributions if allowed by the plan.

2023 Estate & Gift Exemption Amounts

Estate Tax	12,920,000
Generation Skipping Tax	12,920,000
Gift Tax	12,920,000
Annual Gift Tax Exclusion	17,000

SECURE Act – Summary of Key Changes
The SECURE Act – Signed into law on December 20, 2019
Most provisions are effective in 2020

Biggest change:
Eliminates the stretch IRA and replaces it with a 10-year payout rule for most beneficiaries

Key changes: Became Effective in 2020

1– Eliminates the 70 ½ age limit for making traditional IRA contributions

2 – Raises the RMD age to 72 (**SECURE 2.0 Act** raises this to age 73 in 2023, and to age 75 in 2033)

3 – Allows $5,000 penalty free withdrawals for births or adoptions

4 – Allows taxable non-tuition fellowship and stipend payments to be treated as compensation to qualify for an IRA (or Roth IRA) contribution; also allows nondeductible IRA contributions for certain foster care payments

5 – Provides employer liability protection for annuities in plans, and new annuity portability options

6 – Eliminates the "stretch IRA" – replaced with a 10-year rule for most beneficiaries, but there are exceptions for ***"Eligible Designated Beneficiaries"*** (EDBs), a new category of beneficiaries created under the law for those who inherit after 2019

New IRS SECURE Act Regulations Bring Big Surprises

On February 23, 2022, the IRS released long-awaited regulations (**REG-105954-20**) on required minimum distributions (RMDs) from IRAs and workplace retirement plans. The 275-page document replaces the current regulations that were issued in 2002. Many of the provisions in the new regulations reflect the sweeping changes made to post-death RMDs by the SECURE Act, but the regulations also incorporate IRS guidance on RMDs issued in recent years (e.g., through private letter rulings).

The regulations are proposed to be effective for 2022 RMDs. For 2021 RMDs, the IRS says that taxpayers can use a "reasonable, good faith interpretation" of the SECURE Act.

The most surprising provision of the proposed regulations is the one requiring annual RMDs for some IRA or plan beneficiaries subject to the 10-year rule. Before the new regulations were issued, most commentators believed the 10-year rule never required annual RMDs for years 1-9 of the 10-year period. Recently, the IRS has given mixed signals on this issue. However, in the new regulations, the IRS very clearly says that certain beneficiaries are subject to BOTH the 10-year payment rule *and* a requirement to take annual RMDs in years 1-9 of that 10-year period.

Whether a beneficiary of an account holder is subject to the annual RMD rule depends on whether the account holder died before or after her required beginning date (RBD). The RBD is the date by which the first RMD is due.

- The RBD for a traditional IRA owner born before July 1, 1949, is April 1 of the year following the year she turns age 70½. The RBD for a traditional IRA owner born on or after July 1, 1949, is April 1 of the year following the year she turns age 72.

  SECURE 2.0 Act Update: Age 73 for those who turn age 72 *AFTER* 2022, and then increases to age 75 in 2033.

- Roth IRA owners are not subject to RMDs and are therefore always considered to have died before their RBD.

- Plan participants who do not own more than 5% of the company sponsoring the plan can often delay their first RMD until April 1 of the year following the year of retirement.

The proposed regulations take the position that when death occurs on or after the RBD and the 10-year rule applies, the beneficiary must empty the account by the end of the 10th year following the year of death AND must receive annual RMDs in the first nine years following the year of death.

Major tax reform affects virtually every client!

Consumers are looking for competent, educated advisors and moving away from financial salesmen. They want true advisors and will demand that their advisors invest in their education.

Advisors with new planning ideas based on the tax law changes will see their value increase. For example, Roth conversions, which are now permanent (no do-overs anymore) will require a higher level of professional advice from you.

People are in transition and IRA money is in motion.

Many clients believe they have a long-term tax and estate plan for their retirement savings, but they don't. This presents a business-building opportunity for financial advisors who can learn these IRA and employer plan tax rules and apply them.

SECURE 2.0 Act of 2022 – Date of enactment – December 29, 2022

New Tax Laws Mean NEW Opportunities to Grow Your Business!

It is essential that advisors are continuously up to speed on current events and tax law changes so they can provide the highest level of service to clients.

You should keep in touch with clients and guide them through any changes or adjustments that may have to be made to their estate or other financial plans. **Major tax changes like these present opportunities to communicate with clients and build your client relationships.**

The End of the Stretch IRA

The SECURE Act Eliminates the Stretch IRA

Effective: *For deaths* ***after 2019.***

Old Stretch IRAs are grandfathered.
For deaths in 2019 or prior years, the current rules would remain in place. ***Those accounts will be grandfathered.***

The result is two different sets of rules for beneficiaries, depending on when the account owner died.

What is (or what was) the Stretch IRA?

The stretch IRA is a simple concept. It is the ability of the named beneficiary to spread (or stretch) required post-death distributions over the beneficiary's life expectancy using the IRS Single Life Expectancy Table. All that has to be done to guarantee the stretch is to name an individual beneficiary on the IRA beneficiary form.

Must be a Designated Beneficiary
An individual named on the beneficiary form and qualifying see-through trusts are designated beneficiaries and any designated beneficiary who inherited before 2020 still gets to continue the stretch IRA.

In addition, the SECURE Act created a new designated beneficiary category named **Eligible Designated Beneficiary** (EDB). EDBs continue to get the stretch IRA.

SECURE Act

Retirement Plan Payouts to Beneficiaries Under the SECURE Act

(for deaths *after* 2019*)

***Extended Effective Dates**

The effective date for the elimination of the stretch and application of the 10-year rule is generally for deaths after December 31, 2019. But that effective date is extended for two years (for deaths after December 31, 2021) for governmental plans, including 403(b) and 457(b) plans, and the Thrift Savings Plan. It is also extended for as long as two years for collectively-bargained plans, depending on the expiration date of the union contract.

Retirement Accounts Affected

The elimination of the stretch IRA and inclusion of the 10-year rule provisions apply to defined contributions plans, including 401(k), 403(b) and 457(b) plans, and traditional and Roth IRAs. They do not apply to defined benefit plans.

Under the SECURE Act, there are now 3 kinds of retirement plan beneficiaries for determining post-death payouts after 2019:

1. Non-Designated Beneficiary (NDB)

2. Non-Eligible Designated Beneficiary (NEDB)

3. Eligible Designated Beneficiary (EDB)

1. Non-Designated Beneficiary (NDB)

These are not people. Examples: Estate, charity or non-qualifying trust (non-look-through trust)

Post-death Payout Rules for NDBs
Based on whether the IRA owner or plan participant dies before or after the owner's required beginning date (RBD). The RBD is generally April 1 after the year of the 72nd birthday. For those who turn age 72 *after* 2022, the RBD is April 1 after the year of the 73rd birthday.

If owner dies before the RBD, the account must be withdrawn by the end of the 5th year after death – the 5-year rule. There are no annual RMDs during the 5-year window.

If owner dies on or after the RBD, RMDs must be taken over the deceased IRA owner's (or plan participant's) remaining single life expectancy – *"ghost life rule."* (Note: This can produce a post-death payout exceeding 10 years)

2. Non-Eligible Designated Beneficiary (NEDB)

10-year rule

All designated beneficiaries who do not qualify as EDBs (see #3 below).
Examples: grandchildren, older children, some look-through trusts

Post-death Payout Rules for NEDBs - *depends on whether death occurs before or after the required beginning date (RBD)*

• If owner dies ***before*** the RBD, there are no annual RMDs during the 10-year window.
• If owner dies ***on or after*** the RBD, annual (stretch IRA) RMDs must be taken for years 1-9.

Entire account must be emptied by the end of the 10th year after death – the 10-year rule.

3. Eligible Designated Beneficiary (EDB)

Stretch applies

The SECURE Act exempts these beneficiaries from the 10-year rule. However, if the account owner dies before the RBD, an EDB can elect the 10-year rule.

EDBs must be designated beneficiaries.

5 Classes of Eligible Designated Beneficiaries
1. Surviving spouses
2. Minor children of the account owner, until age 21 - but *not* grandchildren
3. Disabled individuals – under the strict IRS rules
4. Chronically ill individuals
5. Individuals not more than 10 years younger than the IRA owner. (Those older than the IRA owner also qualify.)

Plus - Any designated beneficiary (including qualifying trusts) who inherited ***before*** 2020. These beneficiaries are grandfathered under the pre-2020 stretch IRA rules. In addition, trusts for the sole benefit of these EDBs should qualify as an EDB.

<u>**EDB status is determined at date of owner's (or plan participant's) death and cannot be changed.**</u>

Post-death Payout Rules for EDBs
Once an EDB no longer qualifies as an EDB, or dies, the 10-year rule is applied for them, or for their beneficiaries (i.e., successor beneficiaries).

Application of the 10-year payout rule

Under the IRS Proposed Regulations, the Required Beginning Date (RBD) is a key factor in determining beneficiary RMDs.

Did the IRA owner (or plan participant) die BEFORE or ON OR AFTER the RBD?

RBD = Required Beginning Date
RBD = Really Big Deal!

In addition to the RBD, the category of beneficiary must be known to determine post-death RMDs.

Non-Designated Beneficiary or Designated Beneficiary?

If Designated Beneficiary, then:
Is the beneficiary also an eligible designated beneficiary (EDB)?
To be an EDB, the beneficiary must first be a designated beneficiary (an individual, or a qualifying trust named on the beneficiary form).

10-Year Rule Basics

For most non-spouse beneficiaries, the ability to stretch RMDs from an inherited IRA will be replaced with a 10-year rule.

SECURE Act regulations say the deadline for emptying the account under the 10-year rule is December 31 of the tenth year following the year of death.

100% RMD
In the 10th year following the year of death, any funds remaining in the inherited IRA would then become the RMD. If they are not taken by the 12/31 deadline, an RMD penalty would be owed.

Example 1:
10-year rule ending date
Barry, age 65, dies on January 12, 2020, and leaves his IRA to Mandy, his granddaughter. Mandy, as a non-eligible designated beneficiary, would have to empty the IRA account by December 31, 2030 (the end of the 10th year after death). If any funds remain in the inherited IRA after December 31, 2030, Mandy will owe an RMD penalty on those funds.

Death Before the Required Beginning Date (RBD)

When the IRA owner dies before the RBD or when a Roth IRA owner dies at any age, **there are no annual RMDs under the 10-year rule.** The account must be emptied by the end of the 10th year after the year of death.

During the 10-year period, there is flexibility. The beneficiary may choose to take nothing during a particular year or large distributions in others, as long as the account balance is emptied by the end of the 10-year term.

Example 2:
10-Year Rule – Death Before RBD
Tricia, age 65, dies in 2022. The beneficiary of her IRA is her son, Todd, age 40. Todd is subject to the 10-year rule. He does not have to take annual RMDs, but the entire inherited IRA must be distributed by December 31, 2032.

Example 3:
10-Year Rule – Inherited Roth IRA
Rodney, age 75, dies in 2022. The beneficiary of his Roth IRA is his daughter, Rhianna, age 50. Rhianna will be subject to the 10-year rule. She does not have to take annual RMDs, but the entire inherited Roth IRA must be distributed by December 31, 2032.

The Roth IRA Advantage

Key planning point for inherited Roth IRAs
Since Roth IRAs are not subject to lifetime RMDs, every Roth IRA owner is deemed to have died before his/her RBD, regardless of the age at death, because Roth IRAs have no RBD. For example, a Roth IRA owner who dies at age 100 is still deemed to have died before his RBD.

Under the proposed regulations' interpretation of the 10-year rule, non-eligible designated beneficiaries of traditional IRAs who are subject to the 10-year rule have to take RMDs in years 1-9 after death when death occurs on or after the RBD. But this is never the case for a non-eligible designated Roth IRA beneficiary, since all Roth IRA owners are deemed to have died before their RBD. This can allow the inherited Roth funds to continue to accumulate income tax free for the full 10-year term. This can benefit both individual and trust beneficiaries. The full balance of the inherited Roth must still be withdrawn by the end of the 10^{th} year after death.

Caution! – Watch out for the 5-year rule
Since all Roth IRA owners are deemed to have died before their RBD, this can trigger the 5-year rule if there is no designated beneficiary. A designated beneficiary is an individual named on the beneficiary form or qualifying trust. Examples of a non-designated beneficiary (NDB) are an estate, a charity, or a non-qualifying trust.

Under the RMD rules for inherited IRAs, when an NDB, inherits from someone who died before the RBD, the 5-year rule applies, and the inherited IRA funds must be withdrawn by the end of the 5^{th} year after death (but no withdrawals are required for years 1-4).

At Least as Rapidly Rule (ALAR) Effect

Death On or After the RBD - The *"at least as rapidly"* rule

The SECURE Act Regulations take the position that when death occurs on or after the RBD, a non-eligible designated beneficiary ***must take annual RMDs AND the 10-year rule also applies.*** The rule requiring annual RMDs when an account owner dies on or after her RBD is sometimes called the ***"at least as rapidly"*** rule. While it does not require the same amount that was taken by the IRA owner to also be taken by the beneficiary, it does require that the process of taking RMDs continue. Therefore, annual RMDs must continue after death.

From page 44 of the "Explanation of Provisions" of the Proposed Regulations:

Accordingly, if an employee dies after the required beginning date, distributions to the employee's beneficiary for calendar years after the calendar year in which the employee died must satisfy section 401(a)(9)(B)(i) as well as section 401(a)(9)(B)(ii).

In order to satisfy both of these requirements, these proposed regulations provide for the same calculation of the annual required minimum distribution that was adopted in the existing regulations but with an additional requirement that a full distribution of the employee's entire interest in the plan be made upon the occurrence of certain designated events (discussed in section I.E.3.c. of this Explanation of Provisions).

Translation: Both rules apply when death is on or after the RBD
1 – The "at least as rapidly" rule which requires RMDs each year after death (when death occurs after the RBD)

2 – The 10-year rule – where all funds in the inherited IRA must be withdrawn by the end of the 10th year after death

UPDATE: Due to continued confusion over how these rules work, the IRS waived RMDs in the 10-year period for years 2021 and 2022 (Notice 2022-53). This relief was extended for 2023 RMD in Notice 2023-54.

Example 4:
10-Year Rule – Death After RBD
Kevin, age 80, dies in 2022. The beneficiary of his IRA is his son, Daniel, age 40. Daniel will have to take annual RMDs from the inherited IRA based on his single life expectancy for years 2023 - 2031 (years 1-9 of the 10-year period). Also, the entire remaining inherited IRA balance must be distributed by December 31, 2032.

RMDs for years 1-9 are required under the "at least as rapidly" rule and the full balance withdrawal in year 10 is required under the 10-year rule of the SECURE Act. Both RMD rules apply in this situation. Daniel's RMD for 2023 would be waived under Notice 2023-54.

Pre-2020 Stretch IRA Rules - the “old rules”
These remain in place for beneficiaries who inherited before 2020

Lifetime Beneficiary Planning

Change of Beneficiary
The beneficiary can be changed at any time during the lifetime of the IRA owner and, in some cases, even after death (through disclaimers or death of a beneficiary). Lifetime distributions do not depend on the existence or identity of the beneficiary except in limited cases. However, every retirement account should still have a designated beneficiary and a contingent beneficiary in place at all times. Failure to have a designated beneficiary in place at death could result in the loss of the extended payout, that is, the stretch IRA, for beneficiaries who will still qualify for the stretch IRA under the SECURE Act.

Failure to have a designated beneficiary can also result in the loss of the new 10-year post death payout option for deaths in 2020 or later.

Adding Advisor Value
Since the IRA distribution rules allow changes in IRA beneficiaries at any time without any adverse tax consequences, that gives advisors an opportunity to make changes when necessary, keeping the estate plan flexible. **Anytime you have the opportunity to communicate with the client, it builds your value to that client.** You should take an interest in your clients so that you know when major life events occur. Life events are things like a marriage, divorce, birth, death, an adoption, new tax law changes and so on. Every one of these life events may necessitate a change in the IRA beneficiary or require more insurance or other services.

In addition, the SECURE Act may require a new look at beneficiary planning depending on which post-death options a client may desire.

Setting Up the Stretch IRA (over the beneficiary's lifetime) – for deaths in 2019 or earlier (if not already done), and for Eligible Designated Beneficiaries who will still qualify for the stretch IRA

Setting up the stretch IRA is easy. To qualify, the IRA owner simply names a living person (or qualifying trust) who is an eligible designated beneficiary as a beneficiary.

When you talk to a beneficiary about the retirement account they inherited, ask this question: Were you *named* on the beneficiary form?

That will allow the named beneficiary (if an eligible designated beneficiary) to stretch required distributions on the inherited IRA over his remaining life expectancy, keeping in mind that the IRA custodian or plan agreement can limit this option. If the stretch is allowed, the beneficiary will use the IRS Single Life Expectancy Table reproduced below:

To be used beginning with 2022 RMDs

Single Life Expectancy Table (for Inherited IRAs)

(To be used for calculating post-death required distributions to beneficiaries)

Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)	Age of IRA or Plan Beneficiary	Life Expectancy (in years)
0	84.6				
1	83.7	41	44.8	81	10.5
2	82.8	42	43.8	82	9.9
3	81.8	43	42.9	83	9.3
4	80.8	44	41.9	84	8.7
5	79.8	45	41.0	85	8.1
6	78.8	46	40.0	86	7.6
7	77.9	47	39.0	87	7.1
8	76.9	48	38.1	88	6.6
9	75.9	49	37.1	89	6.1
10	74.9	50	36.2	90	5.7
11	73.9	51	35.3	91	5.3
12	72.9	52	34.3	92	4.9
13	71.9	53	33.4	93	4.6
14	70.9	54	32.5	94	4.3
15	69.9	55	31.6	95	4.0
16	69.0	56	30.6	96	3.7
17	68.0	57	29.8	97	3.4
18	67.0	58	28.9	98	3.2
19	66.0	59	28.0	99	3.0
20	65.0	60	27.1	100	2.8
21	64.1	61	26.2	101	2.6
22	63.1	62	25.4	102	2.5
23	62.1	63	24.5	103	2.3
24	61.1	64	23.7	104	2.2
25	60.2	65	22.9	105	2.1
26	59.2	66	22.0	106	2.1
27	58.2	67	21.2	107	2.1
28	57.3	68	20.4	108	2.0
29	56.3	69	19.6	109	2.0
30	55.3	70	18.8	110	2.0

31 32 33 34 35	54.4 53.4 52.5 51.5 50.5	71 72 73 74 75	18.0 17.2 16.4 15.6 14.8	111 112 113 114 115	2.0 2.0 1.9 1.9 1.8
36 37 38 39 40	49.6 48.6 47.7 46.7 45.7	76 77 78 79 80	14.1 13.3 12.6 11.9 11.2	116 117 118 119 120+	1.8 1.6 1.4 1.1 1.0

This is a recalculating table (meaning you get a new life expectancy for every year you live), but only a spouse beneficiary who is the sole beneficiary can go back to the table each year and recalculate life expectancy. A non-spouse beneficiary cannot recalculate.

This table is used to calculate RMDs for:

- Designated Beneficiaries (DBs) who inherited before 2020.
- DBs who inherit in 2020 or later when the account owner dies ON OR AFTER his RBD - for years 1-9 of the 10-year period.
- Eligible Designated Beneficiaries (EDBs).
- Non-Designated Beneficiaries when the account owner dies ON OR AFTER his RBD for "ghost rule" RMDs.

This table is NOT used by:

- DBs who inherit in 2020 or later when the account owner dies BEFORE the RBD.
- IRA owners to calculate lifetime RMDs.
- Roth IRA beneficiaries, who are not EDBs.

How the stretch IRA works for ***pre-2020*** deaths and for EDBs

Re-setting RMDs to the 2022 Single Life Table

Example:
The named beneficiary is a daughter, Mary. Once the IRA owner dies, Mary can stretch the inherited IRA over her life expectancy from the Single Life Expectancy Table. If the IRA owner died in 2019 when Mary was 39, then Mary would use her age in 2020 - 40 (the age that she turned on her birthday in the year after the account owner's death), because that is her first required distribution year (even though the CARES Act waived RMDs in 2020). Mary would look up the life expectancy for age 40 which is 43.6 years. This means that she is entitled to spread required distributions over 43.6 years. For each succeeding year until 2022, Mary subtracts one from the life expectancy. In this example, the required distribution for 2021 (her second distribution year) would be calculated using a 42.6-year life expectancy (43.6 years less one year = 42.6 years). For 2022, Mary must **reset her RMD by looking at the new table** to determine what her life expectancy would have been for her first RMD (in 2020) – 45.7 years. Then, she must subtract one for each succeeding year to arrive at her 2022 life expectancy – 43.7 years. Beginning in 2023, Mary will subtract one from the previous year's life expectancy until the 43.7-year term has expired, unless she withdraws everything from the IRA before that time. The beneficiary can always withdraw more than the required amount.

Older Beneficiaries Can Use the Longest Life

If the IRA owner dies **AFTER** his required beginning date (RBD) (i.e., April 1 after their age 73 year) and the designated beneficiary is **older** than him, the beneficiary can use the deceased **IRA OWNER'S remaining** single life expectancy rather than the beneficiary's life expectancy. This will give the beneficiary a longer life expectancy than he would have had if he had to use his own life expectancy.

Caution: Under the IRS proposed regulations, the older beneficiary would still have to monitor his own life expectancy to determine when the inherited account would need to be emptied.

SECURE Act

Stretch IRA and Beneficiary Payout Rules and Examples

Eligible Designated Beneficiary (EDB) Payout Rules

EDBs can stretch RMD payments over their life expectancies, but non-eligible designated beneficiaries cannot.

Example 1:
Non-EDB inherits a Roth IRA in 2022

In 2022, Tom, age 42, inherits a Roth IRA from his father who died at age 78. Because this is a Roth IRA, Tom's father is deemed to have died before his RBD (required beginning date), regardless of how old he was at death. Tom is a designated beneficiary, but he is not an eligible designated beneficiary. This means he is subject to the 10-year rule. Tom can take as much or as little out of his Roth IRA each year during the 10-year period, but he must withdraw the entire Roth IRA by December 31, 2032, or he will be subject to an RMD penalty on the amount not taken. Since the inherited IRA was a Roth, Tom does not need to take annual RMDs over the 10-year period.

Example 2:
Non-EDB inherits a Traditional IRA in 2022 – Death After the RBD

Same as example #1 above, except that Tom inherited a Traditional IRA instead of a Roth IRA

In 2022, Tom, age 42, inherits a Traditional IRA from his father who died at age 78 (after his RBD). Tom is a designated beneficiary, but he is not an EDB. This means he is subject to the 10-year rule. Tom is subject to RMDs for years 1-9 after death under the ALAR rule (at least as rapidly rule) AND must withdraw the entire inherited Traditional IRA balance remaining by December 31, 2032, or he will be subject to an RMD penalty on the amount not taken. Notice 2023-54 waives the RMD for 2023.

If Tom's father died before his RBD, then Tom would still have to withdraw the entire inherited Traditional IRA balance by the end of the 10th year after death but would not be subject to RMDs for years 1-9. He could always take voluntary distributions during those years to smooth out the ultimate tax bill.

Example 3:
EDB (minor child) inherits in 2020

In 2020, Lisa, age 10, inherits an IRA from her mother. Lisa is an eligible designated beneficiary (EDB) and can stretch distributions over her single life expectancy. This goes on for 11 years. Lisa's 21st birthday is in 2031. Because Lisa has reached the age of majority, the 10-year rule will then apply. This means that Lisa must empty the inherited IRA by December 31, 2041 – by the end of the 10th year after she reached the age 21 – the age of majority in the proposed regulations.

ALAR Rule Quirk in the RMD Rules for Minor EDBs?

Based on one interpretation of the IRS proposed regulations, in this case the RBD may have no effect.

Whether Lisa's mother dies before or after the RBD, the result may be the same. RMDs may be required for years 1-9 after death, and then the full payout in year 10. That's because the IRS may be applying the ALAR, essentially telling us that once RMDs begin for the EDB (in this case Lisa), then they cannot stop when she reaches age 21.

Surviving Spouse is an Eligible Designated Beneficiary

Example 4:
Spouse inherits in 2020

Jim and Joann are a married couple. Jim dies in 2020 at age 75 (after his RBD) and leaves his IRA to Joann, age 57. Joann needs access to the funds, so she elects to do an inherited IRA. She will have an RMD, but by choosing to do an inherited IRA, she will be allowed to take additional distributions while avoiding the 10% early withdrawal penalty.

As an eligible designated beneficiary, Joann stretches the RMD payments over her single life expectancy, recalculated each year. At age 60, Joann does a spousal rollover of the inherited IRA, and her inherited IRA RMDs stop. Joann dies two years later at age 62 and leaves the IRA to her son Jeffrey, age 30. Jeffrey is not an EDB. The SECURE Act requires a 10-year term to pay out the IRA. Jeffrey must deplete the account by the end of the 10th year following his mother's death. Since Joann died before her required beginning date, Jeffrey is not required to take annual RMDs during the 10-year period.

Hypothetical RMDs for a Surviving Spouse

As an EDB, a surviving spouse can elect the 10-year rule if death occurs before the RBD

IRS closes perceived RMD avoidance "loophole"

In the IRS proposed regulations, IRS says that the surviving spouse cannot avoid RMDs by electing the 10-year rule. In fact, the IRS goes even further than that. They created yet another new term to know; "Hypothetical RMDs," as a type of deterrent to make sure RMDs are not avoided by a spouse who would have otherwise been required to take those RMDs upon reaching age 72.

Example 5:
Hypothetical RMDs Example
Spouse inherits from an IRA owner who died before the RBD

Ken and his wife Linda are both 70 years old. Ken dies with Linda as his primary IRA beneficiary. As an EDB spouse, Linda can do a spousal rollover or elect to remain a beneficiary. If Linda elects to remain a beneficiary, she can also elect the 10-year payout. Since Ken died prior to reaching his RBD, Linda will have no RMDs during the 10-year window. She will simply have to empty the account by December 31 of the 10th year after the year of Ken's death. There is no deadline for a spousal rollover, so Linda may believe that she can have her cake and eat it too. She may think she can use the 10-year rule (without annual RMDs) and then do a spousal rollover years later to avoid several years of annual RMDs that she otherwise would have had to take from her own IRA. That is the "loophole" the IRS is closing with this "hypothetical" retroactive spousal RMD provision.

Once again, the IRS is relying on a version of the ALAR rule. In this case though, it involves a spouse who otherwise would have been able to skip RMDs by using the 10-year rule.

In a later year (but before the end of year 9) when Linda decides to do the spousal rollover, she cannot roll over the full amount. Before completing the spousal rollover, Linda must calculate hypothetical RMDs for each year she was age 72 and older. These hypothetical RMDs are not eligible for rollover. (The years when Linda was 70 and 71 are not considered because they were before her first RMD year.)

Payout for Eligible Designated Beneficiary – Disabled or Chronically Ill

Those who are disabled or chronically ill as defined under the tax code on the date of the IRA owner's death qualify as an eligible designated beneficiary and are permitted to stretch inherited RMD payments over their life expectancy.

Proof required:

The proposed regulations require the individual to produce evidence of chronic illness or disability to the IRA custodian or plan by October 31 of the year after the year of death.

Example 6:
Chronically ill beneficiary inherits in 2020

Grandma Gertrude dies on July 4, 2020. She named her grandson Gary, age 30, as her primary beneficiary. On that date, Gary qualifies as "chronically ill" under the tax code definition. He also provides documentation of his chronic illness to the IRA custodian by October 31, 2021. Because he is an eligible designated beneficiary due to his medical condition, Gary can stretch the RMD payments. Gary uses the Single Life Expectancy Table for inherited IRAs to determine his RMD factor. Gary is required to take an annual RMD until the account is depleted.

10-Year Rule for Those Not More than 10 Years Younger than the IRA Owner

A beneficiary who is not more than 10 years younger than the deceased IRA owner (based on their actual birthdates) is an EDB under the SECURE Act and can use his own age to stretch inherited IRA RMD payments.

Example 7:
Sibling less than 10 years younger inherits in 2020

Three sisters are a tight group.

Sandra was born on May 1, 1950 and is the eldest at 70.
Sheri was born on May 1, 1960 and is age 60, and
Celeste is 59.

Sandra dies in 2020 and leaves an IRA to each of her younger sisters. Based on their actual dates of birth, Sheri is considered not more than 10 years younger than Sandra. Therefore, she qualifies as an eligible designated beneficiary and can stretch RMD payments over her single life expectancy. Since Sandra died before her RBD, Sheri could instead elect the 10-year rule. In that case, she would not be required to take annual RMDs in the first nine years (since Sandra died before her RBD).

Younger sister Celeste is only 59. She is more than 10 years younger than Sandra. Therefore, she is not considered an EDB and is bound by the 10-year payout term. Celeste's inherited IRA must be emptied by the end of the 10th year following her older sister Sandra's death, but annual RMDs are not required. (Meanwhile, if she only takes the RMD, middle sister Sheri can continue to stretch her inherited IRA RMD payments for more than another decade beyond when younger sister Celeste had to empty her account.)

However, since younger sister Celeste is a non-eligible designated beneficiary, Sheri can only use the stretch if Sandra's IRA is split into separate accounts by December 31, 2021.

Timing
- Determination of an Eligible Designated Beneficiary is Date of Death

From the Act: *"Time for Determination of Eligible Designated Beneficiary - The determination of whether a designated beneficiary is an eligible designated beneficiary shall be made as of the date of death of the employee."*

Example 8:
Non-EDB inherits in 2020, but becomes disabled in a later year

John dies on August 1, 2020. He named his son Jerry, age 30, as his primary beneficiary. Jerry is bound by the SECURE Act which dictates he must use the 10-year payout for the inherited IRA. Jerry gets into a car accident 6 months later and before his father's IRA was titled in his name as an inherited IRA. Jerry is fully disabled under the tax code rules. Jerry still cannot stretch the inherited IRA over his life expectancy. He cannot qualify as an EDB because he was not disabled as of the date of his father's death.

Non-Designated Beneficiary (NDB) Payout Rules

While much attention has been focused on the fate of designated beneficiaries under the SECURE Act and the fact that they will mostly be subject to a 10-year payout rule, there has not been as much attention paid to non-designated beneficiaries. Are they also subject to the 10-year rule?

The answer is "no" – whether Congress actually intended that to be the case is unknown. The SECURE Act leaves the rules for non-designated beneficiaries (e.g., estate as beneficiary, non-qualifying trust, charity) completely unchanged.

As such, the old rules for non-designated beneficiaries still apply.

- If the death is before the owner's required beginning date (RBD), payments must be made under the 5-year rule. The account must be emptied by the end of the 5th year after death.
- If death is on or after the RBD, payment must be made over the deceased IRA owner's remaining single life ("ghost" life expectancy).

Under the SECURE Act, it still pays to have a non-eligible designated beneficiary if death is before the RBD to avoid the 5-year rule.

However, now the difference between the 5-year rule and the 10-year rule is not as much as it was under the old law, where it might be a difference between the 5-year rule and maybe a 30-year stretch period. But for deaths on or after the RBD, a non-designated beneficiary can actually have a longer payout than the 10 years that apply to non-eligible designated beneficiaries.

Example 9:

Non-designated beneficiary inherits – the year does not matter since these rules did not change, except for the fact that the RBD in 2020 and later years is changed from age 70 ½ to age 72, and then to 73 under SECURE 2.0 Act.

Death before the RBD – 5-Year Rule

Allen dies at age 65 (before his RBD) and leaves his IRA to his estate (a non-designated beneficiary). Allen's son, David, age 40, inherits through the estate so he is a non-designated beneficiary. RMDs to David would be based on the 5-year rule. The entire inherited IRA account balance must be withdrawn by the end of the 5th year after Allen's death.

Example 10:
Same facts as Example 9, except IRA owner dies at age 87

Death after the RBD

Allen dies at age 87 (after his RBD) and leaves his IRA to his estate (a non-designated beneficiary). Allen's son, David, age 40, inherits through the estate so he is a non-designated beneficiary. RMDs to David would be based on his father Allen's remaining life expectancy non-recalculated. The first RMD in the year following the year of death would be based on Allen's 6.1-year remaining single life expectancy (7.1 for an 87-year-old, minus one).

Example 11:
Same facts as Example 9, except IRA owner dies very soon after passing his RBD
IRA owner dies at age 73

Allen dies at age 73 (after his RBD) and leaves his IRA to his estate (a non-designated beneficiary). Allen's son, David, age 40, inherits through the estate so he is a non-designated beneficiary. RMDs to David would be based on his father Allen's remaining life expectancy non-recalculated. The first RMD in the year following the year of death would be based on Allen's 15.4-year remaining single life expectancy (16.4 for a 73-year-old, minus one).

Example 12:
Same beneficiary inherits as a designated beneficiary

Same facts as in Example 11 above, except IRA owner named his son on the beneficiary form. In this example, Allen names his son David on the IRA beneficiary form, so David is now a designated beneficiary (a non-eligible designated beneficiary). David would be subject to the 10-year rule, which is a quicker payout vs. when he was a non-designated beneficiary.

It does not seem that Congress could have intended that result. In any case, it still pays to name a beneficiary to avoid the IRA going to the estate, which would entail probate costs and delays and even possible contests.

Payout Rule for Beneficiaries of Owners Who Die BEFORE 2020

The rules are the same as they were before the SECURE Act

If an IRA owner dies before January 1, 2020, and he named a designated beneficiary, that person is **<u>automatically considered an eligible designated beneficiary</u>** and can stretch RMD payments, the same as under the old rules.

That is the case even if the beneficiary would not otherwise be an eligible designated beneficiary under the SECURE Act definitions (i.e., is not a spouse, a minor child, a person not more than 10 years younger than the owner, a chronically ill individual or a disabled individual). ***<u>Designated beneficiaries of an owner who died before 2020 are in essence a 6th category of eligible designated beneficiary.</u>***

Example 13:
Grandchild inherits in 2019

Grandpa Thomas dies in December of 2019. He named his granddaughter Susan as his primary beneficiary. Susan is not an eligible designated beneficiary under the SECURE Act, but nonetheless she “gets in the club” and can use the stretch rules. As such, Susan, age 35 in the year after death, establishes an inherited IRA and can stretch the RMD payments over her life expectancy.

Successor Beneficiary Payout Rules

The successor beneficiary is the original beneficiary's beneficiary

Which Successor Beneficiaries Are Affected by the SECURE Act?
The SECURE Act rules for successor beneficiaries will only apply when the original beneficiary of an IRA owner dies in 2020 or later.

10-Year Payout Rule for Successor Beneficiaries
Successor beneficiaries of owners who die before January 1, 2020 do not get to "step into the shoes" of the first beneficiary and continue the stretch RMD payment if the first beneficiary died after 2019. They are instead automatically bound by the 10-year payout term. However, if the first beneficiary also died before 2020, the successor does get to continue the stretch over the first beneficiary's remaining life expectancy, the same as under the old RMD rules.

Successor beneficiaries of owners who die after 2019 are also subject to the 10-year payout rule – even if the first beneficiary was considered an eligible designated beneficiary and could use the stretch.

Example 14:
IRA owner dies in 2019, and beneficiary dies in 2020
Successor beneficiary is subject to the 10-year rule

Ann dies on November 1, 2019. She named her daughter Bea, age 48 on Ann's death, as her primary beneficiary. Even though Bea is not an eligible designated beneficiary under the SECURE Act, she gets to take advantage of the stretch rules. Bea dies on January 1, 2020 with her child CeCe (Ann's grandchild) as beneficiary. CeCe must receive the remaining IRA by the end of the 10th year following Bea's death (December 31, 2030).

Example 15:
Follow-up from above example
Same example as above, except Bea dies on December 31, 2019. In that case, the old pre-SECURE Act rules still apply, and CeCe can continue taking RMDs based on Bea's remaining life expectancy.

Example 16:
Chronically ill beneficiary inherits in 2020, and then dies in 2028
Successor beneficiary is subject to the 10-year rule

Grandma Gertrude dies on July 4, 2020. She named her grandson Gary, age 30, as her primary beneficiary. On that date, Gary qualifies as "chronically ill" under the tax code definition, so he can begin taking stretch RMDs. Gary dies in 2028 with his minor child Jay as primary beneficiary. Jay must receive the remaining IRA portion by the end of the 10th year following his father's death.

Under the SECURE Act, the general rule is that a successor beneficiary will be subject to the 10-year rule. However, the application of the 10-year rule will depend **on whether the IRA owner died before or after the required beginning date (RBD)** and whether the original beneficiary was a designated beneficiary (DB) or an eligible designated beneficiary (EDB). **Note that all Roth IRA owners are considered to die before their RBD.**

Death Before the RBD with a DB (a non-eligible designated beneficiary)

If an IRA owner dies before her RBD and the original beneficiary is a DB, then the successor beneficiary will be subject to the same 10-year rule as the original beneficiary. The successor's payout term is the remaining years in the original beneficiary's 10-year term. No annual RMDs are required in years 1-9 of the 10-year payout period.

Example 17:

Roth IRA

Louise, age 70, dies in 2020. Her Roth IRA beneficiary is her adult daughter, Lisa. Lisa is a designated beneficiary, and she is subject to the 10-year rule. Lisa names her daughter Ava as successor beneficiary. Lisa dies in 2022. Ava must empty the inherited Roth IRA by December 31, 2030, which is the end of Lisa's original 10-year term. **The successor cannot tack on a new 10-year term of her own.** She continues the remaining years of the original 10-year term which in this example is 8 more years since Lisa died 2 years into the 10-year term. No annual RMDs are required to be taken in years 1-9 by either Lisa or Ava.

Death Before the RBD with an EDB

When the IRA owner dies before his RBD and the original beneficiary is an EDB, the successor beneficiary will be subject to the 10-year rule beginning in the year of the EDB's death. In this case, the successor beneficiary gets his own full 10-year term. However, under the IRS's apparent strict interpretation of the ALAR rule, RMDs could be required for years 1-9 after death of the original beneficiary, with a full payout required by the successor beneficiary by the end of the 10^{th} year after death.

Example 18:

Death Before the RBD with an EDB

Gertrude, age 50, dies in 2020. She named her son Gary, age 30, as beneficiary of her traditional IRA. On that date, Gary qualifies as "chronically ill" under the tax code definition, so he can begin taking stretch RMDs. Gary dies in 2028 with his disabled son, Jay, as primary beneficiary. Jay must receive the remaining IRA portion by the end of the 10^{th} year following his father's death (December 31, 2038) but may also have to take RMDs for years 1-9 based on Gary's original RMD (stretch IRA) schedule.

Death On or After the RBD with a DB (a non-eligible designated beneficiary)

If the IRA owner dies on or after the RBD and the original beneficiary is a DB, then the successor beneficiary will be subject to the same 10-year rule as the original beneficiary. Annual RMDs are required in years **1-9 of the 10-year payout period by both the original beneficiary and the successor beneficiary.** These are calculated based on the life expectancy of the original beneficiary.

Example 19:
Kevin, age 85, dies in 2020. His IRA beneficiary is his adult son Robert. Robert is a designated beneficiary (but NOT an EDB). Therefore, he is subject to the 10-year rule and must take annual RMDs in years 1-9 over his life expectancy. Robert names his son Aiden as successor beneficiary. Robert dies in 2022. Aiden must empty the inherited IRA by December 31, 2030. He must also continue annual RMDs in years 3-9 (2023-2029) of the 10-year period based on Robert's single life expectancy. No RMD would be required in 2023 (Notice 2023-54).

Death On or After the RBD with an EDB

If an IRA owner dies on or after her RBD and the original beneficiary who is an EDB also dies, then the successor beneficiary will be subject to the 10-year rule beginning in the year of death of the EDB. Annual RMDs based on the EDB's life expectancy must be paid to the successor beneficiary in years 1-9 of the 10-year period, and the entire account must be emptied by the 10th year following the year of the EDB's death.

Example 20:
Monica, age 73, dies in 2020. Her IRA beneficiary is her sister, June, age 65. June is an EDB (because she is not more than 10 years younger than the deceased IRA owner) and can take annual RMDs using her single life expectancy. June names her daughter, Clare, as the successor beneficiary. June dies in 2022. Clare is subject to the 10-year rule, and she must empty the inherited IRA by December 31, 2032. During the 10-year period, she must take annual RMDs in years 1-9 based on June's single life expectancy.

Automatic Waivers of Missed RMD Excise Tax

SECURE 2.0 Act of 2022 Update:

Beginning in 2023, the 50% penalty is reduced to **25%**, and then to **10%** if timely corrected by making up the missed RMD. "Timely" means corrected generally in 2 years (unless the penalty is assessed earlier). However, IRS penalty waivers on Form 5329 apparently can still be requested.

The tax code previously imposed a penalty on missed required minimum distributions (RMDs) equal to 50% of the annual RMD not taken.

Existing IRS regulations allow the IRS to waive the penalty if the missed RMD was due to reasonable error and proper steps are taken to fix the mistake. The IRS will normally waive the penalty if the missed RMD is taken, and Form 5329 is filed with an explanation of the reason for the error.

The new IRS proposed regulations retain the discretionary waiver and address a situation where the IRS will grant an automatic waiver (i.e., Form 5329 does not have to filed).

Missed Year-of-Death RMD
The first situation is new and applies when a beneficiary fails to take a year-of-death RMD by the end of the calendar year in which the IRA owner's (or plan participant's) death occurs. In that case, there is an automatic waiver as long as the year-of-death RMD is taken by the beneficiary's tax filing deadline, including extensions. This waiver will be very helpful when an owner or participant dies near the end of the year before taking the RMD for that year.

Example:
Michael, age 75, has a traditional IRA with his wife Holly as beneficiary. Michael's annual RMD is normally paid on December 15. Michael dies on December 10, 2022. Holly is responsible for taking his 2022 RMD, but she does not become aware of that obligation until early 2023. Before the proposed regulations, Holly would have faced a 50% excise tax for not taking the 2022 RMD by December 31, 2022. Now, Holly would be eligible for an automatic waiver if she takes the 2022 RMD by her 2022 tax filing deadline (April 18, 2023 or October 16, 2023 if she goes on extension).

Why Most Beneficiaries Overpay Their Taxes

Common Mistakes in Setting up Inherited IRAs

How to Retain Retirement Accounts and Preserve the Stretch IRA

Only eligible designated beneficiaries (EDBs) qualify for the stretch IRA.

Titling of an Inherited IRA
The deceased IRA owner's name must remain on the inherited IRA account title and the account title must indicate that it is an inherited IRA by using the word "beneficiary" or "beneficiary IRA" or "inherited IRA." There is no set format as long as the deceased IRA owner's name remains on the account and it is clear that this is an inherited IRA.

Properly Titled Inherited IRA:

"John Smith IRA (deceased 11/27/22) F/B/O John Smith, Jr., Beneficiary"

An inherited IRA can be established by any beneficiary, including a spouse. A non-spouse IRA beneficiary **<u>cannot</u>** do a 60-day rollover. Only a spouse can do that (via a spousal rollover). The non-spouse beneficiary can move an inherited IRA to another IRA **only by trustee-to-trustee transfer.**

IRA Beneficiary Form Mistakes

SECURE Act Update

Only Eligible Designated Beneficiaries (EDBs) qualify for the stretch IRA, for deaths after 2019

To qualify as an EDB, the beneficiary must first be a designated beneficiary meaning that the beneficiary needs to be named on the beneficiary form.

This is often ignored, or people think someone else took care of it or it’s covered in the estate plan or the will or somewhere. It isn’t.

Many people do not realize the importance and long-term significance of the IRA beneficiary designation form and lose track of it. It is interesting that most people can locate their wills, but the ***wills do not cover the IRA***. The IRA passes outside the will by beneficiary designation.

Where’s the Beneficiary Form?
Think about it. We certainly do not wish anything bad on anyone, but let’s say something terrible happened today, and you had to leave this minute and go home and put your hands on your own IRA beneficiary form for every IRA or retirement account you have; could you do it? For most, the answer is “No.”

This is incredible. Some people think, “Well, the bank must have it.” They don’t. With all the recent financial institution mergers, the retirement plan paperwork has not been followed up on. The paperwork is not being carried over to the new institution. The old institution may have brought it to the new institution, but the new institution used new forms and didn't enter the information. Clients may be surprised to go to the new institution now and ask for those beneficiary forms only to find out that the beneficiary forms are blank, meaning that the estate may now be the beneficiary.

It is not uncommon for brokers and advisors to move to a different firm. When the broker/advisor switches to a new firm, the paperwork is often lost in the shuffle.

For the biggest financial institutions keeping track of IRA beneficiary forms or updating them is **<u>not a big priority</u>.**

This is the time to provide real tangible value by checking these forms for your clients and your future clients.

Right now, more people are looking to move to an advisor who is on the case, working for them. Get the conversation started by checking beneficiary forms.

It is amazing to think that the one document that:

- Will determine how long you will be in business,
- Will determine the value of your practice,
- Is the main estate planning document for what may be the largest asset in the client's estate,
- Controls the distribution for money that the client worked for and saved for his entire working life,
- Is, in effect, the will for the IRA,
- Will guarantee the stretch IRA for eligible designated beneficiaries

…Cannot be found by anyone in America anywhere!

Herring v. Campbell – August 17, 2012

Stepchildren Disinherited - The Beneficiary Form Wasn't Updated

Plan says that stepsons are not children - They lose $300,000!

Herring v. Campbell, No, 11-40953, U.S. Court of Appeals, 5th Circuit, August 7, 2012

The Appeals Court ruled that a plan administrator did not abuse her discretion in concluding that stepsons were not "children" under the terms of their stepfather's employer retirement plan. As a result, when the plan participant died with no beneficiary, the stepchildren were disinherited, and other family members got the money - $300,000 - under the plan's default beneficiary rules.

Facts of the Case

John Hunter worked for Marathon Oil Company and participated in their qualified retirement plan. The plan allowed him to name a primary and secondary (contingent) beneficiary. He named his wife Joyce Hunter as primary beneficiary ***but did not name a contingent beneficiary***. After Joyce died in 2004, he did not update his plan beneficiary. John later died in 2005.

Because he died without a living primary or contingent beneficiary, his plan defaulted to one of five beneficiaries in the following order: (1) his surviving spouse; (2) surviving children; (3) surviving parents; (4) brothers and sisters, or; (5) his estate.

Because his wife was already deceased, the plan's next default beneficiary was his surviving children. **He did not have any biological or legally adopted children, but he did have two stepsons, Stephen and Michael Herring.** The employer plan administrator, Eileen Campbell, looked into whether his two stepsons should inherit the funds, which totaled more than $300,000. However, she decided that his stepsons were not his children because they were not his biological children and were never adopted by him. She based her decision on three criteria: (1) the need for a uniform standard for determining who were "children"; (2) the need for a practical and objective mechanism to avoid potentially burdensome and expensive investigations into a claimant's status; and (3) her conclusion that excluding stepchildren from the definition was most likely to align with the expectations of the majority of plan participants.

Under the terms of the plan, because Hunter's wife had predeceased him, he had no biological or legally adopted children, and he had no surviving parents, the plan distributed the funds to the next category of default beneficiaries - Hunter's six brothers and sisters.

The stepsons later challenged the distribution, arguing that they were Hunter's "children" and should have gotten the money. They cited the fact that he referred to them as his "beloved sons" in his will.

<u>From the Court:</u>
"…the Herrings challenged the distribution, arguing that they were Hunter's 'children' and should have been given priority over Hunter's siblings. Citing their close relationship with Hunter, the fact that Hunter left his estate to them, and the fact that Hunter referred to them as his 'beloved sons' in his will…"

Lower Court Rules Plan Administrator Was Wrong
The first court, a district court, ruled in favor of the stepsons and concluded that the plan administrator "abused her discretion by failing to consider the stepsons' claims of adoption by estoppel." The plan administrator then appealed the district court's ruling.

Appeals Court Reverses Lower Court – Stepchildren Disinherited
The Court of Appeals reversed the lower court's ruling and agreed that stepchildren are not children who were entitled to the retirement plan assets.

The Court of Appeals had to first determine whether the plan administrator's interpretation of the term "children" was "legally correct." They ruled that the plan administrator's interpretation of the word "children" to ***<u>exclude</u>*** stepchildren who were not legally adopted was correct. Furthermore, nothing in the plan or pension law required the plan administrator to address the concept of equitable adoption in the plan's definition of "children." Thus the retirement plan funds were properly distributed to Hunter's siblings as the default beneficiaries of the plan. **<u>The stepsons were disinherited.</u>**

Poor Beneficiary Planning Leads to Taxable IRA Distributions for Beneficiary

IRA Beneficiary Form Trumps Deceased IRA Owner's Wishes

Elroy Earl Morris et ux. v. Commissioner
T.C. Memo. 2015-82; No. 30167-13, April 27, 2015

In a recent Tax Court case, a taxpayer failed to properly report distributions taken from his father's IRA that were, in accordance with what he believed were his father's wishes, given to his siblings. The IRS challenged the taxpayer's claim, and the Court upheld the IRS' position, rejecting arguments that it would be inequitable to hold the husband solely liable for the tax because he shared the proceeds with his siblings and because he received bad advice from a law firm.

Facts of the Case
Elroy Earl Morris was the sole beneficiary of his father's IRA. In 2011, his father died and Morris elected to take a lump sum distribution from the IRA. The IRA custodian issued a 2011 Form 1099-R, showing a $95,484 distribution coded as a death distribution. No funds were withheld for income tax.

Morris served as the personal representative of his father's estate. Implementing what he believed to be his father's wishes, he issued checks in July 2011 to two of his siblings in the aggregate amount of $37,000. These funds came from the IRA distribution. Morris secured assistance from a local law firm in settling his father's estate.

A paralegal did most of the work for Morris with regard to his father's estate. At one point, the paralegal told Morris that there would be no tax due on the IRA distribution. Evidently, she meant that there would be no federal estate tax or state inheritance tax due, but Morris understood her to mean that no tax of any kind would be due. When Morris filed his federal income tax return for 2011, he did not report the IRA distribution as income. The IRS sent him a notice of deficiency, determining that the IRA distributions constituted taxable income. Morris brought the case to the Tax Court.

The Court's Decision
Morris argued that it would be inequitable to hold him solely liable for the income tax on the IRA distributions because he voluntarily shared the proceeds with his siblings, from whom he is unlikely to recover anything. He further contended that he was disadvantaged by what he believes was erroneous advice from the law firm that assisted him in settling his father's estate. The Court rejected both arguments.

From the Court:
Although petitioner acted honorably in executing what he believed to be his father's wishes, his good conduct has no bearing on whether the IRA distributions were includible in his gross income under the Internal Revenue Code. And whereas the advice he thought he received from the law firm might have affected his liability for the accuracy-related penalty, it is irrelevant in determining the taxable status of the distributions themselves.

While the Court admitted Morris "acted honorably," that was not enough for him to avoid being held responsible for the taxation of the IRA distributions.

There are several lessons to be learned from his unhappy outcome.

Review IRA beneficiary designation forms. This court case could have been avoided if the IRA owner (Morris's father) had reviewed the beneficiary designation form for his IRA during his lifetime and named all three of his children as beneficiaries.

Consider a disclaimer. Morris could have executed a qualified disclaimer on the portion of the IRA he did not want. By doing so, he would avoid the taxation on those funds. He could not, however, direct the funds to be paid to his siblings. Instead, those funds would be paid to the contingent beneficiary, or the default beneficiary listed in the IRA document. From the facts in this case we do not know for sure who that would be.

There's no way to know for sure, but it's possible that by disclaiming, Morris would have been able to have his father's IRA flow to his father's estate, and then ultimately to his siblings (without him having to give them portions of his distributions).

Be careful with legal advice. Morris claimed to be receiving advice primarily from a paralegal at a law firm handling his father estate. His communications with her were less than completely clear and he misunderstood the tax consequences of the IRA distribution. And remember, many attorneys, even estate planning attorneys, are unaware of the special rules and tax provisions that apply to IRAs and other retirement accounts.

Check Beneficiary Forms!

Check beneficiary forms!! And don't just check the forms for assets you have under management. Check all the beneficiary forms for your clients.

Beneficiary forms trump ALL other estate planning documents. The beneficiary forms must be checked to be sure that they carry out the account owner's wishes and that they are in agreement with other estate planning documents such as pre- or post-nuptial agreements, divorce decrees, trust documents, etc.

How to Fix the Problem

Lucky for you, this amazing phenomenon is easily corrected. Here's what to do for yourself and every client with a retirement account.

Get a copy of the beneficiary form for every IRA and other retirement account you own and for those of your clients. Many of these can now be accessed online.

Make sure you check that a beneficiary is named. Go one step further. Make sure a secondary or contingent beneficiary is named in case the first one predeceases or to take advantage of post-death estate planning and disclaimer opportunities now available under the IRA rules.

Make sure that when there are multiple beneficiaries, each name and share is clearly stated. Make sure percentages add up to 100% or fractional shares add up to 1. The form must identify each beneficiary and his share, by using either a fraction, a percentage or the word "equally" if that is applicable. Otherwise, some beneficiaries may be left out or it may be unclear what their portion is. There should be no question as to who gets what. This includes contingent beneficiaries as well.

How to Use the IRA Beneficiary Form to Build Referrals

The single most meaningful service you can provide to your clients is to keep a copy of their IRA beneficiary designation form on file for them.

After the SECURE Act, **beneficiary form planning is more critical**, since not all beneficiaries will qualify for the stretch IRA.

To qualify as a designated beneficiary, the person or qualifying trust must be named as the beneficiary on the IRA or plan beneficiary form.

Also, make sure that the client's beneficiaries know to contact you after their death. After the client dies, their beneficiaries should know that they do not have to wonder where the forms are or if they even exist at all. They can come to you and know you'll have a copy of the beneficiary form (similar to the way that beneficiaries go to the attorney for the will after the death of a loved one). That form can be the difference between a stretch IRA, a 10-year payout or even a possible 5-year payout when there is no designated beneficiary.

It is not enough to keep the IRA beneficiary form on file. You must review these forms with clients no less than once a year or more often if any changes due to life events or new tax laws warrant it

It is up to you to develop the kind of relationship with your client that ensures communication when events that will lead to beneficiary form changes occur. That form must be continually kept up to date.

Every client file should have a current beneficiary form inside it. That must be a priority. You may have to contact many clients. That's okay. That's also good business.

Should you look for missing beneficiary forms? **NO!** Don't waste your time. All prior choices can be changed now anyway. Have clients execute new beneficiary forms and you keep copies of those forms on file for them. Do the same for your own retirement accounts.

IRA Beneficiary Selection

Estate as Retirement Plan Beneficiary

When we talk about using the estate tax exemption, we do **NOT** mean to name the estate as the retirement plan beneficiary. **<u>As a general rule, never, ever name the estate as a retirement plan beneficiary</u>**, but so many people do. Why? Many times they are told, "Just name your estate and your retirement plan will pass through the provisions of your will and go to all the right people." That statement may be true, but it should have been changed to say, "It will go to all the right people; that is, whatever is left after taxation of 70% or more." Why? Because the estate is not a designated beneficiary, which means it has no life expectancy. For maximum IRA stretch-out, you need to make sure that your client has a ***designated*** beneficiary.

Another way the retirement plan can be left inadvertently to an estate is where no beneficiary is named at all. If there is no beneficiary for the retirement plan, the estate may become the beneficiary by default, even though the client thought he named somebody. **If the estate becomes the beneficiary for whatever reason, then the IRA stretch option is lost, even for someone who would have qualified as an eligible designated beneficiary (EDB) if they hadn't inherited from the estate. If a person inherits through the estate, they lose their status as a designated beneficiary, and under the SECURE Act as an EDB.**

When the estate is named as the IRA beneficiary, the retirement plan, which is usually a non-probate asset because it has a beneficiary form, is turned into a probate asset. Anything that passes through the will becomes a probate asset. Not only would the tax ramifications be expensive, but the estate would be subject to any probate costs on the retirement plan. If there is a large retirement plan, that could be a substantial amount of money, maybe even up to 5% in some cases, depending on lawyer's and court filing fees. If a client dies without a will, then the entire retirement account passes to beneficiaries through the intestacy laws of the state. This may not result in the choice that the client had in mind for beneficiaries. It could also get dragged out in a contest if certain beneficiaries come out of the woodwork and claim to be the rightful heirs to this retirement plan. Most, or all, of it could get eaten up in legal fees.

Check Beneficiary Forms

Post-death fixes are expensive, and may not always work

PLR Relief is Expensive!

In a number of PLRs (private letter rulings) where the estate became the beneficiary, IRS has allowed spousal rollovers when the spouse was the sole beneficiary and had complete control of the funds.

Spousal Rollovers Allowed

Some PLRs where IRS allowed a spousal rollover when the estate was the beneficiary: 201936009, 201821008, 201839005, 201736018, 201612001, 201618011, 201430020, 201430027, 201211034, 202210016, 202214008.

Non-Spouse Beneficiary PLRs

IRS has also allowed non-spouse beneficiaries to set up inherited IRAs when the estate was the beneficiary, but they would still not be designated beneficiaries, since the estate was the original beneficiary.

PLR 202039002

Released by the IRS on September 25, 2020

IRS Allows Non-Spouse Beneficiaries to Move Funds to Inherited IRAs Even Though Estate was IRA Beneficiary

https://www.irs.gov/pub/irs-wd/202039002.pdf

In PLR 202039002, the IRS allowed trustee-to-trustee transfers to separate inherited IRAs for each of the non-spouse beneficiaries of an IRA owner's estate, citing Revenue Ruling 78-406. This PLR is like many previously issued PLRs allowing this despite the estate being named as the IRA beneficiary. Also, PLRs 2015,03024, 201430022 (18 beneficiaries in this PLR), 201208039, 201128036, 200647030, 200647029, 200343030, 200646028, 200646027, 200646025.

But these post-death fixes are an expensive route, especially compared to the no-cost method of checking beneficiary forms ahead of time.

Some of these IRS PLR fees alone were $10,000, PLUS thousands more in professional fees to file the ruling requests.

SECURE Act Warning:

It is as yet unknown whether IRS would allow the creation of an EDB with PLRs like these below where IRS allowed the spouse to be the beneficiary even though the estate or a trust for the spouse's benefit was the named beneficiary.

Do not take a chance!

Check beneficiary forms!

Charity as Beneficiary

<u>IRAs are the best assets to leave to a charity,</u> especially after the SECURE Act has significantly decreased the benefit of using an IRA in an estate plan, mainly due to the elimination of the stretch IRA for most beneficiaries.

Result:

- Leave less taxable IRA funds to beneficiaries
- Leave more tax-free non-IRA funds that get a step-up in basis to beneficiaries (capital gain on lifetime appreciation is eliminated for beneficiaries)

For individuals who are charitably inclined and have made provisions for certain charities under their will and also have substantial retirement plans, an effective tax strategy would be to **<u>reverse the bequests.</u>** Revoke the old will and execute a new will, leaving the funds that were going to go to the charity to the family instead, and make up the difference by leaving the same amount of retirement plan money to the charity.

This way, the charity receives the same amount that they were going to receive in the will, but the heirs will end up with more because the money they will inherit will not be subject to income tax, as the retirement plan would be.

Split IRAs. Ideally, do not name a charity as a co-beneficiary on a retirement plan. The charity does not have a life expectancy. The charity is not a person so its life expectancy is zero. Therefore, if you name a charity as a beneficiary with any other person, automatically the person reverts to a "0" life expectancy. To fix this, the living beneficiaries need to be sure the charity is paid out by September 30th of the year after the IRA owner's death or that the account is split into separate accounts by that date with the charity having its own account. This way, the remaining designated beneficiaries (those with a pulse and breathing) get to use either the 10-year payout rule under the SECURE Act or for EDBs, their own life expectancies in calculating required distributions. It is still best to keep charitable beneficiaries on separate IRAs, with no other co-beneficiaries.

Disclaimer planning with charitable beneficiary
Name the charity as the secondary beneficiary. This way, upon death, the primary beneficiary can disclaim any portion he or she wants to go the charity.

Spouse as Beneficiary

SECURE Act – The surviving spouse is an EDB

RMD age is changed from age 70 ½ to age 72 (and to age 73 under SECURE 2.0 Act)

Spouse Beneficiary Advantages
The special rules below only apply if the spouse is the **sole** IRA beneficiary. However, even if the spouse is one of several IRA beneficiaries, the spouse can still qualify as a sole beneficiary if her share is split into a separate IRA by December 31st of the year following the year of the IRA owner's death.

Rules Effective for Deaths Before 2024

If a spouse inherits before 2024, the spouse beneficiary will have three options

(1) Spousal Rollover
Only a spouse beneficiary can do a spousal rollover of an inherited IRA into her own IRA. There is no deadline for a spousal rollover. However, any RMDs (including "hypothetical" RMDs under the new IRS regulations) must be taken prior to the spousal rollover. RMDs must be taken before a 60-day rollover is permitted. However, RMDs can be transferred (trustee-to-trustee) to another account and taken later in the year. A retirement plan can be rolled over or transferred by a spouse regardless of whether the retirement plan owner died before or after the RBD. If the spouse chooses the rollover, the IRA will be treated as the spouse beneficiary's own IRA.

(2) Treat IRA as the Spouse's Own
A spouse who is the sole beneficiary can treat the IRA as her own. She cannot do that if separate accounts are not set up. The regulations impose a deadline for a spouse beneficiary to elect to treat the IRA as her own.

This deadline is the later of:
- The end of the year following the IRA owner's death, or
- The end of the year in which the surviving spouse beneficiary reaches age 72.

After this deadline, the surviving spouse cannot "treat the account as her own," but she can still do a spousal rollover.

(3) Spouse as Beneficiary of Retirement Plan (no rollover)
A spouse can also be treated as a retirement plan beneficiary. This is different than a spousal rollover.

Delayed Distributions
If the spouse is the sole beneficiary, and the IRA owner dies before his RBD, the spouse can delay required distributions until December 31st of the year the IRA owner would have turned 73 years old, regardless of the age of the spouse. She cannot do that if separate accounts are not set up.

Recalculate Life Expectancy
A spouse who is a sole beneficiary can recalculate life expectancy each year. She cannot do that if separate accounts are not set up. The payments start in the *later of* the year after the year of the account holder's death, or the year the account holder would have attained age 73. The age 73 option is only available if the spouse is the sole beneficiary. Under the Regulations, if there are multiple individual beneficiaries at death, the account may be split into each beneficiary's share, so that each beneficiary is the sole beneficiary of that share.

Example:
Assume that Frank dies before his RBD, at 68, and named his spouse, Barbara, as IRA beneficiary. Barbara is 65 years old. She has two choices. She can either be a direct beneficiary or use a spousal rollover and treat the IRA as her own. If Barbara chooses to be a direct beneficiary, she does not have to begin taking distributions until December 31 of the year that Frank would have attained age 73. If Barbara chooses a spousal rollover, she treats it as her own IRA and would not have to begin taking distributions until the year she attains age 73. In most cases, it would be beneficial to use the spousal rollover.

It would pay to be treated as a beneficiary only where the spouse was under age 59½. If instead of 65 years old, Barbara was 40 years old and did a spousal rollover, the account would be treated as her own IRA. If she wanted to take any money out before age 59½ there would be a 10% penalty which is assessed on retirement plan owners who tap into their retirement plan accounts before age 59½. But this 10% penalty does not apply to retirement plan beneficiaries. In this case, where the beneficiary is younger than 59½ years old, it would pay to be treated as a beneficiary and the surviving spouse could take distributions without incurring the 10% penalty. After reaching age 59½, the spouse still has the rollover option available. Choosing to remain a beneficiary does not restrict the spouse from being able to roll over later on.

It might also pay to use the beneficiary route if the surviving spouse was much older, for example, 75 years old, and the retirement plan owner was 65 years old. If the surviving spouse chose to be a beneficiary, they would not have to start RMDs until the year the retirement plan owner would have attained age 73. He or she would not have to draw down for another seven years. A spousal rollover would mean they would have to begin withdrawals by December 31st of the year following death.

If the spouse is named as the retirement plan beneficiary, when the retirement plan owner dies the spouse should immediately name new beneficiaries to avoid having the IRA go through probate if the estate becomes the beneficiary.

Death Exception to the 10% penalty –

Does not apply when the spouse rolls the retirement funds over to his/her own IRA – The spouse is then the IRA owner – and *NOT* a beneficiary.

Charlotte Gee et vir. v. Commissioner; 127 T.C. No. 1; No. 8755-05, July 24, 2006

Rollover mistake causes a $97,789 penalty!

A spouse under age 59½ inherited $2,646,798 from her deceased spouse and rolled it over to her own IRA, as a spousal rollover. While still under age 59½ she withdrew $977,888 as a taxable distribution but claimed that the 10% early withdrawal penalty did not apply to her because she was a beneficiary. She went to Tax Court to fight this and lost her case. She was wrong and it cost her $97,789.

IRS assessed a $97,789 early withdrawal penalty (10% of the $977,887 early withdrawal) and the court agreed that the penalty applied since she rolled the funds over to her own IRA and withdrew the funds from there. If she had remained a beneficiary and withdrew from an inherited IRA instead, there would have been no penalty since the early withdrawal never applies to a beneficiary.

"…although the distribution would have been exempt from the 10-percent additional tax when it was made to petitioner's IRA upon Mr. Campbell's death, the funds became subject to the 10-percent additional tax when distributed to her from her own IRA."

"…once petitioner chose to roll the funds over into her own IRA, she lost the ability to qualify for the exception from the 10-percent additional tax on early distributions. The funds became petitioner's own and were no longer from her deceased husband's IRA once petitioner rolled them over into her own IRA. The funds therefore no longer qualify for the exception."

Peggy Ann Sears v. Commissioner; T.C. Memo. 2010-146; No. 12454-08 July 6, 2010

Surviving spouse (Peggy Ann Sears) did a spousal IRA rollover and then withdrew funds before reaching age 59½ triggering the 10% early withdrawal penalty. She tried to claim that the 10% penalty did not apply to her because she was a beneficiary, but she lost her case. In fact, once she did the spousal rollover, she became the owner of the account and was no longer a beneficiary.

When a spouse who is under age 59½ inherits an IRA, the account should generally remain as an inherited IRA to avoid a 10% early withdrawal penalty until the surviving spouse reaches age 59 1/2.

Section 327: Another Fine Mess Congress Has Gotten Us Into

Of the 92 provisions in the Secure 2.0 Act, enacted on December 29, 2022, none has proven more perplexing than section 327, which significantly changes the distribution rules for spouse beneficiaries of IRA and workplace plan accounts beginning in 2024.

What Did Congress Intend?

It is hard to figure out what Congress intended for spouse beneficiaries in drafting section 327. The legislative history is scant.
The Senate Finance Committee Report, which explains the provisions of SECURE 2.0, says only the following*: "Section 327 allows a surviving spouse to elect to be treated as the deceased employee for purposes of the required minimum distribution rules."*

Interpreting the intent of Congress based on so little is challenging. To some, this is evidence that the provision was designed simply to create more favorable rules for surviving spouses who inherit from younger retirement account owners. Yet, this group represents a small minority of spouse beneficiaries. For the vast majority of spouses who inherit from older owners, Congress (probably unintentionally) completely upended the distribution rules and in some cases put those beneficiaries in a worse situation than they would be under the current rules. Under the new section 327 rules, some spouse beneficiaries will benefit but others will not. There will be winners and losers.

The bottom line is that section 327 is extremely difficult (some would say impossible) to navigate, with many thorny unanswered questions. And, since it is effective January 1, 2024, the IRS does not have much time to answer those questions. Because of all the uncertainty, it is entirely possible the IRS will delay the effective date.

Rules Effective for Deaths On or After January 1, 2024

Under SECURE 2.0, a spouse inheriting on or after January 1, 2024, has four options: (1) Do a spousal rollover; (2) Treat the IRA as the spouse beneficiary's own; (3) Remain a beneficiary and make a Section 327 election; (4) Remain an IRA beneficiary and not make a 327 election.

New Option 3: Make the Section 327 Election

A surviving spouse who inherits before 2024 and does nothing will be deemed to have a beneficiary IRA, and RMDs will be *automatically* delayed until the deceased spouse would have turned age 73. After 2023, this ability to defer RMDs is *no longer automatic*. The surviving spouse must take the affirmative step of making an election in order to get the delayed RMD. We call this election the "section 327 election." The tax code says that making this election requires that a spouse beneficiary be treated as the deceased IRA owner for RMD purposes.

But what exactly does "being treated as the deceased IRA owner" mean? It clearly means that surviving spouses can delay RMDs until the IRA owner would have reached age 73. (This is no different than what the current rules allow when the surviving spouse remains a beneficiary.)
It also clearly means that once minimum distributions are required, the surviving spouse will be able to calculate RMDs using the Uniform Lifetime Table – rather than the Single Life Table that would have been required under the pre-2024 rules had she remained a beneficiary.
***The use of the Uniform Lifetime Table to calculate spousal beneficiary RMDs is a departure*.**
This table has only previously been used to calculate RMDs during an individual's lifetime. A spouse beneficiary could use the Uniform Table, but only after a spousal rollover.

Example Deborah dies at age 65 with her 70-year-old husband, Al, as her IRA beneficiary.

Death in 2023: Al has two options. He could do an immediate spousal rollover, which would require him to start RMDs at age 73. Or, he could remain a beneficiary and delay required distributions until Deborah would have turned age 73 (at his age 78) – a better option. Al's RMDs would be calculated under the Single Life Table based on his own age. Al's first RMD at age 78 would be calculated using a life expectancy factor of 12.6 years.

Death in 2024: Al is much better off. As long as he makes a timely section 327 election, he can still delay required distributions until Deborah would have turned 73. However, once RMDs start, they would be calculated under the Uniform Lifetime Table and likely would be based on Deborah's age had she lived (73). Al's first RMD at 78 would be based on a factor of 26.5 years, producing a much smaller required distribution than if Deborah had died before 2024.

It is important for Al to make a timely election because if he does not, he would need to start RMDs by December 31, 2025. If minimizing RMDs is his goal, a spousal rollover would also not be a good choice for him because RMDs would begin at his age 73.

Option 4: Remain a Beneficiary and Not Make the Section 327 Election

Section 327 is clear that if the surviving spouse does not take the affirmative act of making a timely election, she defaults to being treated like any non-spouse beneficiary for RMD purposes. That is, a spouse beneficiary who does nothing is deemed to have remained a beneficiary and must start taking RMDs in the year after the year the IRA owner died. In addition, the spouse must use the Single Life Table (although, unlike non-spouse beneficiaries, she can recalculate the life expectancy factor each year).

Unknown: How is the Uniform Lifetime Table Applied?

What *isn't* clear is how the Uniform Lifetime Table will be applied. Does the surviving spouse use the deceased spouse's age to calculate the life expectancy factor or her own age? It seems likely that "being treated as the deceased IRA owner" would require the spouse beneficiary to use the age the decedent would have attained had he lived. However, section 327 doesn't specifically address whose age should be used. This is one of many areas where IRS guidance is necessary.

Unknown: Does the 10% Penalty Apply?

What *also isn't* clear is what the surviving spouse's status is after making the 327 election. Is she deemed to remain an IRA beneficiary or is she deemed to become the owner of the deceased spouse's IRA? This becomes significant if the surviving spouse is under age 59 ½. If she remains a beneficiary even after making the election, then the 10% early distribution penalty will not apply to pre-59 ½ withdrawals. But if she becomes the IRA owner, then tapping into the IRA before 59 ½ will subject her to penalty.

This is another area where IRS guidance is necessary. On the one hand, "being treated as the deceased IRA owner" may indicate that the surviving spouse is deemed to become the IRA owner. On the other hand, section 327 makes clear that the requirement of "being treated as the deceased IRA owner" is only for purposes of the IRS regulations governing which life expectancy method is used for RMDs. Also, subjecting under-59 ½ surviving spouse beneficiaries to a new 10% penalty by virtue of making the 327 election would run counter to one of the overriding themes of SECURE 2.0: expanding the exceptions to the penalty.
More likely, a surviving spouse electing Option 1 would take on a hybrid status: remaining an IRA beneficiary (and thereby being able to avoid the 10% penalty) but also being treated as an IRA owner for the limited purpose of being able to use the Uniform Lifetime Table to calculate RMDs.

Unknown: How Will the Election Be Made?

Section 327 says very little about the mechanics of the section 327 election: *"An election described in this clause shall be made at such time and in such manner as prescribed by the Secretary, shall include a timely notice to the plan administrator, and once made may not be revoked except with the consent of the Secretary."*

This provision does indicate that, once made, the 327 election will generally be irrevocable. But it's up to the IRS to provide details about how the election must be made and the election deadline. It would seem that the deadline could be no later than December 31 of the year following the year of the IRA owner's death. This is because the surviving spouse's first RMD would be due by that date if she has not made the election.

Unknown: Is the 10-Year Rule Still Available?

The IRS proposed SECURE Act regulations allow an eligible designated beneficiary (EDB) who inherits before the IRA owner reaches his RMD required beginning date to elect the 10-year payment rule in lieu of the RMD stretch. A surviving spouse is an EDB. However, it is not clear whether this option will remain for spouses after section 327 becomes effective. Section 327 seems to require spouse beneficiaries who do not make the 327 election to begin RMDs in the year after the IRA owner's death and arguably leaves no room for the 10-year payment election.

Unknown: Is a Spousal Rollover Still Available After Making a Section 327 Election?

It is less clear whether a rollover is available after a 327 election has already been made. This will depend on whether the IRS interprets the rule that says a 327 election is generally irrevocable to bar a spouse beneficiary from doing a spousal rollover after having made an election.

If it remains available, the spousal rollover option would still be a good idea at age 59 ½ (as it is for deaths before 2024) for a spouse beneficiary who inherits from an older IRA owner and wants to defer RMDs. This would be the case whether or not the spouse has previously made a 327 election. An immediate spousal rollover for a younger spouse before age 59 ½ could also work if she knows she will not need to tap into the rolled-over funds.

Non-Spouse as Beneficiary

A non-spouse is any other entity or person who is not the spouse of the retirement plan owner, for example: child, grandchild, brother, sister, parent, friend, trust, estate, charity.

But only a living person named on the beneficiary form can be a designated beneficiary and be entitled to the stretch IRA if also an EDB. So from the list above, the trust, the estate and the charity are not designated beneficiaries. The trust could be a designated beneficiary if the trust qualifies under the various IRS rules.

An eligible designated beneficiary (EDB) can extend post-death payouts over their own life expectancy. The identity of the designated beneficiary to take post-death distributions is not determined under the rules until September 30 of the year after the year of the account holder's death. This will give beneficiaries and financial institutions an added three months to calculate and withdraw required amounts by December 31st of the year following the year of the owner's death.

This does not mean that a designated beneficiary can be named after the death of the IRA owner. **The IRA owner must name all designated beneficiaries, both primary and contingent, while he is still breathing.** Then, after death, the designated beneficiary may be changed, but only amongst the group of beneficiaries named by the IRA owner.

A beneficiary named through an estate can ***never*** be a designated beneficiary or an EDB.

For EDBs who still qualify for the stretch IRA, the lifetime payout (the stretch IRA) is the default under the tax code. The lifetime payout is based on the life expectancy of the EDB in the year after the year of the account holder's death, and is decreased by one each year thereafter. However, if the IRA owner dies before his required beginning date (RBD), an EDB, including a spouse, can instead elect the 10-year payout.

Death during the "GAP" Period

Since the designated beneficiary is not determined until September 30th of the year following the year of the IRA owner's death, a so-called "GAP" period is created. The gap period begins on the date of death and ends on September 30th of the following year.

SECURE Act

If the beneficiary dies in the gap period, the successor beneficiary cannot use the original beneficiary's life expectancy. The successor will be subject to the 10-year payout rule, even if the original beneficiary was an EDB.

Post-death instructions for family

TOUCH NOTHING!

Inherited IRA account titling
Splitting IRAs
Required distributions – 10-year payout rules
Beneficiaries naming beneficiaries – Successor beneficiary rules
IRA trust management
Changing investments on inherited IRAs
Trustee-to-trustee transfers only for non-spouse beneficiaries

Address the Beneficiary's own Estate Plan

Also…ask your clients about their parents' estate plans.

Naming Trusts as IRA Beneficiaries

When Clients Should and When They Shouldn't

A Warning about IRA Trusts

Before we get started here, advisors should be aware of the tax and estate planning complications created by naming trusts as IRA beneficiaries. They are not for everyone. However, there are certain IRA owners who should be setting up trusts as IRA beneficiaries. Those situations are detailed below. There are times when naming a trust as your IRA beneficiary may be the only solution, and that is when it should be used. It should not be used haphazardly because "my attorney told me to do it" or because you were told it would save taxes. ***There is no tax benefit that can be gained with a trust that cannot be gained without one.*** Therefore, you would generally only use trusts for personal (non-tax) reasons. This will be even more true going forward after the elimination of the stretch IRA – a key tax benefit that was afforded to IRA trusts.

Examples of non-tax reasons are: to restrict access in some way, such as when the IRA beneficiary is a minor, disabled, incompetent, or unable to make his or her own decisions; to assist in the management of the trust funds; in second marriage situations; or for creditor protection (although many states now protect IRAs).

Trusts as IRA beneficiaries create unique problems and tax complications even when executed perfectly. IRA trusts cannot provide the panacea of tax and personal solutions that many IRA owners are looking for. There are trade-offs and consequences. Consider this paragraph a disclaimer and warning. **Don't name trusts as IRA beneficiaries unless you know what you are doing and it's the only solution.** Even then, most trusts will have to be revised or scrapped altogether after the SECURE Act changes eliminating the stretch IRA.

Overview of IRA Trusts

Large accumulations in IRAs and other retirement accounts have created interest in naming trusts as beneficiaries, in order to better control post-death distributions and restrict access to beneficiaries who might otherwise squander large inherited IRAs.

Instead of naming a person (for example a child or grandchild) as a direct beneficiary on the account, a trust would be named. The trust's beneficiary would be the child, grandchild or other person that the IRA owner wants to receive the IRA. There could also be one income beneficiary and other beneficiaries who receive what's left after the income beneficiary dies.

Trusts are not for everyone though. The main purpose is to control or protect post-death distributions from the inherited IRA or retirement plan. If that is not the intention, then a trust may not be appropriate.

3-Step Process for IRA Trusts:

Step 1

Should your clients leave their IRAs to a trust?

Find out if your client actually does need to name a trust as IRA beneficiary.

Reasons to name a trust as an IRA beneficiary.

Step 2

Assumption: You and your client have decided that a trust should be the IRA beneficiary.

Setting up the trust.

How to name the trust as the IRA beneficiary.

Step 3

The IRA owner has died.

Implementing the IRA trust.

Things that must be done by the beneficiary after the death of the IRA owner.

Step 1
Should your clients leave their IRAs to a trust?

Find out if your client actually does need to name a trust as an IRA beneficiary.

Control is the main reason

Reasons to Name a Trust as an IRA Beneficiary

These are mostly non-tax reasons – Control is a non-tax reason

Name a trust as beneficiary of the IRA when a beneficiary is:
A minor
Disabled
Incompetent
Unsophisticated (vulnerable to those seeking money or promoting investments).

Minor as Beneficiary
If a grandchild or other minor (under 18 or 21 depending on state law - but age 21 for EDB status) is named as the IRA beneficiary, clients should use a trust because minors are not able to make tax elections like IRA distribution decisions. If the minor were named as a direct beneficiary of the IRA, the surrogate's (probate) court could require a guardian to be appointed for the minor. A custodian could be named as beneficiary on behalf of the minor under the Uniform Gifts to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA), but the custodian in most states cannot make IRA distribution elections. The custodian also does not have the same powers that would be granted to the trustee of a trust. A trust may be the best way to go with a minor as a beneficiary.

Management
A trust may be advisable if an IRA beneficiary is someone who may need help with managing the IRA funds and taking required distributions, even if the beneficiary is an adult. Clients may want the trust to provide for someone who is not physically or mentally able to care for themselves or to handle money. They may also want to protect a vulnerable or unsophisticated beneficiary from unscrupulous people who might take advantage of him or her. The trust could be used to protect the beneficiary from creditor problems, as many states may not provide creditor protection for IRA beneficiaries.

If clients simply want to control the IRA well past their death (some call it ruling from the grave), the trust can accomplish this, but if this is the only reason they are creating the IRA trust, it generally is not a healthy plan for good family relations.

To provide an income stream.

To protect the retirement money for the family in a second marriage situation (but this may not work well because of the adverse interests – children of first marriage vs. new spouse).

Second Marriages
A trust would be used as the IRA beneficiary when clients want to control the ultimate disposition of the IRA. In a typical second marriage situation (or even with some first marriages), they may want to leave the spouse the annual IRA income, but after the spouse's death they want to make sure that the IRA goes to their children and not to those from a spouse's prior marriage. Clients may also want to use a trust with a first marriage where, again, they want to control the ultimate disposition of the IRA after the surviving spouse dies. They may want to make sure that if the spouse remarries that their IRA goes to their children at the spouse's death and not to his or her new spouse.

The trust you would use in these situations is called a QTIP (qualified terminable interest property) trust. This is a special trust that is created to qualify for the marital deduction and also gives the IRA owner / trust creator control over the trust principal (the IRA) after his death and after the death of the spouse. The QTIP trust must also integrate with the IRA distribution rules.

QTIP trusts however have unique problems and generally should not be named as an IRA beneficiary (Revenue Ruling 2006-26, issued by IRS on May 4, 2006 contains guidance on how income is to be paid out to the spouse as beneficiary of a QTIP Trust).

To avoid state estate tax or inclusion in the beneficiary's estate.

For generation skipping purposes – must control the amount of bequests to grandchildren, not to exceed GST limits – 2023 GST limit is $12,920,000.

To set up a continuation plan for distributions after the death of the beneficiary.

To control disposition of large IRAs.

Creditor protection.

Divorce protection.

To fund charitable bequests – through Charitable Remainder Trusts.

Reasons ***NOT*** to Name a Trust as an IRA Beneficiary

Main reason is simplicity – to avoid restrictions on beneficiaries and trust complications

Also, to avoid the ongoing trust administration expenses

To avoid trust taxation.
Trust income tax rates are the highest income tax rates.

Comparison of Tax Rates
Trust Tax Rates vs. Individual Tax Rates

2023 Trust Tax Rates - Ordinary Income Tax

10%	$0 - $2,900
24%	$2,901 - $10,550
35%	$10,551 - $14,450
37%	Over $14,450

For **2023** trust tax returns, income over **$14,450** is taxed at 37%.

A married couple filing jointly would not reach the top tax rate of 37% in **2023** until taxable income exceeded **$693,750**.

A single person would not reach the top tax rate of 37% in **2023** until taxable income exceeded **$578,125**.

The surtax on net investment income can add **3.8%** for a total of **40.8%** (37% + 3.8% = 40.8%) on net investment income retained in a trust.

Roth IRA Solution
The Roth IRA is the best IRA to leave to a trust.

Post-death Roth IRA distributions will be income tax free
– no trust tax problem.
Strategy – Convert IRA to Roth IRA; leave Roth IRA to trust.

<u>Step 2</u>

Setting up the Trust

How to name the trust as the IRA beneficiary

Assumption:
You and your client have decided that a trust should be the IRA beneficiary.

Things that the advisor must go over with IRA owner:

You CANNOT give an IRA away during lifetime through a trust. – Not without triggering an income tax – The trust cannot "own" the IRA.

IRA Trust Basics

To better understand the impact of naming a trust as a beneficiary of a retirement account, you first must know a few basic IRA trust concepts.

First, when we use the term "IRA Trust," we are referring to any trust that is named as the beneficiary of an IRA.

You must also know the difference between a "look through" or "see-through" trust, a "conduit" trust and a "discretionary trust."

Look Through (or See-through) Trusts

Only individuals who are named on the IRA beneficiary form (or named through the IRA custodial document if no beneficiary is named on the beneficiary form) can be *designated* beneficiaries.

A trust is not an individual, so it cannot be a designated beneficiary. But if the trust qualifies as a "look through" or "see-through" trust, then the individual beneficiaries of the trust can qualify as designated beneficiaries for IRA distribution purposes. However, if one of the trust's beneficiaries is not an individual, there may still be no designated beneficiary for IRA distribution purposes, even if the trust qualifies as a look through trust.

To qualify as what the IRS refers to as a **"look-through"** or **"see-through"** trust for IRA distribution purposes, the trust must meet the following requirements outlined in Regulation Section 1.401(a)(9)-4, A-5:

1. The trust is valid under state law or would be but for the fact that there is no corpus.

2. The trust is irrevocable, or the trust contains language to the effect it becomes irrevocable upon the death of the employee or IRA owner.

3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's or IRA owner's benefit are identifiable.

4. The required trust documentation has been provided by the trustee of the trust to the plan administrator no later than October 31st of the year following the year of the IRA owner's death.

In addition to the above requirements, ***all trust beneficiaries must be individuals*** or there could be no designated beneficiary on the IRA and the stretch option could be lost.

If the trust does not qualify as a see-through trust, then the IRA will be treated as if there was no designated beneficiary and the post-death payout will not be based on the rules that apply when there is no designated beneficiary.

If any one of a discretionary trust's beneficiaries is not a person (for example an estate), then then the IRA does not have a designated beneficiary.

Non-designated beneficiary rules
– These rules will apply to post-death distributions to a trust that does not qualify as see-through trust

Based on when the IRA owner died
If the beneficiary was not a designated beneficiary, for example, a non-person such as an estate, charity or non-qualifying trust, then the post-death payout to the beneficiary would be based on when the IRA was inherited.

Death before the RBD
Those rules, ***which are still in place*** under the SECURE Act, state that if death is before the required beginning date (RBD) for taking RMDs, then the 5-year rule would apply, meaning that the entire account balance would have to be emptied into the trust by the end of the 5th year after death.

Death on or after the RBD
If death was on or after the RBD, then the payout term to the beneficiary is the deceased IRA owner's remaining single life had he lived. Some call this the ***"ghost"*** life expectancy. Under the old rules (which are still in effect) this would be 15 years at most. RMDs would be required for each of the remaining years in the term.

Types of IRA Trusts – Conduit vs. Discretionary Trust

Conduit Trust
This type of trust is merely a "conduit" to pass required minimum distributions from the IRA to the trust beneficiary. When a conduit trust is the beneficiary of an IRA, the post-death RMDs are first paid from the IRA to the trust and then from the trust to the beneficiaries of the trust. No IRA distributions remain in the trust. The beneficiaries of the trust then pay any tax on those distributions at their own personal income tax rates.

Trust tax rates are generally much higher than personal tax rates. Conduit IRA trusts eliminate any tax at trust tax rates. If the IRA is a Roth IRA, then trust taxes are not an issue at all since distributions from an inherited Roth IRA will be tax free (if the account was held for at least five years including the time the Roth IRA owner held it).

If the conduit trust does not meet all four requirements, then there will be no designated beneficiary. The IRA distributions will still pass through the trust and then to the trust's beneficiaries, but the RMDs on the inherited IRA will follow the rules that apply when there is no designated beneficiary.

Discretionary (or Accumulation) Trust

A discretionary trust (sometimes referred to as an accumulation trust) does not have to pay out all IRA distributions to the trust's beneficiaries. The trustee is given discretion to either pay out some, all, or none of the IRA distributions to the primary trust beneficiaries. Whatever IRA distributions are not paid out though, are accumulated and taxed in the trust at trust tax rates. IRA owners who want maximum control over the post-death distributions to the trust and to the trust's beneficiaries would set up this type of trust. With a discretionary trust, even annual RMDs can be held in trust until certain trust conditions are met, for example, until a child reaches age 30. The terms of the trust determine how much or when the trustee will pay out IRA distributions received by the trust to the beneficiaries of the trust.

A discretionary trust must also meet the four trust requirements to qualify as a look through trust. If any of the four requirements are not met, the IRA will not have a designated beneficiary and the post-death distributions will be paid out according to the rules that apply when there is no designated beneficiary.

Remainder Beneficiaries for Accumulation (Discretionary) Trusts

If the discretionary trust does meet the four requirements and qualifies as a look through trust, then you would use the age of the oldest of the trust's beneficiaries to calculate RMDs on the inherited IRA. But with a discretionary trust (as opposed to a conduit trust) **you must consider the ages of *both* the income and remainder trust beneficiaries when you look to see who the oldest beneficiary is (i.e., which beneficiary has the shortest life expectancy).** That is the beneficiary whose life expectancy will be used to calculate RMDs on the inherited IRA.

Exceptions - Disregarded Beneficiaries

The proposed regulations provide exceptions where certain beneficiaries of accumulation trusts can be disregarded.

A remainder beneficiary of an accumulation trust can be disregarded if the beneficiary could receive payments from the trust only after the death of another beneficiary whose sole interest is a residual interest in the trust.

Example 1: Assume an accumulation trust provides that if the residual beneficiary of the trust predeceases the primary trust beneficiary, then the funds are to be paid to a charity. The charity can be disregarded as a beneficiary. This allows the trust to satisfy the see-through trust rule that all trust beneficiaries must be individuals.

A remainder beneficiary can also be disregarded when the trust terms require a full distribution to a minor child trust beneficiary of any IRA funds by the end of the year when she reaches age 31. The only way the remainder beneficiary would be entitled to those funds would be if that beneficiary died before age 31.

Example 2: Roger named his see-through trust as the beneficiary of his IRA. The trust is an accumulation trust with the terms requiring a full distribution of all trust assets when the beneficiary of the trust, his son James, reaches age 31. If James dies before this scheduled termination, then any amounts in the trust would be paid to Roger’s brother Gene. Gene can be disregarded as a beneficiary. James is an EDB, so distributions to the trust can be made over his life expectancy. However, if James would die before turning age 31, the 10-year payout period would apply to Gene.

Identifiability of Beneficiaries

The proposed regulations also address the see-through trust requirement that all beneficiaries be “identifiable.”

Classes of Beneficiaries

The regulations make it clear that the addition of another member of a class of beneficiaries would not cause the trust to fail the identifiability requirement.

Example 3: Larry named his see-through trust as his IRA beneficiary. He named his grandchildren as the beneficiaries of the trust. The birth of another grandchild would not mean that the trust would fail to meet the see-through rules.

Do a Trust Check-Up

If a trust will be named (or has already been named) as the beneficiary of the IRA, first make sure that the trust qualifies as a see-through trust, otherwise the account owner will have no designated beneficiary. This goes for each trust that is named as a beneficiary. You'll need an attorney that specializes in this niche area, and one that will be able to incorporate the SECURE Act rules when drafting the trust.

Existing trusts should be reviewed and probably revised for all trust beneficiaries to receive the most favorable distribution options.

Conduit or Discretionary Trust?

The answer will be based on how much post-death control the client wants the trustee to have over the IRA distributions paid to the trust, and ultimately to the trust beneficiaries.

The client must decide what type of trust is needed. Will it be a conduit trust or a discretionary trust? There might be young or incompetent beneficiaries and you want them to have very limited access to the IRA funds. The client may want to keep the inherited IRA out of the income beneficiary's estate or protect against a divorce. A trust can do that. Again, you will have to prioritize. If the client wants maximum control, he will want the discretionary trust.

SECURE Act Changes for IRA Trusts

IRAs are downgraded as an estate planning vehicle

To understand the gravity of this change, let's first review what are now the old rules for inherited IRAs.

Pre-2020 tax rules for IRA and plan beneficiaries
Under the old rules, designated beneficiaries could "stretch" required minimum distributions (RMDs) from the inherited IRA (or company plan) over their lifetimes, possibly over decades depending on their age. See-through trusts also qualified for the stretch IRA, so a person with a large IRA could name a trust for the benefit of a grandchild and RMDs could be spread over 50 years or more, depending on the age of the grandchild.

The SECURE Act changes all of this. Most IRA trusts are now subject to the 10-year post-death payout.

SECURE Act – Stretch IRA Elimination - New rules for beneficiaries
The SECURE Act eliminates the stretch IRA option for all but a few exceptions and replaces it with a 10-year pay down period for designated beneficiaries. In addition, the IRS proposed regulations require RMDs to be taken for years 1-9 of the 10-year term when death occurs on or after the RBD. The entire remaining inherited IRA (or plan) account balance must be emptied by the end of the 10th year after death. All the funds would be taxed by that time (except for tax-free Roth IRA distributions). This is exactly what Congress wanted. They wanted to downgrade IRAs as an estate planning vehicle, and that is what the new tax rules do.

The Trust Problem
Most trusts are now subject to the 10-year post-death payout. Clients with large IRAs often name trusts as their IRA beneficiaries because they want two things from their estate plans:

-Post-death control – they don't want beneficiaries squandering this money, or putting it at risk of financial mismanagement, lawsuits, divorce or being vulnerable to financial predators.

-Minimized taxes.

Qualifying "see-through" trusts under the old rules could often accomplish both objectives, but not anymore. Here's why:

There are two types of IRA trusts – Conduit and Discretionary (accumulation) trusts. Assuming they each qualified as designated beneficiaries by meeting the conditions of a see-through trust, payouts from the inherited IRA to the trust under the old rules could be stretched over the lifetime of the oldest trust beneficiary.

SECURE Act effect on IRA trust planning

Two words: Not good!

A conduit trust will no longer work to accomplish either of the two objectives of post-death control and tax minimization. Since the new law does away with RMDs, there may be no payouts until the end of the 10 years, and then ***all the funds are released to the trust's beneficiaries**, **exactly what the client with a large IRA wanted to protect against.***

The IRS proposed regulations for post-death RMDs adds to the trust tax problem when RMDs could be required in years 1-9 under the 10-year rule, and the inherited IRA funds are retained in the trust for protection. This would generally be the case when death is on or after the RBD.

100% RMD at the end of the 10 years

Under the 10-year rule, most of the taxes will be bunched into the last year, unless the trust has language allowing distributions throughout the 10 years to spread out the income, or if RMDs are required for years 1-9. Either way, the entire account will be released to a beneficiary who may squander the funds or lose them, and the inherited IRA funds will all be taxed by the end of the 10 years, making this a lousy estate plan. Trusteed IRAs offered by some financial institutions are conduit trusts and have these same problems under the SECURE Act.

Example 1:
Conduit trust for grandchild

Alexander has set up a trust for his grandson, Jake, age 30. The trust is a conduit trust with language carefully crafted to say that the amount of the RMD must be paid out from the inherited IRA and then distributed to Jake. Alexander intended to have RMDs stretched out over Jake's lifetime. Alexander dies in 2020 without revising this trust in the wake of the SECURE Act. This trust will not work as Alexander planned. The 10-year rule will apply. The entire IRA balance will be distributed to the trust and then to Jake in 2030. Plus, if Alexander (the IRA owner) died on or after the RBD, **then RMDs would be required for years 1-9 after death** (under the proposed IRS regulations).

Critical Action Required Immediately!

- Anyone who has named a trust as their IRA beneficiary will need to immediately review and probably revise the trust - or scrap it altogether.

- Conduit trusts would have to be changed to discretionary-type trusts to either allow distributions within the 10 years to smooth out the tax bill or to be held within the trust for long-term protection.

- Trusteed IRAs are conduit trusts and are affected the same way. Anyone with a trusteed IRA will need to review this decision.

The conduit trust would generally only work now for EDBs who can still stretch payouts over their lifetimes, but even then, once the EDB no longer qualifies as an EDB (for example, when a minor reaches majority), the 10-year payout rule kicks in.

Discretionary (Accumulation) trust will work better after the SECURE Act
If a trust is still deemed necessary, then a discretionary trust would work somewhat better since inherited IRA funds can still be retained and protected in the trust, even after the 10 years. But all of those funds will still be taxed either at high trust tax rates for funds retained in the trust or at the beneficiaries' personal tax rates for distributions to the trust beneficiaries.

This provides the trust protection clients desire but at a possibly prohibitive tax cost, so this may not work too well either.

Alternatively, the trust could pay out the remaining IRA balance to the individual beneficiaries. In that case, the beneficiaries would have to pay the tax on the balance at their own rates (lower than trust rates) – but then the funds are no longer protected in trust.

Example 2:
Discretionary trust for adult children who are not EDBs
Annie knows her adult children are not responsible with money, so she has named a discretionary trust as beneficiary of her IRA. Annie dies in 2020. The trust is subject to the 10-year rule and subject to RMDs for years 1-9 if death is after the RBD. The trustee (depending on the terms of the trust) can either retain these RMDs in the trust for further protection, or pay part or all of the RMDs to the trust beneficiaries (the children). However, any funds remaining in the inherited IRA must be emptied – that is - paid into the trust by December 31, 2030. Taxes must either be paid by Annie's children if the funds are distributed to them or by the trust at high tax rates if the funds remain in the trust for continued protection.

Roth IRA Solution
The better option then, if a trust is desired, would be to have the client convert to a Roth IRA and leave the Roth IRA funds to a discretionary trust providing the post-death control and eliminating trust or personal taxes.

Example 3:
Roth IRA and trust beneficiary
In 2021, Annie, in response to the SECURE Act and historically low tax rates, decides to convert her traditional IRA to a Roth IRA. She dies later in 2021 after naming a trust for her adult children as her Roth IRA beneficiary. The trust will be subject to the 10-year rule, but big tax bills (if paid to the children) or high trust tax rates (if kept in the trust) are avoided. This is because the Roth IRA funds are tax-free when the funds go to the trust or to the trust beneficiaries.

Roth RMD Advantage:
Roth IRA owners are deemed to have died before the RBD, so if the trust qualifies as a see-through trust, no RMDs would be required for years 1-9. However, the balance in the inherited Roth IRA must still be withdrawn by the end of the 10-year term.

Trusts for Eligible Designated Beneficiaries

Under the SECURE Act, there are provisions allowing a trust to be set up to inherit retirement funds for the benefit of a disabled or chronically ill individual. The law, however, does not address trusts for the other three classes of EDBs – spouses, minors and those within 10 years of the age of the deceased. However, in the proposed regulations, IRS has allowed for this.

Trusts for these "other" categories of EDBs can be set up for these groups, and the stretch IRA would work as before, but only while they still qualify as eligible designated beneficiaries. After that point, the 10-year payout rule would apply (and the IRS regulations also may require annual RMDs during years 1-9 of the 10-year period).

Because the old rules for non-designated beneficiaries still apply (the 5-year rule and the deceased's life expectancy), it is still important that the trust qualify as a see-through trust as under the old rules.

Example 4:
Spouse beneficiary of a conduit trust – Spouse is an EDB
Loretta dies in 2020. The beneficiary of her IRA is a qualified conduit trust for her surviving spouse, Lou. Because Lou is an EDB, the stretch can still apply and RMDs can be paid to the trust each year based on Lou's remaining single life expectancy.

Example 5:
Minor is the beneficiary of a conduit trust – Minor is an EDB
Rick dies in 2020. The beneficiary of his IRA is a qualified conduit trust established for the benefit of his minor daughter, Ava, age 12. Until Ava reaches the age of majority (age 21, regardless of state law), RMDs from the inherited IRA to the trust can be stretched over Ava's single life expectancy. However, once Ava reaches age 21, the 10-year rule would apply. After the 10 years, all of the remaining inherited IRA funds will be paid to her, possibly still at an age too young to inherit a large sum. In addition, under the proposed regulations, RMDs may have to continue (from the inherited IRA to the trust and from the trust to Ava) for years 1-9 of the 10-year term (when she is no longer an EDB). Under one interpretation of the ALAR rule (at least as rapidly rule), since RMDs had already begun, they cannot be stopped or put on hold until the end of the 10-year term.

SECURE Act Rules for a Trust for Disabled or Chronically Ill Beneficiaries

While the SECURE Act will limit most beneficiaries to a 10-year payout, there are special rules for a trust for disabled or chronically ill beneficiaries that allow RMDs to be paid from the IRA to the trust using the beneficiary's life expectancy.

To qualify to use a life expectancy payout for the trust, at least one beneficiary of the trust must be one of two classes of "eligible designated beneficiaries."

Under the SECURE Act, there five classes of beneficiaries considered "eligible designated beneficiaries" who are still able to get the stretch when named on the beneficiary form.

They are:
(1) surviving spouses,
(2) minor children (up to age 21) of the account owner – but ***not*** grandchildren,
(3) beneficiaries not more than 10 years younger than the owner (and those older),
(4) disabled individuals, and
(5) chronically ill individuals.

However, only the last two, the **disabled** and **chronically ill**, are addressed in the SECURE Act provision that allows a stretch payout to a trust.

EDB Definitions for Disabled and Chronically Ill:

<u>Disabled</u>

– Subject to the strict IRS standard of Tax Code Section 72(m)(7):

"Meaning of Disabled.-For purposes of this section, 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."

You cannot be able to work for a long or indefinite period and ***you must be able to prove it.***

Chronically ill
Under the SECURE Act, a chronically ill individual is a based on the definition under Tax Code Section 7702B(c)(2), under the tax rules for defining Long-Term Care Services under Long-Term Care Insurance Policies.

From the Tax Code Section 7702B(c)(2)
This seems similar to disability, but this goes beyond in some respects since it brings in activities of daily living (listed below).

Tax Code Section 7702B(c)(2)

(B) Activities for daily living
For purposes of subparagraph (A), each of the following is an activity of daily living:

(i) Eating.
(ii) Toileting.
(iii) Transferring.
(iv) Bathing.
(v) Dressing.
(vi) Continence.

To qualify as a Chronically Ill Individual under the SECURE Act the person would have to be certified (by a licensed health care practitioner) to be unable to perform at least 2 activities of daily living for at least 90 days – or – require "substantial supervision" due to a severe "cognitive impairment."

Under the SECURE Act, the ability to use the stretch for chronically ill or disabled beneficiaries is available to an ***"applicable multi-beneficiary trust."*** An "applicable multi-beneficiary trust" can have other beneficiaries of the trust besides the disabled or chronically ill beneficiary. The other beneficiaries (other than the disabled or chronically ones) do not have to be "eligible designated beneficiaries," but they all have to be designated beneficiaries. That would include living individuals with a life expectancy but would exclude entities like a an estate.

SECURE 2.0 Act of 2022 Update:

For these special needs trusts, a qualified charity (under the regular IRS rules) will qualify as a designated beneficiary.

Example 6:
Disabled beneficiary – special needs trust – charity is remainder beneficiary
Brian names a special needs trust for the benefit of his disabled son, Christopher, as the beneficiary of his IRA. After Christopher's death, any remaining funds from the IRA are to be paid to a local charity. This is ok since under SECURE 2.0 the charity is a designated beneficiary and the trust will still qualify as an applicable multi-beneficiary trust. This means that stretching the RMDs over Christopher's life expectancy will still be allowed.

Additionally, to qualify as an "applicable multi-beneficiary trust," the trust would have to be established in one of two ways:

1 - It can provide that it is to be divided immediately upon the death of the IRA owner into separate trusts for each beneficiary, or

2 - It can provide that no beneficiary, other the eligible designated beneficiary, has any right to the IRA funds until the death of the eligible designated beneficiary.

If the trust is divided upon the death of the IRA owner into separate trusts, only the eligible designated beneficiary will be able to use the stretch for RMD payouts. Any other trust beneficiary would be subject to the 10-year rule.

Example 7:
Chronically ill beneficiary – special needs trust - trust is divided into sub-trusts
Mitch names his trust as the beneficiary of his IRA. At Mitch's death, the trust is to be divided into two trusts, one for each of his daughters. His daughter, Page, age 32, is chronically ill and qualifies as eligible designated beneficiary at Mitch's death. Payments from the inherited IRA to the trust for Page can be made over Page's life expectancy. Mitch's other daughter, Patty, age 28, is not disabled or chronically ill. Payments from the inherited IRA to Patty's trust are subject to the 10-year rule.

The proposed IRS regulations clarify that even if Patty is a remainder beneficiary of the trust for Page, the stretch would still be available during Page's lifetime. At Page's death, the 10-year rule would apply to Patty as the successor beneficiary.

Example 8:
Disabled beneficiary – one trust –remainder beneficiary is a designated beneficiary
Cathy names a trust for her disabled daughter, Emily, age 43, as the beneficiary of her IRA. The trust provides that any funds left in the trust at Emily's death will go to her younger sister, Amanda, age 41. Amanda is not disabled or chronically ill. During Emily's lifetime, RMDs may be paid from the inherited IRA to the trust based on Emily's single life expectancy. However, at Emily's death, payments from the inherited IRA to Amanda would be subject to the 10-year rule and would need to be paid out by December 31 of the tenth year following the year of Emily's death. Under a possible interpretation of the ALAR rule, RMDs would also be required for years 1-9 of the 10-year term, since RMDs had begun in the year after death.

Post-Death IRA Trust Administration

Step 3
Implementing the IRA Trust
Touch Nothing!

Titling
The trust is a NON-SPOUSE beneficiary and post-death RMDs follow those rules. This is an inherited IRA (even if the spouse is the sole beneficiary of the trust).

Set Up the Inherited IRA
Title it correctly.
The inherited IRA would be titled as follows:

Fred Johnson, IRA (deceased June 19, 2023) F/B/O Adam Hill, Trustee of The Johnson Family Trust, beneficiary
If the beneficiary is an estate or trust, file for a federal identification number

Deadlines for inherited IRAs
September 30th of the year after the IRA owner's death is the beneficiary designation date
Shake-Out Period (or Gap Period)
Check to see if any trust beneficiaries should be removed during the shake-out period. This can be done either by cashing out or by disclaiming

If a trust is named as the IRA beneficiary - October 31st of the year following the year of the IRA owner's death is the deadline for the trustee of the trust to provide trust documentation (or a copy of the trust) to the IRA custodian.

IRA owner's year of death distribution is a required distribution and any undistributed RMD *must* be taken by the trust

The year of death RMD for the IRA owner does NOT go to the estate (unless the estate is the beneficiary)

Under the SECURE Act, for most trusts, other than for eligible designated beneficiaries, the entire inherited IRA balance will be distributed to the trust (or through the trust to the trust beneficiaries) under the 10-year rule.

Avoid Major IRA Trust Mistakes That Most Other Advisors Make Routinely

<u>IRA Trust WAR Story # 1 of 3</u>

Attorney advised paying out entire IRA to trust

An attorney advised a terminally ill IRA owner to change the IRA beneficiary from his wife to a newly created IRA trust. When the IRA owner died, the attorney advised the bank to distribute the entire $608,000 IRA to this IRA discretionary trust. Result: Over $240,000 in unnecessary taxes and the tax deferral on the inherited IRA was lost forever. The mistake could not be corrected. It was not caught until the following year by the accountant who was preparing the trust tax return. The only amount that should have been paid to the trust was the annual required distribution (only about $24,000 in this case), NOT the entire IRA account balance! The attorney was sued for $2 million due to negligence on how to fund the IRA trust that he created and advised his client to name as his IRA beneficiary.

After the IRA owner dies, if a trust is named as the IRA beneficiary, **the IRA balance SHOULD NOT be paid to the IRA trust.** After the death of the IRA owner, only the RMD has to be paid from the IRA to the trust, NOT the entire IRA account balance.

<u>IRA Trust WAR Story # 2 of 3</u>

Client who went to estate planning seminar and put her IRA into her revocable living trust

Related (Almost an IRA War Story) –
This is the exact text of an email I received from a client in Smithtown, NY:

"My estate lawyer is having me put all my IRAs into my new Revocable Living Trust. Is this appropriate in view of my wish to leave IRAs to my sons?"

Luckily this client asked first. I advised her that if she followed this advice, the entire balance of her IRA would all be taxable immediately and the sons would never inherit the IRAs because the IRAs would have ceased to exist the minute she put them in the trust. This is a common and extremely costly mistake. The IRAs can be left to the trust upon death, but if you put them in the trust during your life, that is an IRA distribution and the IRA ceases to exist.

IRA Trust WAR Story # 3 of 3

IRA owner never named trust as IRA beneficiary on IRA beneficiary form

Trust set up for beneficiaries.
Rest of estate goes to different beneficiaries.
Trust never named as beneficiary on IRA beneficiary form.
Intended IRA trust beneficiaries are disinherited.

10-Point IRA Trust Checklist

Once the trust is named as the IRA beneficiary use this checklist to make sure the IRA trust works as planned

First - Check to see if the trust has been updated for the SECURE Act! And for the IRS proposed regulations which are already in effect.

Existing trusts may no longer work as planned (for example: no stretch IRA) - **Evaluate Planning Alternatives:**

Using Roth conversions to eliminate future trust taxes (if inherited IRA funds will be retained in the trust for post-death protection)

Naming contingent beneficiaries – spouse or other individual beneficiaries (leaving post-death disclaimer options open)

Naming direct beneficiaries (if post-death control is not an issue)

Life insurance – better asset to leave to a trust after the SECURE Act

Charitable trusts (CRTs) to replace and simulate the stretch IRA (if charitably inclined)

1. Check to see…

If the IRA trust is actually named as the trust beneficiary on the IRA beneficiary form.

Name the trust as the IRA beneficiary on the IRA beneficiary form.

2. Check to see…

If the IRA custodial agreement will accept a trust as the IRA beneficiary and payout the inherited RMDs to the trust.

For a company plan, check the company plan agreement – the "Summary Plan Description."

3. Check to see…

If the IRA trust qualifies as a see-through trust (if that is the intention)
It must meet the four IRA trust requirements.

4. Check to see…

If the right type of trust is named.
Conduit or discretionary trust?

Does it fit the estate plan? - Does it work after the SECURE Act changes?

5. Check to see…

Who are the beneficiaries?

What will the post-death payout be?
- 10-Year rule? Will RMDs for years 1-9 be required (under IRS proposed regulations)?
- Non-designated beneficiary rules?
- Stretch IRA as an eligible designated beneficiary?

No separate account rule for trusts.

This will determine the post-death payout terms

6. Check to see…

If all of the trust beneficiaries of a conduit or discretionary trust are individuals – in order to qualify as a see-through trust

7. Check to see…

If the estate may be considered as one of the discretionary trust beneficiaries based on wording requiring estate expenses to be paid from trust.

8. Check to see…

If the IRA trust is set up as a separate irrevocable trust (for better state creditor protection).
Trust under will is ok.

Does the trust refer to a specific company plan or IRA rather than just say "retirement accounts" or "retirement benefits"?

9. Check to see…

If the trustee is informed as to the payout of post-death distributions from the IRA to the trust.

How will the IRA trust beneficiary be paid out?

Who determines the form and timing of the payouts to the trust beneficiaries? It can be the beneficiary.

10. Check to see…

When does trust end? Everyone should know that now.

Trustee must be warned not to touch IRA funds without proper professional guidance.

Income vs. remainder trust beneficiaries.
Trust tax issues – how much of the distribution from the inherited IRA to the trust will be subject to trust tax rates.

Avoid any post-death surprises!

