# THE SECURE ACT

## What You Need to Know

*Presented by*

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# The Secure Act

- Effective January 1, 2020.
- Some of the open questions will remain as such until the IRS issues regulations and other guidance.
- Many different clients will be affected in a variety of ways.

# Changes to Lifetime Rules

- Required Beginning Date - The Secure Act changed the Required Beginning Date from April 1st of year after participant reached 70 ½ to April 1st of year after participant reached age 72.
- This applies to all individuals who reach age 70 ½ in 2020, or later.
- Example: Jane reaches age 72 in 2025. Jane must take her first required minimum distribution before April 1, 2026. As with prior law (i.e., pre-Secure Act), Jane must then take subsequent required minimum distributions by December 31st of each year, starting with her second required minimum distribution, which she must take by December 31, 2026.

# Changes to Lifetime Rules

- The RBD change does NOT apply to individuals who reached age 70 ½ in 2019 or earlier.
- Example: Jane reaches age 70 ½ in 2019. Jane must take her first required minimum distribution before April 1, 2020. Jane must then take subsequent required minimum distributions by December 31st of each year, starting with her second required minimum distribution, which she must take by December 31, 2020.

# Changes to Lifetime Rules (cont'd)

- Individuals of any age can make contributions to IRAs (so long as they are earning income).

# Lifetime Gifts to Charity from IRAs

- As a reminder, Section 408(d)(8) of the Internal Revenue Code, commonly known as the "IRA Charitable Rollover" provision, permits an individual taxpayer who is at least 70 ½ years old to distribute up to $100,000 directly from the taxpayer's IRA to a qualified public charity on a tax-free basis each taxable year as a qualified charitable distribution.
- The IRA Charitable Rollover provision does not apply to distributions to donor advised funds, private foundations and supporting organizations.
- Prior to the Secure Act, a direct gift from an IRA to charity would not be taxable income to the taxpayer, nor will the taxpayer receive a charitable deduction.
- Following the 2017 tax law changes, given the higher standard deduction, this provision could be particularly helpful for clients who did not itemize deductions to obtain an indirect charitable deduction and, in some states (but not PA), to save state income tax.

# Lifetime Gifts to Charity from IRAs (cont'd)

- Following the Secure Act, the annual $100,000 gift to charity during participant's lifetime is still allowed after 70 ½.
- However, the Secure Act now permits individuals of any age to make IRA contributions (so long as the individual has earned income) and, correspondingly, any distributions to charity directly from an IRA only will be a qualified charitable distribution to the extent that the distribution exceeds the aggregate additions to the IRA after the participant has reached age 70 ½. Any distributions attributable to additions after such age will be treated as income payable to the participant, and the participant can take a related income tax deduction.
- Any qualified charitable distributions prior to age 72 will not count towards future RMDs.

# Lifetime Gifts to Charity from IRAs (cont'd)

- Example: Client at age 71 contributes $5,000 to his IRA. At age 74, the client makes a $100,000 distribution to charity directly from his IRA. The first $5,000 would be treated as being taxable income to the client and the client can take an associated charitable deduction. The remaining $95,000 would be a qualified charitable distribution.

# “Designated Beneficiaries” v. “designated beneficiaries”

- For the purposes of our discussion, it is important to clarify these terms.
- When working with clients to complete beneficiary designations as part of an estate plan, the named beneficiaries are often referred to as “designated beneficiaries.”
- However, for the purposes of retirement assets under the IRC and Regulations, “Designated Beneficiaries” have a special meaning and refer to individuals and qualifying trusts.

# Changes to Post-Death Rules

- The new rules apply to all retirement accounts owned by individuals who die after December 31, 2019.
- Prior to the Secure Act, subject to certain exceptions, the general idea was that distributions to a "Designated Beneficiary" must be made over the life expectancy of the beneficiary. The Secure Act has greatly changed this.
- Example: Jane dies and leaves her IRA to her son, Chris, who is 50 years old at Jane's death. Under prior law, the period over which Chris could withdraw the IRA would 34.2 years (the life expectancy of a 50-year old). Under the Secure Act, Chris has to withdraw the IRA within 10 years.

# Changes to Post-Death Rules (cont'd)

- The new Secure Act rules apply to post-death distributions from Roth IRA accounts.
- As with prior law, however, required minimum distributions from an IRA or 401(k) result in taxable income; required minimum distributions from a Roth IRA or Roth 401(k) do not result in taxable income, but remove the distribution amount from the tax-advantaged Roth account.
- In the case of Roth assets, the new rules accelerate the shift of those assets out of tax-exempt accounts.

# Changes to Post-Death Rules (cont'd)

- As a reminder, the governing instrument of the retirement asset could, and still may, limit a beneficiary's options. For example, qualified plans (e.g. §401(k) plans) often severely limit distribution options at a participant's death, and in many cases require a full payout upon death; but the beneficiary may have the ability to roll-over the account to an inherited IRA. IRAs generally do not impose such limitations, because the IRA providers generally want to provide any option allowed by the IRS.

# Secure Act Terminology

- The Act keeps the existing terminology defining beneficiaries as a “Designated Beneficiary” (individuals and certain qualifying trusts) and “Non-Designated Beneficiaries” (estates, charities and non-qualifying trusts).

# Secure Act Terminology (cont'd)

- However, the Secure Act adds the concept of an "Eligible Designated Beneficiary," which include:
  - The surviving spouse of the Participant.
  - A Child of Participant who has not reach majority.
  - Disabled or Chronically Ill Beneficiary.
  - Designated Beneficiary not more than 10 years younger than Participant (think sibling or unmarried partner). Query whether this applies to older designated beneficiaries?

# Distributions to Charity at Death

- Retirement assets are still often the ideal place from which to make charitable gifts because charities do not pay income tax.
- However, remember that charities are Non-Designated Beneficiaries.
- If the retirement asset has both Designated Beneficiaries and Non-Designated Beneficiaries, you will need to "remove" the charity (by satisfaction, for example) no later than September 30th of the year after the year of participant's death. This is not usually an issue with outright gifts, but can be an issue with gifts to trusts – more discussion later.
- As with prior law, Roth accounts should <u>not</u> be used for charitable gifts.

# Federal Income Tax Rules for Post-Death Distributions – Spouse (Still the Gold Standard)

- Option 1: Roll-Over to Own IRA
  - If the spouse rolls-over the decedent's retirement asset into his or her own IRA, he or she will calculate future RMDs based on the Uniform Lifetime Table (which is based on the joint-and-survivor life expectancy of a participant and a spouse ten years younger) and the spouse may recalculate her life expectancy annually.
  - Allows for maximum possible deferral.
  - The account will be treated for all purposes as if the retirement account was the spouse's own retirement account.
- Option 2: Treat Decedent's Account as Own
  - Has the same effects as the roll-over for the purposes of determining the spouse's RBD and RMD.

# Federal Income Tax Rules for Post-Death Distributions – Spouse (cont'd)

- Jane, 75, dies and leaves her IRA outright to her husband, John, 67.
- John rolls over the IRA into his own IRA.
- John can defer taking RMDs until his RBD and then take distributions based on his life expectancy based on the Uniform Lifetime Table, re-calculated each year.
- After John's death, <u>his</u> named beneficiaries may take distributions over the maximum permitted period based on that status.

# Federal Income Tax Rules for Post-Death Distributions – Spouse (cont'd)

- Option 3: Roll-Over into inherited IRA.
  - A spouse can roll-over the proceeds to an IRA in the name of the decedent and take on the same basis as a non-spousal beneficiary.
  - Because the spouse is an Eligible Designated Beneficiary, future RMDs will be calculated based on the spouse's life expectancy (and not the 10-year rule).

# Federal Income Tax Rules for Post-Death Distributions – Spouse (cont'd)

- Option 3 may make sense for younger spouses.
  - If a spouse takes distributions from an inherited IRA as a non-spousal beneficiary, distributions are not subject to a 10% penalty.
  - However, if the spouse rolled-over retirement asset into his or her own IRA, he or she would be subject to a 10% penalty on distributions taken prior to age 59 ½.
  - Accordingly, in instances involving a younger spouse, in which the spouse may need to take distributions before reaching age 59 ½, it may not make sense to roll-over the proceeds into the spouse's IRA.
  - Example: John, 75, leaves his IRA to his wife, Jane, who is 50. Jane can elect to roll-over the IRA into an inherited IRA and take the distributions over 34.2 years.

# Federal Income Tax Rules for Post-Death Distributions for Designated Beneficiaries (Who are not Eligible Designated Beneficiaries)

- The overall effect of the new rules is to accelerate the distribution from tax-advantaged retirement accounts. In the case of pre-tax non-Roth accounts, this accelerates the taxation of those assets. In the case of Roth assets this accelerates the shift of those assets out of tax-exempt accounts.
- For individual beneficiaries, the acceleration of distributions will become primary an income-tax management issue; how to time the distributions, to the extent possible, to have the income taxed at the lowest possible rates.
- For accumulation see-through trusts, the additional complication is the higher trust income tax rates. Many typical accumulation trusts include significant flexibility that would permit the trustee, where appropriate, and not inconsistent with the non-tax purposes of the trust, to shift taxable income to the trust beneficiaries through principal distributions.

# Federal Income Tax Rules for Post-Death Distributions for Designated Beneficiaries (Who are not Eligible Designated Beneficiaries) (cont'd)

- Under Prior law - Designated Beneficiary could take required minimum distributions each year over the Designated Beneficiary's life expectancy (and in some cases if the participant died after the participant's RBD over the participant's remaining life expectancy if longer than the Designated Beneficiary's life expectancy).
- The Secure Act now applies a new "10 year rule" to a Designated Beneficiary. This 10 year rule requires that the account balance must be withdrawn by December 31st of the year containing the 10th anniversary of the participant's death. There is no requirement for annual distributions before then.

# Federal Income Tax Rules for Post-Death Distributions – One or more Non-Designated Beneficiaries

- The Secure Act does not change prior law.
- If the participant died before his or her RBD, the account balance must be withdrawn by December 31st of the year containing the 5th anniversary of the participant's death. There is no requirement for annual distributions before then.
- If the participant died after his or her RBD, the account balance must be withdrawn over the balance of the life expectancy of the participant. Annual distributions must be taken in each year after the year of the participant's death.

# Federal Income Tax Rules for Post-Death Distributions – One or more Non-Designated Beneficiaries (cont'd)

- John, age 70, dies and leaves his IRA to his estate (of which his children are the beneficiaries). The IRA will be subject to the 5-year rule.
- If the facts are the same, but John had been 78, distributions must be taken each year based on John's life expectancy of 11.4 years.

# Forms of Trusts – Accumulation, See-Through Trusts

- Accumulation trusts can be for more than one beneficiary and do not require that any withdrawals from a retirement asset must be distributed.
- A see-through trust is an accumulation trust in which the trust qualifies as a Designated Beneficiary.

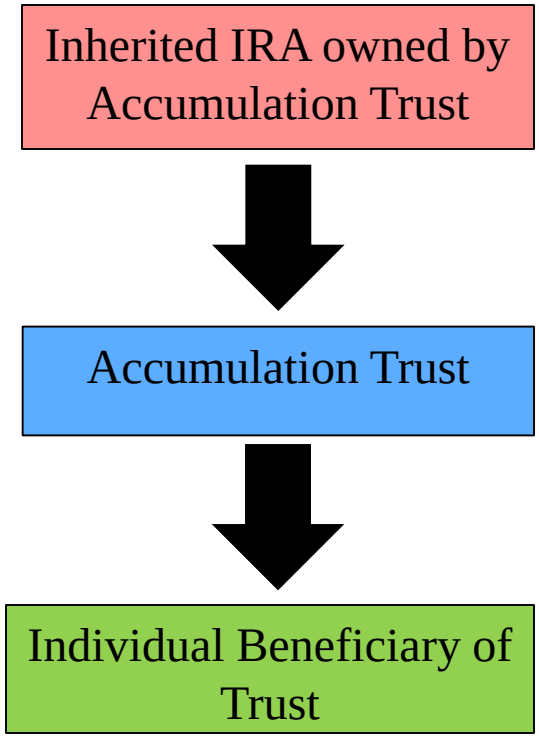
# Forms of Trusts – Accumulation, See-Through Trusts (cont'd)

- In order for a trust to be a qualified "see-through" trust that qualifies as a "Designated Beneficiary," the following requirements must be met:
  - The trust must be valid under state law.
  - The trust is irrevocable or will, by its terms, become irrevocable upon the death of the participant.
  - The beneficiaries of trust who are beneficiaries with respect to the retirement account must be identifiable from the trust instrument.
  - Certain documentation, including the trust instrument, must be supplied to the plan administrator by October 31st of the year after participant's death.
  - All trust beneficiaries must be individuals with respect to the retirement assets.

# Forms of Trusts – Accumulation, See-Through Trusts (cont'd)

- The key requirement is all trust beneficiaries are individuals (rather than, for example, a charity or estate).
- Under the prior law, being able to identify the oldest possible beneficiary (not just the primary beneficiary) was important because that individual's life expectancy set the required minimum distribution.
- Under prior law (and potentially under the new law), many trusts were carefully drafted to qualify as a Designated Beneficiary with a specific individual as the oldest potential beneficiary.
- Focus on powers of appointment, disaster beneficiaries, payment of death taxes and expenses.

# Forms of Trusts – Accumulation, See-Through Trusts (cont'd)



# Forms of Trusts – Conduit Trusts

- A conduit trust is a trust for a single beneficiary.
- All funds withdrawn from the retirement asset by the trustee – not just required minimum distributions - must be promptly distributed to the beneficiary. None may be accumulated in the trust.
- The benefit of the conduit trust is that the conduit trust is considered the beneficiary of the retirement plan for purposes of determining post-death RMDs. The identity of the remainder beneficiary does not matter, and so could include a charity, or other Non-Designated Beneficiary.
- With the Secure Act, there may be additional reasons to use conduit trusts, and also some reasons to no longer use conduit trusts in some instances.

# Forms of Trusts – Conduit Trusts (cont'd)

- We typically used conduit trusts in more limited instances, such as a trust that is withdrawable by a beneficiary during his or her lifetime (i.e., 25/30/35 trusts) or if the beneficiary wants the assets to pass a non-qualified beneficiary as the remainder beneficiary.
- Example: John, age 55, dies leaves his IRA in a conduit trust for wife, Jane (age 50), and at Jane's death the balance of the trust assets will go to charity. The conduit trust allows distributions to be taken over Jane's 34.2 year life expectancy instead of over 5 years.
- Conduit trusts will not have the same advantages for Designated Beneficiaries who are not Eligible Designated Beneficiaries following the Secure Act.

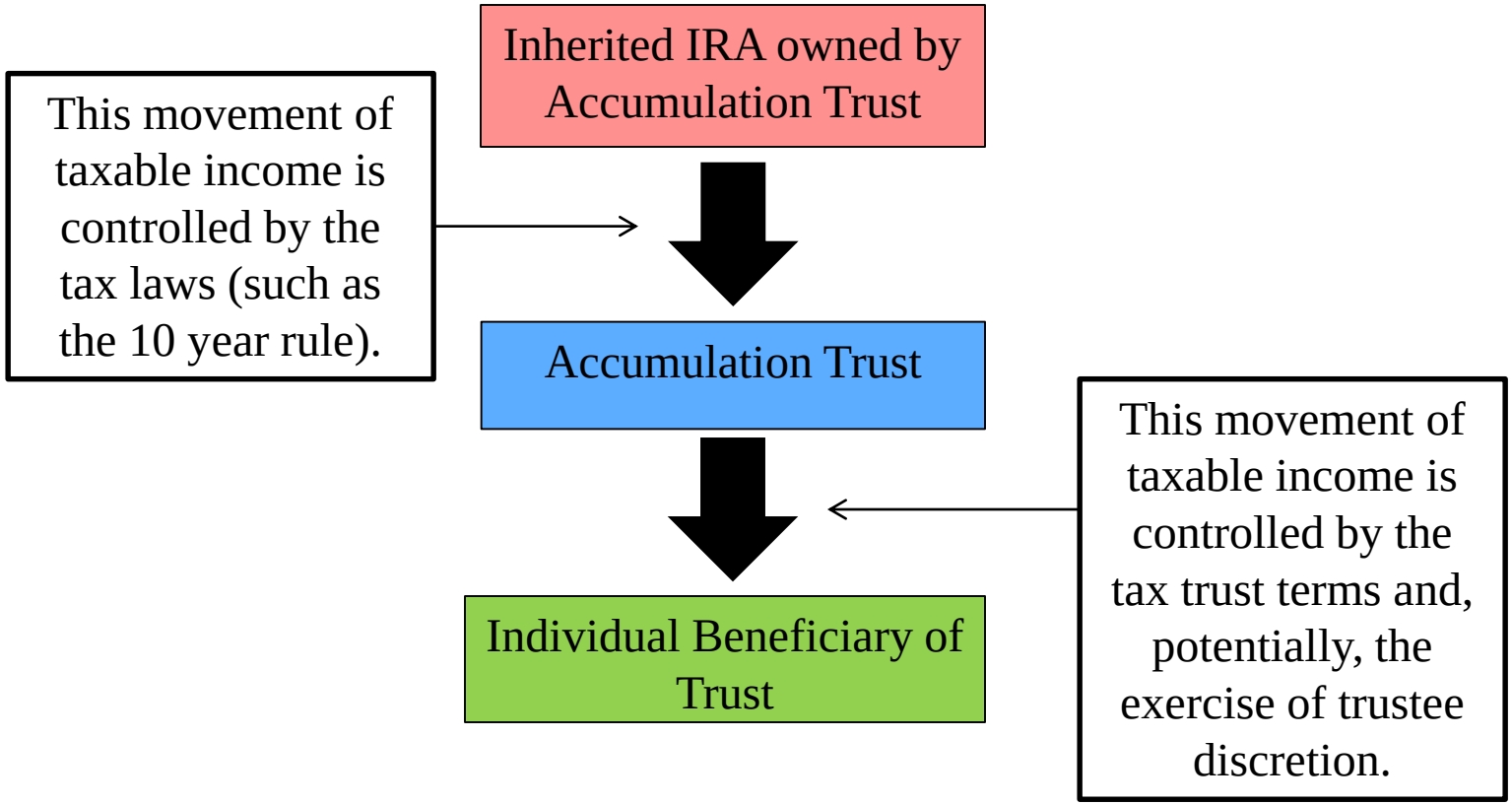
# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 1: 85 year-old participant wishes to leave benefits in lifetime trusts for children.
- Prior law. A carefully drafted accumulation see-through trust will permit required minimum distributions from the account over the lifetime of oldest child (or possibly lifetime expectancy of each child with respect to each child's trust if the division among the trusts for each child occurs at the beneficiary designation level).
- Secure Act. A carefully drafted accumulation see-through trust is subject to the 10 year rule.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries (cont'd)

- Planning implications. In many cases, no change in planning. In some cases, the reduced distribution period may encourage outright distribution, or more significant changes, e.g. a CRUT.
- More subtle drafting implications. The powers of appointment each child can have at death over his or her respective primary beneficiary trust can be modified to permit appointment to individuals older than the participant's oldest child. This could include a current or subsequent spouse of a child, whether by name or by class. The power of appointment still cannot include non-individual beneficiaries such as charities.

# Income Tax Management for Accumulation Trusts



# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 2: Same as Example 1, except that 85 year-old participant really wants his 84 year old sister to be an eligible sprinklee of the trusts for children.
  - Prior law. Including the sister as a potential beneficiary would require the trustee to take required minimum distributions over sister's life expectancy, even if no distributions ever were made to sister. Including sister as a potential trust beneficiary therefore had a big potential cost.
  - Secure Act. Whether or not the sister is a potential beneficiary of the trusts, the 10 year rule applies.
  - Planning implications. The ability to include participant's sister as a potential sprinkle is much more feasible under the Secure Act.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Examples 3, 4 and 5. Participant (not specifying age for a moment) wishes to include a Non-Designated Beneficiary in the accumulation trust for children. For example, this could include a charity as remainder beneficiary; or giving each child a broad non-general power of appointment at death.
  - Prior law. Including these Non-Designated Beneficiaries will make the trust ineligible to take required minimum distributions over the life expectancy of the oldest child. Instead, the retirement account will need to be distributed over the 5 year rule (if participant died before his or her RBD) or over the participant's remaining life expectancy (if participant died after his or her RBD).
  - Secure Act. The law is same as prior law. However, the *implications*, and tradeoffs of including a Non-Designated Beneficiary, are different depending on the age of the participant.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 3 - young participant – for example, age 50
  - Including a Non-Designated Beneficiary would require distributions over the 5 year rule, rather than the 10 year rule.
  - Some clients will not view this as a significant cost.
  - For example, under the prior law, if client was age 50, and child was age 25, including a Non-Designated Beneficiary would take the period over which distributions could be made from 58.2 years (life expectancy of a 25 year old) to 5 years.
  - Under the Secure Act, including a Non-Designated Beneficiary would take the period over which distributions could be made from 10 years to 5 years.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 4 - older participant – age 81 or older.
  - The participant's life expectancy is less than 10 years. Therefore, with only Designated Beneficiaries of the trust, the trustee may withdraw funds using the 10 year rule.
  - Including a Non-Designated Beneficiary will require the use of the participant's remaining life expectancy, which will be less than 10 year. Some clients will not view this as a significant cost.
  - For example, under the prior law, if client was age 85, and child was age 50, including a Non-Designated Beneficiary would take the period over which distributions could be made from 34.2 years (life expectancy of a 50 year old) to 7.6 years.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 4 - older participant – age 81 or older (cont'd).
  - Under the Secure Act, including a Non-Designated Beneficiary would take the period over which distributions could be made from 10 years to 7.6 years.
  - One subtlety is that under the 10 year rule no distributions must be taken until the end of the 10 years, whereas if the participant's remaining life expectancy is used a required minimum distribution must be taken each year starting in the year after the participant's death.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 5 - Participant older than RBD and younger than age 80.
  - Including a Non-Designated Beneficiary actually may lead to a longer distribution period.
  - Including a Non-Designated Beneficiary would permit distributions over the participant's remaining life expectancy, which will be greater than 10 years, rather than the 10 year rule. For example, the life expectancy of a 73 year-old is 14.8 years.
  - However, distributions would need to be taken each year, rather than selecting the most advantageous tax years during the 10 year period. Including a Non-Designated Beneficiary would require distributions over the 5 year rule, rather than the 10 year rule.

# Federal Income Tax Rules for Post-Death Distributions – Accumulation Trusts for Designated Beneficiaries other than Eligible Designated Beneficiaries

- Example 5 - Participant older than RBD and younger than age 80 (cont'd).
  - This example creates a small window (under the current life expectancy tables), where including a Non-Designated Beneficiary would create a longer period over which RMDs can be withdrawn.
  - There is much speculation as to whether one may design a see-through accumulation trust that could be qualify as either a Designated Beneficiary (subject to the 10 year rule) or not qualify as a Designated Beneficiary (to obtain the longer distribution period if the participant dies between age 72 and 80).

# Conduit Trust Examples

- Trust for Husband: Discretionary distributions of income and principal but requires that all distributions from retirement assets pass outright to husband – *Conduit Trust.*
- Marital Trust for Wife – Requires all income be distributed to wife and allows for discretionary distributions of principal, but the trust is silent regarding retirement assets – *NOT a Conduit Trust.*

# Eligible Designated Beneficiaries

- We discussed how a retirement asset passing outright to a surviving spouse is subject to special rules.
- As a reminder, the other beneficiaries entitled to special rules as an Eligible Designated Beneficiary are:
  - Conduit trust for a spouse
  - Minor child of participant
  - Chronically ill or disabled beneficiary
  - Beneficiary not more than 10 years younger than the participant

# Conduit Trust for a Spouse

- Under both prior law and the Secure Act, if the surviving spouse is the beneficiary of conduit trust, then, until the spouse's death, required minimum distributions may be taken over the spouse's life expectancy (and, by definition, paid outright to the spouse). The conduit trust is treated as the surviving spouse would have been if the surviving spouse was the outright beneficiary and rolled the IRA into an inherited IRA.
- This does not delay the RBD.
- Under both prior law and the Secure Act, after the spouse's death, the same rules apply as if the spouse was the participant (e.g., a child named as outright beneficiary could under prior law take required minimum distributions over his or her life expectancy, and under the Secure Act, the 10 year rule applies).

# Conduit Trust for a Spouse (cont'd)

- The problem with a conduit trust is that even if only the required minimum distributions are taken, if the spouse lives a long life, most of the retirement asset will be distributed to the trust – certainly well in excess of what the fiduciary accounting income would have been.
- If the spouse is the beneficiary of an accumulation see-through trust, the spouse receives no special benefit, and the normal rules governing trusts (e.g., the 10 year rule if the trust is a Designated Beneficiary).

# Exception for Minor Children of Participant

- Minor children of the participant are deemed to be Eligible Designated Beneficiaries
- Does not apply to grandchildren or any minor beneficiary other than a minor child of the participant.
- If paid outright to the child or to a conduit trust for the benefit of the child, then, until the child reaches majority, required minimum distributions may be taken over the child's life expectancy (e.g., 1/77.7 for a five year old beneficiary). After the child reaches majority, the 10 year rule applies.
- "Majority" is certainly 18; but there is a cross-reference in the Secure Act that could allow a child still being educated to not reaching majority until age 26 for a child who is under the age of 26 and who has not completed a "specified course of education." The cross-reference is confusing and the commentators aren't sure how this will be interpreted.
- A see-through accumulation trust (i.e., a trust that qualifies as a Designated Beneficiary) for the benefit of a minor child is subject to the normal 10 year rule.
- *This "outright or conduit trust for minor child of participant as beneficiary option" probably is not appealing to many clients because it forecloses the ability to use a see-through accumulation trust.*
- Likely does not apply to pot trusts.

# Exception for Disabled or Chronically Ill Beneficiary

- A designated beneficiary who is "disabled" is defined as follows: "an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require."
- A designated beneficiary who is "a chronically ill individual" "if there is a certification that as of such date, the period of inability described in such subparagraph with respect to the individual is an indefinite one which is reasonably expected to be lengthy in nature)."
- If paid outright to the disabled or chronically ill beneficiary, or to a trust of which a disabled and chronically ill beneficiary is the sole beneficiary during his or her lifetime (this trust can be a see-through accumulation trust, or a conduit trust), required minimum distributions may be taken over the beneficiary's life expectancy. After the death of the disabled or chronically ill beneficiary, the 10 year rule applies.
- *Because a see-through accumulation trust qualifies for life expectancy distributions – and allows those distributions to be accumulated in the trust – this seems far preferable to a conduit trust.*

# Exception for Disabled or Chronically Ill Beneficiary (cont'd)

- A brief note on this exception: The regulations have not been updated yet, so although the intention of the Secure Act seems to be that the an accumulation trust for the sole benefit of a disabled or chronically ill beneficiary qualify for the longer distribution period, the current regulations raise a question regarding whether the oldest potential beneficiary of the trust could alter that distribution period.
- Example: John leaves his IRA to an accumulation trust for adult son Sam (50) who is a disabled beneficiary. At Sam's death, the remaining assets will be distributed to John's brother, Jeff (77). The concern is that the existing regulations will use Jeff's life expectancy instead of Sam's to determine RMDs.
- We will need to see the new regulations to get clarity on this point.

# Exception for Designated Beneficiary Not More than 10 Years Younger Than Participant

- Think of a sibling or unmarried partner.
- There is a question regarding exactly what this exception entails. Query does the exception apply to a designated beneficiary who is older than the participant?
  - For example, a participant who is 72 leaves his IRA outright to his 70 year old sister, the sister can withdraw the IRA using her life expectancy.
  - Conversely, if the sister dies and leaves her IRA to the participant, does the participant, who is not more than 10 years younger, get to use his life expectancy or does the 10 year rule apply?
  - From a fairness perspective, it would seem that in the second scenario, the participant should be able to use his life expectancy. However, we will need to see what the regulations say before we have clarity.

# Exception for Designated Beneficiary Not More than 10 Years Younger Than Participant (cont'd)

- If a retirement asset is paid outright to the Designated Beneficiary or a conduit trust for the Designated Beneficiary, then required minimum distributions may be taken over the Designated Beneficiary's life expectancy. After the Designated Beneficiary's death, the 10 year rules applies.
- Accumulation trusts are subject to the normal rule (e.g. 10 year rule assuming the trust otherwise qualifies as a Designated Beneficiary).
- This "outright or conduit trust for Designated Beneficiary within 10 years of Participant's age" option will be appealing to clients who are comfortable with their beneficiary having full ownership of the retirement asset either immediately (if the beneficiary is named outright) or over a period of time (with a conduit trust).
- However, unique to Pennsylvania, clients likely to fall into this "Exception for Designated Beneficiary age within 10 years of Participant" will be in the 15% inheritance tax bracket. Using this retirement asset exception likely will result in more inheritance tax.

# Summary of Post-Death RMD Calculations Prior to the Secure Act

| If Decedent Died After RBD | Who Is the Beneficiary? | Decedent Died Before RBD or Roth IRA (Regardless of Age) |
|---|---|---|
| The greater of (i) the life expectancy of the beneficiary or (ii) the remaining life expectancy of the participant. Annual required minimum distributions. | One non-spouse Designated Beneficiary (including a qualified trust) | The life expectancy of the beneficiary. Annual required minimum distributions. |
| The greater of (i) the life expectancy of the oldest beneficiary or (ii) the remaining life expectancy of the decedent; unless divided prior to December 31st of the year after death. Annual required minimum distributions. | Multiple Beneficiaries all of whom are qualified | The life expectancy of the oldest beneficiary, unless divided prior to December 31st of the year after death. Annual required minimum distributions. |
| Remaining life expectancy of decedent. Annual required minimum distributions. | If there is a non-qualified beneficiary (charity, estate, non-qualifying trust) not removed by 9/30 of year after death | All funds must be distributed from the account no later than December 31st of the year that contains the 5th anniversary of participant's death (not by the 5th anniversary of participant's death). No annual required minimum distribution. |
| Spouse may:<br>(i) roll-over funds into his or her own IRA, in which case the account will be treated for all purposes as if it were his or her own retirement account,<br>(ii) take as a beneficiary, without rolling over the account; or<br>(iii) for certain plans, elect to treat the retirement plan as the spouse's retirement plan. | Spouse | Spouse may:<br>(i) roll-over funds into his or her own IRA, in which case the account will be treated for all purposes as if it were his or her own retirement account;<br>(ii) take as a beneficiary, without rolling over the account; or<br>(iii) for certain plans, elect to treat the retirement plan as the spouse's retirement plan. |

# Summary of Post-Death RMD Calculations After the Secure Act

| If Decedent Died After RBD | Who Is the Beneficiary? | Decedent Died Before RBD or Roth IRA (Regardless of Age) |
|---|---|---|
| 10 Year Rule. All funds must be distributed from the account no later than December 31st of the year that contains the 10th anniversary of participant's death (not by the 10th anniversary of participant's death) (the "10 Year Rule"). No annual required minimum distributions. | One Non-Spouse Designated Beneficiary (including a qualified trust) who is not an Eligible Designated Beneficiary. | 10 Year Rule. |
| 10 Year Rule. However, if one of the Designated Beneficiaries is an Eligible Designated Beneficiary, and the account is divided prior to December 31st of the year after death, each Eligible Designated Beneficiary may take advantage of the applicable exception to the 10 Year Rule. | Multiple Beneficiaries each of who qualifies as a Non-Spouse Designated Beneficiary. | 10 Year Rule. However, if one of the Designated Beneficiaries is an Eligible Designated Beneficiary, and the account is divided prior to December 31st of the year after death, each Eligible Designated Beneficiary may take advantage of the applicable exception to the 10 Year Rule. |
| No change to prior law. Remaining life expectancy of decedent. Annual required minimum distributions. | If there is a beneficiary who does not qualify as a Designated Beneficiary (charity, estate, non-qualifying trust) not removed (e.g., by disclaimer, satisfaction, etc.) by 9/30 of year after death. | No change to prior law. 5 Year Rule. |

# Summary of Post-Death RMD Calculations After the Secure Act (cont'd)

| If Decedent Died After RBD | Who Is the Beneficiary? | Decedent Died Before RBD or Roth IRA (Regardless of Age) |
|---|---|---|
| The life expectancy of the beneficiary, if outright or a conduit trust, followed by the 10 Year Rule after the death of the Eligible Designated Beneficiary (or reaching the age of majority in the case of a minor child). In the case of a disabled or chronically ill beneficiary, an accumulation see-through trust also qualifies for life expectancy treatment. In the case of other Eligible Designated Beneficiaries whose interest is through an accumulation see-through trust, the 10 Year Rule applies. | One Eligible Designated Beneficiary (including a qualified trust). | The life expectancy of the beneficiary, if outright or a conduit trust, followed by the 10 Year Rule after the death of the Eligible Designated Beneficiary (or reaching the age of majority in the case of a minor child). In the case of a disabled or chronically ill beneficiary, an accumulation see-through trust also qualifies for life expectancy treatment. In the case of other Eligible Designated Beneficiaries whose interest is through an accumulation see-through trust, the 10 Year Rule applies. |
| Spouse may:<br>(i) roll-over funds into his or her own IRA, in which case the account will be treated for all purposes as if it were his or her own retirement account,<br>(ii) take as a beneficiary, without rolling over the account; or<br>(iii) for certain plans, elect to treat the retirement plan as the spouse's retirement plan. | Spouse | Spouse may:<br>(i) roll-over funds into his or her own IRA, in which case the account will be treated for all purposes as if it were his or her own retirement account;<br>(ii) take as a beneficiary, without rolling over the account; or<br>(iii) for certain plans, elect to treat the retirement plan as the spouse's retirement plan. |

# Charitable Remainder Trusts ("CRT") as an option

- Naming a CRT as beneficiary of retirement assets is an effective way to defer the taxable income over a period longer than 10 years.
- The trustee of the CRT will withdraw the retirement asset after the participant's death, but the income will not be subject to tax then. Instead, it will be added to the "bucket" of ordinary income, to be passed out over the subsequent years with each distribution to the non-charitable beneficiary.
- Our initial reaction is that for a client who wishes to leave his or her retirement assets to non-charitable beneficiaries, a CRT will not be a way to <u>increase</u> the net after tax amount that passes to the non-charitable beneficiaries. However, a CRT may be a way to leave a significant gift to charity at a low net cost to the non-charitable beneficiaries.
- Still need to watch the 10% charitable remainder rule.
- CRTs should not be used for Roth assets.

# Federal Income Tax Rules for Post-Death Distributions – After the First Beneficiary's Death

- Once the original beneficiary dies, the retirement asset passes (still in the inherited IRA) to the successor beneficiary designated by the original beneficiary. The Secure Act does not change that.
- Under both prior law and the Secure Act, the successor beneficiary then may take required minimum distributions over the balance of the period over which the original beneficiary could have taken distributions (e.g., balance of the original beneficiary's life expectancy, 5 year rule, 10 year rule, or balance of the participant's life expectancy).
- Under both prior law and the Secure Act, the identity of the successor beneficiary does not the period vary over which the remaining distributions may be taken. For example, the successor beneficiary may be the original beneficiary's spouse, child, or even estate.

# Exception to 1/20/2020 Effective Date

- With respect to a participant who died before January 1, 2020, and who made a retirement asset payable to an individual Designated Beneficiary, such beneficiary could take required minimum distributions over his or her life expectancy. After the original beneficiary dies, the retirement asset passes (still in the inherited IRA) to the successor beneficiary designated by the original beneficiary.
- However, under prior law, if the original beneficiary could take distributions over the original beneficiary's life expectancy, the successor beneficiary then could take required minimum distributions over the balance of the original beneficiary's life expectancy. The Secure Act changed that, even for participants who died before January 1, 2020. After the original beneficiary has died, the successor beneficiary is subject to the 10 year rule.

# Exception to 1/20/2020 Effective Date (cont'd)

- Query if the original beneficiary has been taking required minimum distributions over the balance of the participant's life expectancy. How does the 10 year rule apply?
- Query how this rule applies to trusts? Under prior law the maximum distribution period was set by the age of the oldest potential beneficiary. However, it was the trust itself that was the Designated Beneficiary; the oldest potential beneficiary might not have been the primary beneficiary of the trust. Therefore, although not completely clear, it appears as though the trust may continue to take required minimum distributions over the maximum possible period.

# Spouse Examples

- Spousal Options:
  - Outright to Spouse
  - Conduit Trust for Spouse
  - Accumulation Trust for Spouse
- For the following examples, assume John (77) wants to leave his IRA to his wife, Jane (73).

# Outright to Spouse Example

- John leaves his IRA outright to Jane and she rolls the IRA over into her own IRA.
- In this example, given that she is past her RBD, she will begin taking RMDs the year after John's death.
- In the year in which Jane is 74, her RMD will be 1/23.8, and in the next year it will be 1/22.9.
- Jane's life expectancy will be re-calculated each year.
- Annual distributions are required following the RBD.
- Jane can name her own beneficiaries and the required distributions following her death will be based on who she selects as a beneficiary.
- Of course, Jane can name whoever she wants as beneficiary and could divert the assets from John's intended estate plan.
- The associated income tax will be paid by Jane.

# Conduit Trust for Spouse Example

- John leaves his IRA in a conduit trust for Jane and at Jane's death the trust provides that the balance passes outright to his son from a prior marriage.
- In the year after John's death, when Jane is 74, the trust will have to withdraw 1/14.1 of the IRA, and the next year the fraction will be 1/13.1 (reducing the denominator by one each year).
- Under the terms of the trust, each withdrawal must be distributed outright to Jane.
- Annual RMD distributions are required without re-calculating Jane's life expectancy.
- Jane cannot change remainder beneficiary of trust.
- At Jane's death, when the remaining IRA passes outright to the son, the 10 year rule period starts.
- However, if Jane lives more than 15 years, the entire IRA will be distributed to her outright for her to distribute as she wishes under her estate plan.
- The associated income tax will be paid by Jane.

# Accumulation Trust for Spouse

- John leaves his IRA to an accumulation trust for Jane with discretionary distribution provisions. The trust provides that at Jane's death, the balance passes to John's son.
- The IRA will be subject to the 10 year rule.
- No annual distributions are required.
- Jane cannot name a new beneficiary.
- Jane's death will not start a new 10 year rule period.
- The income tax will be paid by the trust or Jane depending on the distributions made to Jane.

# Examples for Unmarried Partner

- Options:
  - Outright
  - Conduit Trust
  - Accumulation Trust
- For the following examples, assume John (77) wants to leave his IRA to his longtime non-spouse partner, Jane.

# Outright to Unmarried Partner

- If Jane is not more than 10 years younger, Jane with take annual withdrawals based on her life expectancy.
- If Jane is more than 10 years younger, Jane will have to withdraw the IRA pursuant to the 10 year rule, although no annual distributions are required.
- Jane will pay the associated income tax from withdrawals.
- Jane can name a new beneficiary of her inherited IRA.

# Conduit Trust for Unmarried Partner Not More Than 10 Years Younger

- John leaves his IRA in a conduit trust for Jane and at her death the balance passes outright to his son. Jane is not more than 10 years younger than John.
- The trust will take annual withdrawals based on Jane's life expectancy.
- Under the terms of the trust, each withdrawal must be distributed outright to Jane.
- Jane cannot change remainder beneficiary of trust.
- At Jane's death, when the remaining IRA passes outright to the son, the 10 year rule period starts.
- However, if Jane lives more than her life expectancy, the entire IRA will be distributed to her outright for her to distribute as she wishes under her estate plan.
- The associated income tax will be paid by Jane.

# Conduit Trust for Unmarried Partner More Than 10 Years Younger

- John leaves his IRA in a conduit trust for Jane and at her death the balance passes to his son. Jane is more than 10 years younger than John.
- The trust will withdraw the IRA pursuant to the 10 year rule but no annual withdrawals are required.
- Under the terms of the trust, each withdrawal will be distributed outright to Jane.
- Jane cannot change remainder beneficiary of trust, when the remaining IRA passes to the son at Jane's death, any remaining distributions must be taken pursuant to the original 10 year rule period.
- However, if Jane lives more than 10 years, the entire IRA will be distributed to her outright for her to distribute as she wishes under her estate plan.
- The associated income tax will be paid by Jane.

# Accumulation Trust for Unmarried Partner

- John leaves his IRA to an accumulation trust for Jane with discretionary distribution provisions, which passes to John's son at her death.
- The IRA will be subject to the 10 year rule.
- No annual distributions are required.
- Jane cannot name a new beneficiary.
- Jane's death will not start a new 10 year rule period.
- The income tax will be paid by the trust or Jane depending on the distributions made to Jane.

# Examples for Adult Children

- Options for Children
  - Outright
  - Conduit Trust
  - Accumulation Trusts

# Outright to Adult Child

- John leaves his IRA to his adult son, Sam (50).
  - Sam will have to withdraw the IRA pursuant to the 10 year rule.
  - No required annual withdrawals.
  - Sam will pay the associated income tax.
  - Sam can name a new beneficiary of the IRA but his death does not start a new 10 year period.

# Conduit Trust for Adult Child

- John leaves his IRA to a conduit trust for Sam, which then passes to John's brother, Jeff.
  - The trust will have to withdraw the IRA pursuant to the 10 year rule.
  - All IRA withdrawals will be distributed to Sam.
  - No required annual withdrawals.
  - Sam will pay the associated income tax.
  - Sam cannot name a different remainder beneficiary and his death does not start a new 10 year period.

# Accumulation Trust for Adult Child

- John leaves his IRA to an accumulation trust for Sam with fully discretionary provisions, which then passes to John's brother, Jeff.
  - The trust will have to withdraw the IRA pursuant to the 10 year rule.
  - All IRA withdrawals may be distributed to Sam depending on the terms of the trust.
  - No required annual withdrawals.
  - Sam or the trust will pay the associated income tax depending on distributions to Sam.
  - Sam cannot name a different remainder beneficiary.

# Examples for Minor Children

- John wants to leave his IRA to his son, Sam, who will be 7 on 12/31 of the year following John's death. Assume 21 is the age of majority.
- Options:
  - Outright
  - Conduit Trust
  - Accumulation Trust

# Outright to Minor Child

- John makes the IRA payable to an UTMA account for Sam:
- Distributions will be taken based on Sam's life expectancy while he is a minor, and then the 10 year period will start.
- Sam will have full access to the funds at age 21.

# Conduit Trust for Minor Child

- John leaves his IRA in a conduit trust for Sam and at his death the balance passes to charity.
- Distributions will be taken based on Sam's life expectancy while he is a minor, and then the 10 year period will start.
- Under the terms of the trust, each withdrawal will be distributed outright to Sam (or an UTMA account for his benefit).
- Sam will have all the funds by age 31.

# Accumulation Trust for Minor Child

- Same rules as for adult child.

# Minor Child Considerations

- If Sam is 7 in the year of the first RMD, assuming no growth, if the IRA passes outright or to a conduit trust, by the time Sam reaches the age of 21 (the age of majority), approximately 20% of the IRA will have been withdrawn, and the remaining 80% will need to be withdrawn by age 31.
- Of course, John may not want Sam (who was age 7 at his death) to have full access to these funds by age 31.
- For an account is relatively small, it may make more sense just to pay it to an UTMA account.
- If an account is large, the client will likely still want an accumulation trust.
- Additionally, if a client has multiple children, he or she may want to use a pot trust.

# Charity Examples

- Mary wants her IRA to eventually pass to charity.
- Options:
  - Outright
  - Remainder Beneficiary of a conduit trust
  - CRT
  - Accumulation Trust Remainder Beneficiary

# Charity Examples (cont'd)

- Mary leaves her IRA outright to charity. Charity does not pay income tax on the IRA.
- Mary leaves her IRA to a conduit trust for husband, Harry, and at his death the balance passes to charity. Any remaining assets of the IRA at Harry's death will pass to the charity and the charity will not pay income tax.

# Charity Examples (cont'd)

- Mary leaves his IRA to a CRUT for his daughter, Denise, which then passes to charity at Denise's death.
- The trustee of the CRUT will have to withdraw the IRA based on the 5 year rule or take annual withdrawals based on Mary's life expectancy depending on whether she died before or after her RBD.
- However, when the trustee withdraws the IRA, the withdrawal itself will not be subject to income tax, as it is added to "bucket" for the CRUT.
- Income will be passed out based on the unitrust distributions each year. For example, if Mary died before her RBD, the 5 year rule applies. The trustee could wait to withdraw the IRA until the end of the 5 year period so that no income was carried out from the IRA to the beneficiary for the first few years.

# Charity Examples (cont'd)

- John leaves his IRA to an accumulation trust for his son, Sam, which then passes to charity at Sam's death.
- The trustee of the CRUT will have to withdraw the IRA based on the 5 year rule or take annual withdrawals based on John's life expectancy depending on whether he died before or after his RBD.
- Income tax will be recognized upon the withdrawal by the trustee (to be paid by the trust or Sam).

# Disclaimers for Individuals Dying in 2019

- For clients who died in 2019, if there is still time to make a disclaimer with respect to retirement assets, clients should determine if it makes sense to do so.
- The main purpose would be so that younger beneficiaries can use their longer life expectancy.
- Example: Mary, 74, dies December 31, 2019, and leaves her IRA outright to husband, Harry, 72, with their daughter, Denise, 50, named as the contingent beneficiary. If the IRA passes to Denise by Harry's disclaimer, she can take RMDs over approximately 34 years.

# What Will Financial Planners Recommend?

- Should clients contribute less to tax-deferred retirement plans during their lifetime?
- Should clients take larger distributions during life? This is particularly applicable during the now-longer period between when many individuals retire and the RBD. Many participants have lower taxable incomes during this period.
- Should clients convert to Roth IRAs?
- Should clients buy life insurance?
- Discussion of dealing the flow taxable income over a shorter time period.