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The SECURE Act: What Estate Planners Need to Know

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1. SECURE Act Overview; Background Regarding Distribution Requirements from Qualified Plans and IRAs

Some of the following overview of planning implications of the SECURE Act is largely based on presentations and resources from Natalie Choate (Boston, Massachusetts) at the 2020 Heckerling Institute on Estate Planning and by a presentation by Deborah Tedford and Steven Trytten at the ACTEC 2020 Summer Meeting.

a. Introductory Background.

The **SECURE Act** (H.R. 1994, Setting Every Community Up for Retirement Enhancement Act of 2019) was a proposal to make various changes regarding retirement benefits. The bipartisan proposal was unanimously approved by the House Ways and Means Committee and passed the House by a vote of 417-3. Similar proposals had been introduced in the Senate.

The SECURE Act was included as Division O of the late 2019 "spending bill," H.R. 1865, the Further Consolidated Appropriations Act, 2010. That Act passed the House (297-120), the Senate (71-23), and was signed by the President on December 20, 2019.

The miscellaneous retirement plan changes in the SECURE Act include liberalized rules for multiple employers, a new small employer automatic enrollment credit, expanded participation in employer 401(k) plans to include long-term part-time workers, certain expanded uses of Section 529 plans (see the following paragraph), tax-free $5,000 permitted withdrawal within one year after the birth or adoption of a child by the participant, and required annual disclosures of estimated projected lifetime income under annuity elections.

The changes for 529 plans include treating the cost of apprenticeship programs as qualified education expenses and allowing distributions of up to $10,000 for repaying qualified education loans of the beneficiary or the beneficiary's sibling. Note that distributions from a 529 plan that is not owned by the student or a parent of the student are reported as untaxed income on the "Free Application for Federal Student Aid (FAFSA) Form that many colleges use for financial aid applications. College financial aid may be reduced by 50% of the untaxed income reported on the FAFSA Form, but repayments of student loans do not have to be reported. Accordingly, if a 529 Plan has been established by a grandparent, to avoid reporting a $10,000 plan distribution on the FAFSA Form, which may reduce financial aid by 50%, the student could obtain a student loan and use distributions from the plan to repay $10,000 of the loan.

The Act also repeals the provision in the 2017 Tax Act regarding the "Kiddie Tax" applying the income tax rates for trusts to the unearned income of children and allows taxpayers to elect to treat the repeal as effective for 2018 and 2019. (This has been called the "Gold Star" family provision because the 2017 Kiddie Tax changes had adversely impacted children who received government payments because they are survivors of deceased military personnel and first responders.)

MORE important for estate planners, the SECURE Act:

- Changes the age that determines the required beginning date (RBD) for minimum distributions (April 1 of the following calendar year) from 70½ to 72, effective for individuals who reach age 70½ after December 31, 2019 (the effect is that no one will have his or her RBD in 2021); (A similar Senate proposal would have extended the required beginning date age to 75 and removed it entirely for plans [other than defined benefit plans] worth up to $100,000, and those provisions are included in the Neal-Brady "Securing a Strong Retirement Act of 2020" bipartisan bill introduced on October 27, 2020); (Observe that the CARES Act waives required minimum distributions for all retirement accounts except defined benefit accounts in 2020 (this includes IRAs, even inherited IRAs)); and

- Eliminates the prohibition on contributions to an IRA after age 70½ (but the $100,000 limit on qualified charitable distributions from an IRA would be correspondingly reduced [observe that changing the age for required minimum distributions from 70½ to 72 will not change the age at which qualified charitable distributions from IRAs will be permitted]). See Notice 2020-68, 2020-38 IRB. See Item 12.c below for a discussion about IRA charitable rollover planning.

MOST important for estate planners, the SECURE Act **substantially limits "stretch" planning** for distributions from defined contribution plans (and IRAs) following the death of the plan owner (referred to as the "participant"), therefore, the changes apply to 401(k) plans as well. Under prior law, following the participant's death, plan benefits (including IRA benefits) could be paid over the life expectancy of a "designated beneficiary" (DB), to stretch the receipt (and, therefore, the income taxation) of retirement benefits, but the SECURE Act mandates that distributions to a designated beneficiary be made within 10 years following the death of the participant, with exceptions for five categories of "eligible designated beneficiaries" (EDBs). Distributions from the IRA are typically taxed as ordinary income, so the ability to stretch the receipt of those benefits as long as possible defers the time that the income tax must be paid. (Throughout this discussion of the SECURE Act, references to a "plan" or "plan benefits" will include an IRA.)

b. **Post-Death Minimum Distribution Requirements under Prior Law.** A grasp of the prior law minimum distribution requirements following the death of the participant is essential to understand the impact of the changes made by the SECURE Act. Most of this prior law is retained under the SECURE Act (except for the 10-year rule for designated beneficiaries, with special rules for the five categories of eligible designated beneficiaries). The rules are based on regulations proposed in 1987 and 2001 and finalized in 2002, almost 20 years ago. A simplified summary of the prior law follows [provisions impacted by the SECURE Act are briefly noted in italicized comments in brackets].

The treatment varies based on whether or not the beneficiary is a DB, meaning any individual but not an entity such as the participant's estate, a charity, or a trust that is not a "see-through" trust (described in Item 1.c below).

(1) **Beneficiary Not a Designated Beneficiary.** If the beneficiary is not a DB (Non-DB), benefits must be paid within 5 years if the participant died before his or her required beginning date (RBD) or over the participant's remaining life expectancy (this is sometimes referred to as the "ghost life expectancy") if the participant died on or after the RBD. [*This does not change under the SECURE Act.*] The RBD is April 1 of the year after the participant reached age 70½ if the participant reached that age by December 31, 2019 [*changed to age 72 in the SECURE Act*].

(2) **Beneficiary is a Designated Beneficiary Other Than a Surviving Spouse.** If the beneficiary is a DB and is not the surviving spouse, the benefits are paid over the DB's life expectancy (if a see-though trust is the beneficiary, over the oldest beneficiary's life expectancy). (If the participant's remaining life expectancy is longer, that period may be used. Reg. §1.401(a)(9)-5, A-5(a)(1).) [*The SECURE Act changes this to a maximum 10-year payout instead of the DB's life expectancy; whether the Act changes from allowing the participant's life expectancy if that is longer is unclear if the beneficiary is a DB.*]

(3) **Beneficiary is the Surviving Spouse.** If the beneficiary is the participant's surviving spouse, the DB rule described above can apply (that would be applicable, for example, if the beneficiary is a standard QTIP trust that does not mandate that all distributions must pass to the spouse), but even more favorable alternatives may also be elected in some circumstances. If the spouse is the sole beneficiary, the Single Life Table is used, but the life expectancy is recalculated annually.

Better still (in most circumstances), if the spouse chooses to treat the decedent's IRA as his or her own IRA (spousal election) or elects to rollover the decedent's IRA into the spouse's IRA (a spousal rollover), several significant advantages result. (1) Distributions do not need to begin until the spouse reaches his or her RBD. (2) Distributions are made at a slower pace because the Uniform Life Table may be used (which is based on the joint life expectancy of the individual and someone who is 10 years younger). Under the new tables that apply beginning in 2021 (see Item 1.d below), the life expectancy of a 72-year old person under the Single Life table is 17.1 years, and under the Uniform

Life table is 27.3 years, so using the Uniform Life table allows taking withdrawals from the plan at a substantially slower rate. (3) The surviving spouse can designate his or her own beneficiary, and at the spouse's death, the remaining benefits (which may be much reduced if the spouse has lived to near his or her life expectancy) may be paid over the life expectancy of a DB. [*The SECURE Act dramatically alters this third advantage*.]

See Item 5 below for further discussion of planning considerations for a spouse as beneficiary of plan benefits.

c. **Trust Recipients**. The trust rules described below have not been changed by the SECURE Act (but the importance of which category applies to a particular trust may be impacted dramatically by the SECURE Act.)

(1) **See-Through Trusts.** Although DBs must be individuals, trusts that meet five requirements are classified as "see-though trusts," which can be either conduit trusts or accumulation trusts. The individual beneficiaries of a see-though trust are treated as DBs of the plan or IRA (with a special rule as to which such individual's life is used to determine the life expectancy payout period). The five requirements are: (1) the trust must be valid under local law; (2) the trust is irrevocable or becomes so at the participant's death; (3) the beneficiaries are identifiable; (4) certain documentation is provided to the plan administrator by October 31 of the year following the year of the participant's death; and (5) all trust beneficiaries must be individuals (but "mere potential successor beneficiaries" don't count, which generally means that only the initial remaindermen are counted, not remote successor remaindermen). See Letter Ruling 202035010, discussing the requirements for a trust to be recognized as a see-through trust. While the individual beneficiaries are treated as DBs, two special rules do not apply for beneficiaries of a see-though trust – the trust cannot be treated as having separate accounts each having its own beneficiary, and spousal rollovers are not available for any trust, even a see-through trust.

(2) **Conduit Trusts.** A conduit trust is the nickname (not formally called that in the regulations) of a trust that has one individual beneficiary, and the governing instrument requires that all plan or IRA distributions to the trust must be distributed from the trust to the individual beneficiary. The distributions are deemed paid "to" the individual beneficiary, and the beneficiary is considered the sole beneficiary of the trust and the plan or IRA for minimum distribution purposes, regardless who receives any benefits if the beneficiary should die before all plan assets have been distributed to the trust (and to the beneficiary). A conduit trust is a see-through trust. Conduit trusts are straightforward to draft; they just require that plan distributions to the trust are distributed forthwith to the single beneficiary.

(3) **Accumulation Trusts.** An accumulation trust is a see-through trust that is not required to distribute all plan benefits as received, but permits the accumulation of distributions within the trust. All beneficiaries (except "mere potential successor beneficiaries") who might ultimately receive such accumulations are considered for purposes of the minimum distribution rules (and the oldest such beneficiary's life expectancy is used as the relevant payout period). These restrictions have led to considerable complexity in drafting accumulation trusts to assure that some older beneficiary or entity might not be a trust recipient, including under the possible exercise of a power of appointment.

d. **New Life Expectancy Tables for Retirement Plan Required Minimum Distributions**. The Single Life and Uniform Life tables for calculating required minimum distributions are in Reg. §1.401(a)(9)-9(b)-(c). (The Uniform Life table, which is based on the life expectancy of an individual and someone 10 years younger, may be used only while the account owner is living or for a spousal rollover IRA. Otherwise the Single Life (or Joint Lives) Table must be used. The Uniform Life table allows taking withdrawals at a substantially slower rate. For example, the life expectancy of a 72-year old person under the Single Life table is 17.1 years, and under the Uniform Life table is 27.3 years.) Proposed regulations containing revised tables were issued in November 2019. The revised tables will apply to distribution calendar years beginning on or after January 1, 2021. The preamble to the proposed regulations states that the "life expectancy tables and applicable distribution period tables in the

proposed regulations reflect longer life expectancies than the tables in the existing regulations that are generally between one and two years longer than under the existing regulations."

2. SECURE Act Minimum Distribution Provisions

a. Post-Death Minimum Distribution Requirements under SECURE Act; Limits on Stretch Planning.

(1) **Overview—Three Tiers of Beneficiaries.** Three tiers of beneficiaries may benefit from retirement plans, but the perks have changed under the SECURE Act.

(i) Bronze – Non DBs (the rules have not changed; 5-year rule if participant dies before RBD or the participant's remaining life expectancy if the participant dies after RBD).

(ii) Silver – DB (downgraded perks; life expectancy payout has been downgraded to payment within 10 years, but apparently the participant's remaining life expectancy can still be used if that is longer, Reg. §1.401(a)(9)-5, A-5(a)(1), although §401(a)(9)(H)(i)(II)'s direction that the 10-year rule for DBs "shall apply whether or not distributions of the employee's interest have begun" might conceivably be interpreted to override that regulation, see Item 3.d below for further discussion).

(iii) Gold – Favored DBs (this tier has been expanded to five categories rather than just for the surviving spouse; for the surviving spouse, life expectancy with further advantages including delayed starting date, slower payout, and ability to name beneficiary who can receive payout based on the beneficiary's life expectancy and those advantages are unchanged under the SECURE Act except that at the death of the surviving spouse, benefits must be paid within 10 years of the spouse's death; for other eligible designated beneficiaries (EDBs), life expectancy payout as long as the original EDB qualifies as an EDB, but thereafter benefits must be paid within 10 years of when the beneficiary ceases as an EDB).

(2) **Overview of Changes; ACTEC Comments.** The SECURE Act minimum distribution provisions retain the current Code structure as much as possible. These provisions are in Section 401(a) of the SECURE Act (unfortunately, confusingly similar to the Section number of the Code (§401(a)) that contains the rules for qualified retirement plans).

Section 401(a)(9) of the Code contains the provisions about required distributions from qualified retirement plans (including IRAs). The SECURE Act adds a new §401(a)(9)(H), which includes six clauses.

- (i) and (ii) – **10-Year Rule for DBs, Except for EDBs.** These clauses say, rather obtusely with various cross references, exceptions, and special rules layered over the existing provisions, that if the beneficiary is a DB, the plan assets must be distributed within 10 years of the participant's death unless the beneficiary is an "eligible designated beneficiary" (EDB). A modified life expectancy payout applies as long as the beneficiary is an EDB.
- (iii) – **Death of or Otherwise Ceases to be EDB.** If an EDB dies or otherwise ceases to be an EDB before the plan has been entirely distributed, the exception for EDBs will no longer apply, but the plan must be distributed within 10 years after such EDB's death or cessation as an EDB (even if the next successor beneficiary is an EDB at that time).
- (iv) and (v) – **Special Rule for Trusts for Disabled or Chronically Ill Beneficiaries.** Special rules apply to multi-beneficiary trusts if at least one of the beneficiaries is a disabled or chronically ill individual (these provisions are discussed in Item 7.d and Item 9 below); and
- (vi) – **Applicable to Defined Contribution Plans, Not Defined Benefit Plans.** These rules apply to defined contribution plans (including IRAs and Roth IRAs), but not defined benefit plans, i.e., pension plans.

Section 401(a)(9)(E) is amended to describe five categories of EDBs.

Section 401(b) of the SECURE Act has effective date provisions. The provisions generally apply to plans and IRAs for which the participant dies after 2019, but some effects may result even when

participants have died before 2020 (discussed in Item 2.b below), and for some governmental plans there may be a delayed effective date until January 1, 2022. For governmental plans, which could include plans through TIAA or TRS, it is best to contact the staff benefits or human resources department for clarification regarding the plan's effective date.

That's it. Otherwise, all the minimum distribution rules stay the same. The distribution rules have not changed if the beneficiary is not a DB. Determining if a beneficiary is a DB has not changed. The various trust rules (for what is a see-through trust, a conduit trust, or an accumulation trust) have not changed.

These provisions of the SECURE Act create many uncertainties. ACTEC filed comments with the IRS and Department of Treasury on July 14, 2020 and July 29, 2020 identifying various uncertainties and making various recommendations for IRS guidance. American College of Trust & Estate Counsel, Letters to Department of Treasury and IRS titled Request for Guidance from Treasury on Section 401 of the SECURE Act, Part 1 (July 14, 2020) and Part 2 (July 29, 2020). These extremely detailed comments include recommendations regarding various issues about the 10-year rule and the effective date in Part 1, and regarding trusts for DBs other than EDBs, trusts for spouses, EDB issues generally, minor child beneficiary and age of majority, disabled and chronically ill EDBs, applicable multi-beneficiary trusts, and the "not more than 10 years younger" EDB category in Part 2. The comments are available from the "Legislative and Regulatory Comments by ACTEC" webpage of the ACTEC website, found **here**.

(3) **Ten-Year Rule.** The SECURE Act applies its 10-year rule for making distributions to a DB by cross reference to the 5-year rule that applies for non-DBs (if the participant dies before his or her RBD), thus engrafting the body of regulatory law that applies for the 5-year rule. This has the effect of clarifying several issues.

(i) **Proportionate Distributions Not Required.** Distributions do not have to be made proportionately over the 10-year term; they could be made all in a lump sum at the very end of the term (which would have the effect of deferring recognition of the income, but would also result in "bunching" the income, possibly into a high income tax bracket). For Roth IRAs, deferral until year 10 would likely be the most effective strategy.

(ii) **December 31 Due Date.** Distributions must be made by December 31 of the calendar year that contains the tenth anniversary of the relevant person's death. *See* Reg. §1.401(a)(9)-3, A-2. (Presumably that same December 31 due date will also apply to the new 10-year rule, and ACTEC has asked for clarification of this deadline.)

(iii) **Eleven Calendar Years for Payments.** The actual payout period could extend over 11 taxable years (if death occurs in 2020, the final payment must be made by December 31, 2030, so payments can be made in 2020-2030, or over 11 years). Spreading payments over more years increases the chances that lower tax brackets may apply.

(4) **Eligible Designated Beneficiaries.** New Code Section 401(a)(9)(E)(ii) describes the five categories of EDBs. They are (i) the surviving spouse, (ii) a participant's child who "has not reached majority," (iii) a disabled individual, (iv) a chronically ill individual, and (v) an individual not described above who is not more than 10 years younger than the participant. These beneficiaries qualify for a modified life expectancy payout.

Status as an EDB is determined at the participant's death. A DB who later satisfies one of the five categories of EDBs does not become an EDB for purposes of being able to use an adjusted lifetime payout rather than being subject to the 10-year rule. §401(a)(9)(E)(ii)(last sentence). (A special rule applies for minors – if the minor is disabled upon reaching majority, the minor exception continues through the period of disability, as discussed in Item 6.b below.)

Qualification as an EDB for a surviving spouse, a minor child of the participant, or someone not more than 10 years younger than the participant requires that the benefits be paid outright to the beneficiary (or perhaps to a custodian for a minor) or to a conduit trust (at least pending further IRS

guidance). Benefits passing to an accumulation trust (or conduit trust) qualify for EDB status for purposes of the disabled or chronically ill individual exceptions.

Planning considerations for each of the EDB exceptions are described in more detail in Items 5-10 below.

(5) **Death of DB**. At the death of a DB who is not an EDB (someone Natalie Choate refers to as a PODB, or "plain ol' designated beneficiary"), the benefits must still be paid out within the **ORIGINAL** 10-year period (actually by December 31 of the 10th year) after the participant's death.

When an EDB ceases to be an EDB, the benefits must be paid within 10 years of **THAT** time and not over the EDB's remaining life expectancy (for example, 10 years following the death of a surviving spouse or beneficiary not more than 10 years younger than the participant). §401(a)(9)(E)(iii).

When the EDB ceases to qualify as an EDB (due to death or any other reason), whether the successor beneficiary would qualify as an EDB at that time does not matter—the 10-year rule applies when the original EDB is no longer an EDB.

b. **Application of SECURE Act to Pre-2020 Deaths**. The anti-stretch provisions of the SECURE Act generally apply to participants who die after 2019, EXCEPT that if the initial DB dies after 2019 and before the plan assets have been totally distributed, the remaining benefits must be paid within 10 years of when such DB dies (even though the participant died before 2020). (Under prior law, when the DB died, the DB's beneficiary could continue to receive benefits over the DB's remaining life expectancy.)

For a discussion of disclaimer planning for pre-2020 deaths, see Item 11.b below.

The effective date provisions are unclear about what happens if the participant had multiple DBs. For example, the beneficiary may have been an accumulation trust with various individuals as permissible current or remainder beneficiaries, and each of them is a DB, even though only the oldest DB's life expectancy is used to determine the payout period. Does the 10-year rule kick in when the oldest DB has died? When any DB has died? Or when all of the DBs have died? Natalie believes the provision should be interpreted to say that the 10-year rule begins to apply only when all DB's have died (in part because the minimum distribution trust rules have no concept of a "primary" beneficiary, just countable or non-countable beneficiaries). But Natalie notes, "My opinion is worth a lot to me, but I don't know how far it will get you."

3. General Planning Considerations in Light of SECURE Act Distribution Provisions

a. **General Client Triage Approach.** The anti-stretch provisions of the SECURE Act are interesting in that they constitute a major broad tax change, but they affect everybody differently based on specific client situations and goals.

(1) **Little or No Impact.** Many people will not be affected at all.

- Many clients and their families have small enough plans and assets outside of plans that deferring the receipt of money otherwise available for living expenses is the least of their concerns.
- Most retirement plan beneficiaries are not making plan withdrawals only at the minimum rate permitted. The preamble to the proposed regulations containing the new life expectancy tables for determining life payout rates from retirement plans indicates that only about 20% of individuals required to take RMDs make withdrawals at the minimum required level. Most (or at least a substantial portion) of the remaining 80% of plan beneficiaries will not be affected by the SECURE Act's 10-year rule.
- For married couples, naming the surviving spouse as the outright beneficiary of the retirement plan is the most common arrangement. The same rules apply for the surviving spouse as in the past (except that the 10-year rule will apply as to any benefits still in the plan at the spouse's subsequent death, but the likelihood that substantial assets will remain in the plan after making life payments to the surviving spouse may be relatively small).

- If the participant has no surviving spouse, clients with substantial assets in retirement plans are likely to have adult (rather than minor) children and many individuals name their adult children as the outright beneficiaries of the plan assets following the deaths of both spouses (favoring simplicity over the benefits of trusts for receiving retirement benefits).
- A charity may be named as beneficiary, in which event the SECURE Act has no impact.

(2) **Emergency Impact.** For some clients, immediate emergency action is required. Individuals who have wanted to maximize the stretch planning may be using plans to stretch the receipt of taxable benefits over the life expectancies of young children or grandchildren. Those plans often entail naming a conduit trust for the young beneficiary, leaving the trustee and not the young recipient with the power to decide whether large withdrawals would be made from the plan (or IRA). The individual likely anticipated that relatively small annual distributions would be made to the trust (and distributed from the trust to the beneficiary) annually. Instead, under the SECURE Act the entire plan value will be distributed within 10 years and distributed from the trust to the beneficiary (unless the beneficiary is an EDB). Natalie Choate's conclusion: "Almost invariably, conduit trusts will not work the way the client anticipated or wants."

(3) **Slight Tweaks Needed.** For some clients, relatively minor tweaks may be needed in light of the SECURE Act. For example, an individual might tweak the type of QTIP trust that is used for a surviving spouse. A classic QTIP trust (that does not mandate that all retirement plan distributions be distributed immediately to the surviving spouse) qualified for payout over the spouse's life expectancy under the old rules but would be subject to the 10-year payout requirement under the SECURE Act. See Item 5.c below. An individual might prefer to tweak that plan to require the distribution to the spouse of all amounts received from the plan so that the QTIP trust would be a conduit trust and qualify for payments over the spouse's life expectancy (Single Life Table, recalculated annually).

Giving an independent trustee of an accumulated trust a broad distribution standard may facilitate the ability to make distributions to avoid taxing income at compressed trust tax rates.

If disabled or chronically ill persons are plan beneficiaries, tweaks may be needed to special needs trusts for them. See Item 9.c below. For example, accumulation trusts may qualify for special treatment, without the need for conduit trust provisions.

For an excellent discussion about determining whether existing plans need to be revised and considerations for drafting in trusts light of the SECURE Act, see Natalie Choate, *Drafting See-Through Trusts After the SECURE Act*, TRUSTS & ESTATES 36 (April 2020).

b. **Conduit Trusts.** The use of a conduit trust as the beneficiary is especially sensitive under the SECURE Act.

(1) **Conduit Trusts Needed for Certain EDBs.** In some situations, using conduit trusts will be very important if a client wants to use a trust for a beneficiary – for example to qualify for EDB treatment (and a modified life payout) for a surviving spouse, a minor child of the participant, or someone not more than 10 years younger than the participant. (Accumulation trusts can be used for disabled or chronically ill individuals and still qualify for EDB treatment.)

If a conduit trust is used for a minor child of the participant, the planner should take into consideration that the entire account will have to be distributed outright to the child at the latest ten years after the child "reaches majority." The planner should weigh the advantage of the added period of deferral against the fact that all of the account would be distributed to the child within 10 years of reaching majority.

(2) **Conduit Trusts Will Not Generally Be Used in Other Situations; Can be Disastrous in Some Situations.** In other situations, using conduit trusts may be **disastrous**. For example, if the client wanted to have benefits paid over the life of a young child, the client likely wanted to use a trust for the young beneficiary for management purposes. Conduit trusts were much simpler than accumulation trusts in the past because subsequent beneficiaries and permissible appointees are not relevant for purposes of determining the relevant life expectancy payout period. Conduit trusts were

often used in the past because of their relative simplicity. (For example, if an accumulation trust was used and if the contingent beneficiary was older than the young beneficiary, the contingent beneficiary's life expectancy would have been used rather than that of the young beneficiary.) Under the SECURE Act all plan benefits must be paid within 10 years, and with a conduit trust, those benefits are paid immediately to the beneficiary. Therefore, the deferral advantage of using a very young beneficiary is largely lost (benefits must be distributed within 10 years regardless of the beneficiary's age), and all of the nontax benefits of trusts (including preserving assets, protecting from a beneficiary's squandering of the assets, and protecting from creditors) will be available for only up to 10 years. Using a conduit trust as the plan beneficiary for an individual beneficiary who is a spendthrift could lead to the individual's squandering funds after the plan and trust distribute all plan assets to the individual within 10 years.

Again, Natalie Choate's axiom applies: **"Almost invariably, conduit trusts will not work the way the client anticipated or wants."** But conduit trusts can be helpful if they result in EDB treatment for the beneficiary with a payout over the beneficiary's life expectancy until the EDB status ends.

Locating and identifying clients with conduits trusts will be challenging. Firms do not keep track of clients who are using conduit trusts as plan beneficiaries. Contacting past clients with a message to contact the attorney if the client has a "conduit trust" will not work because most clients have no idea what a conduit trust is. (Furthermore, Natalie quips, "clients never read anything you send them anyway.")

c. **Accumulation Trusts Will Become More Common.** In most cases going forward (other than needing to qualify for EDB treatment for spouses, minor children, or beneficiaries not more than 10 years younger than the participant), plan benefits that are being paid to trusts will pass to accumulation trusts. ACTEC comments to Treasury and the IRS have requested whether an accumulation trust for a surviving spouse, minor child, or person not more than 10 years younger than the participant can also qualify for EDB treatment.

The complexity of structuring accumulation trusts in the past is no longer applicable because the life expectancies of the primary beneficiary and successor beneficiaries are no longer relevant – plan benefits must be distributed within 10 years regardless. Presumably regulations will eventually clarify that the oldest potential beneficiary or appointee under a power of appointment does not have to be identifiable. If so, excluding beneficiaries who are older than some specified age will no longer be necessary. The only requirement, for the trust to be a designated beneficiary, is that non-human beneficiaries are excluded as potential beneficiaries and as potential appointees under a power of appointment. (If the accumulation trust is not a designated beneficiary, the traditional non-DB rules apply.)

The terms of accumulation trusts perhaps can be simplified to delete complicated restrictions (for example to assure that no older beneficiaries are possible under the trust). Accumulation trusts going forward must merely prohibit any non-individuals as permissible beneficiaries (other than as "mere potential successor beneficiaries") or as possible appointees under a power of appointment. For example, Mickey Davis (Houston, Texas) indicates that unless future regulations provide otherwise, his trust forms for trusts designed to accept retirement plan benefits as an accumulation trust will remove references to age and life expectancies of beneficiaries and will provide in essence, "if I die before my RBD, or after my RBD when my life expectancy is less than 10 years, this trust will not have any entities as beneficiaries or permissible appointees."

Planners, however, may want to hold off on simplifying provisions in accumulation trusts designed to limit who might be the oldest potential beneficiaries until we get further guidance from the IRS. Natalie Choate points out that a see-through trust must meet various requirements (see Item 1.c above), one of which is that the beneficiaries must be "identifiable," and for members of a class, that means being able to identify "the class member with the shortest life expectancy." Reg. §1.401(a)(9)-4, A-1. Knowing the shortest life expectancy no longer matters for accumulation trusts subject to the 10-year rule, but until the regulation has been updated, the conservative approach is to utilize the limits we have used in the past regarding the oldest potential beneficiary.

Furthermore, when accumulation trusts are used for disabled or chronically ill persons, a life expectancy payout applies, and if a person older than the disabled or chronically ill person is a remainder beneficiary (other than a mere potential successor beneficiary), that older person's shorter life expectancy might be used for determining the payout period. See Item 9.b below. For example, the trust might provide that if the trust has a disabled or chronically ill person as beneficiary, within the meaning of §401(a)(9)(E)(i), no portion of the trust for that person shall ever pass under the terms of the trust or under the exercise of any power of appointment to any person who is older than the beneficiary.

An alternative is giving a "trust protector" the authority to revise the terms of the accumulation trust by the September 30 "finalization date" of the year of the owner's death (discussed in Item 11.b below) to eliminate unneeded restrictions in accumulation trusts based on IRS guidance available at that time. A trust modification could be considered as well.

d. **Planning for Accumulation Trusts in Some Situations *Not* to Be a DB**. Planning for an accumulation trust **to be a DB** would be important if the participant dies before his or her RBD (April 1 of the year after reaching age 72 under the SECURE Act) to use a 10-year rather than a 5-year payout, and if the participant dies after the RBD when he or she is over about age 81 and thus having a life expectancy of less than 10 years. (Under the new life expectancy retirement plan Single Life Table issued in November 2019 and that will apply beginning in 2021, an 81-year person has a life expectancy of 10.5 years.) On the other hand, if the participant dies after the RBD when he or she is 81 years or younger, the participant's remaining life expectancy is greater than 10 years, and using the non-DB payout rules would result in a longer payout than under the DB rules.

Conceivably, the trust could be planned **NOT to be a DB in that circumstance** (by having an entity (for example, a charity) as a discretionary beneficiary, as a successor beneficiary, or as a potential appointee under a power of appointment) in order to use the participant's remaining life expectancy, which would be longer than the 10-year rule that applies for a DB.

- Observe, though, that the trust may qualify for the longer payout using the participant's remaining life expectancy even if the trust is a DB because the regulations allow using the longer of the DB's life expectancy or the participant's remaining life expectancy at the RBD. Reg. §1.401(a)(9)-5, A-5(a)(1).
- However, §401(a)(9)(H)(i)(II)'s direction that the 10-year rule for DBs "shall apply whether or not distributions of the employee's interest have begun" might conceivably be interpreted to override that regulation if the trust is a DB.
- But the "longer of" position in the regulations seems contrary to the "at-least-as-rapidly" statutory requirement that has long existed in §401(a)(9)(B)(i), so perhaps the IRS's "longer of" position in the regulations will continue despite the new statutory language saying that the 10-year rule "shall apply" for DB's "whether or not distributions of the employee's interests have begun."

IRS guidance eventually may clarify that the trust does not have to include provisions making it a non-DB to take advantage of a possible slightly longer payout that might be permitted for non-DBs, in case the participant dies after the RBD and has a remaining life expectancy longer than 10 years. Comments filed by ACTEC, described in Item 2.a above, recommend that Treasury allow a DB "to use the longer of the 10 Year Rule or the Deceased Employee's Remaining Life Expectancy Method, while preserving the existing At Least As Rapidly Rule for EDBs." ACTEC Letter to Treasury dated July 14, 2020, at 12-13, available from the "Legislative and Regulatory Comments by ACTEC" webpage of the ACTEC website, found **here**.

Nancy Welber has pointed out that the maximum participant remaining life expectancy, if the participant dies after his or her RBD (April 1 of the year after reaching age 72) is 16.3, and that payments would not begin until the following year, when the payout period would be 15.3 years. Natalie Choate suggests that future regulations might take the sensible approach of allowing the trust to use the longer payout in that circumstance even if it is a DB.

e. **Rethinking Beneficiary Planning – Brief Summary.**

(1) **Favor Simplicity; Example – Outright to Children.** A participant may prefer the simplicity of leaving plan benefits directly to children, rather than having the benefits paid to trusts for grandchildren (ostensibly to have benefits paid over their long life expectancies), since the benefits must be paid within 10 years in any event.

(2) **Combo Approach.** Melissa Willms (Houston, Texas) suggests that in some cases a combo approach might be appropriate. A portion may go outright to a child (among other things, to take advantage of the child's lower income tax brackets), and a portion might go in trust for the child (for the nontax advantages of trusts). Or a portion might go to a conduit trust and another portion to an accumulation trust for the same beneficiary. Or one child's portion may be outright and another child's portion may be in trust.

(3) **Consider Income Tax Effects.** Estate planning focuses a great deal on the 40% estate tax, but keep in mind that the income tax is also almost 40%, and trusts reach the top bracket after only $12,950 of taxable income. Even if trusts would be helpful for nontax purposes (such as creditor protection, especially if the beneficiary's state does not recognize a creditor exemption for IRA benefits), consider that the trust may pay a 37% income tax whereas individual beneficiaries may be in much lower brackets. (This is also a consideration for what distributions can and should be made out of trusts for income shifting purposes.) If a trust is being used primarily for creditor protection, consider whether the creditor protection is worth the potential income tax cost, and whether that protection might be better afforded by other means (such as an umbrella liability policy where it covers the major creditor risk).

(4) **BDOT Planning to Minimize Income Tax Effects.** As an alternative for using a trust as beneficiary but avoiding taxing trust income (including IRA benefits) at the highest marginal rate, consider using a Beneficiary "Deemed-Owner" Trust (BDOT) as the recipient. A BDOT is structured to provide that the beneficiary can withdraw all taxable income each year, and the taxable income of the BDOT should be reported by the trust beneficiary under §678(a) and be taxed at the beneficiary's rates rather than at the trust's high rate. BDOTs are discussed in Item 17.b(1) & 17.e, and in particular regarding the SECURE Act, in Item 17.e(2), of "Estate Planning Current Developments (September 2020)" found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**. For an excellent discussion of the income tax issues facing accumulation trusts and the use of BDOTs, see Ed Morrow, *Using BDOTs for Optimal Asset Protection and Income Tax Minimization After Passage of the Secure Act*, LEIMBERG INC. TAX PL. NEWSLETTER #192 (Feb. 18, 2020).

(5) **Conduit Trusts.** Any individuals using conduit trusts should review the plan and confirm that it is still appropriate under the SECURE Act, understanding that all plan benefits would be paid to the beneficiary within 10 years of the participant's death unless the beneficiary is an EDB, in which event a conduit trust may be required for EDB treatment to use an adjusted life payout for a surviving spouse, minor child (until reaching majority), or person not more than 10 years younger than the participant. For a minor child, the planner should not knee-jerk into using a conduit trust, but should have the client weigh the advantage of the added period of deferral against the fact that all of the account would be distributed to the child within 10 years of reaching majority. ACTEC comments to Treasury and the IRS have requested whether an accumulation trust for a surviving spouse, minor child, or person not more than 10 years younger than the participant can also qualify for EDB treatment.

(6) **Accumulation Trusts.** In most cases going forward, plan benefits that are paid to trusts will pass to accumulation trusts (again, unless the trust primary beneficiary is an EDB other than a disabled or chronically ill individual). The terms of accumulation trusts can be simplified to delete complicated restrictions (for example to assure that no older beneficiaries are possible under the trust). See Item 3.c above regarding planning considerations for using accumulation trusts under the SECURE Act.

(7) **Disproportionate Allocation of Benefits to EDBs, Particularly Lower Bracket EDBs.** A plan or IRA owner might leave plan benefits disproportionately to a disabled beneficiary or a sibling with modest income, and leave other non-taxable assets to other beneficiaries in high income tax brackets.

(8) **Revocable Trust.** The beneficiary might be the trustee of a revocable trust, and the trustee might have the authority to fund various distributions in a non pro rata manner. For example, a formula allocation with "pick and choose" authority would allow flexibility to decide whether plan benefits would pass to fund a tax shelter trust, a marital trust, or a charitable trust. The planner should confirm with the custodian that directions from the trustee will be followed.

(9) **TEA Pot Trusts.** A corollary of the preceding approach is the use of two discretionary pot trusts with family members as potential beneficiaries. One trust (an accumulation trust) would receive retirement benefits, and the other trust would receive other (non-taxable) assets. The trust agreements would give the trustee discretion over how to distribute funds from the trusts among trust beneficiaries, and the trustee could make distributions in the most tax-efficient manner. For example, IRA distributions from the first trust might be distributed to low-bracket beneficiaries and assets from the second equalization trust might be distributed to higher bracket beneficiaries. Alan Gassman (Clearwater, Florida) refers to this as the twin tax efficient accumulation (TEA) pot trust system, or the TEA POT Trust. Alan Gassman & John Beck, *Is the TEA POT Trust Right for Your Clients?*, TRUSTS & ESTATES 50 (April 2020); Alan Gassman, Christopher Denicolo, & Brandon Ketron, *Feeling InSECURE with Estate Planning for Your Large IRA? Consider the "TEA POT" Trust System, Unless Paying Taxes Is Your Cup of Tea*, LEIMBERG EMPLOYEE AND RETIREMENT PL. NEWSLETTERS (Jan. 7, 2020).

(10) **Charity.** The only way to beat having to pay income tax on retirement benefits is to leave the benefits to charity. The charity is a tax-exempt entity and pays no income on receiving the benefits. Alternatively, a charitable remainder trust could be used to avoid paying income tax on receipt of the plan benefits and payments could be made to an individual beneficiary for life. However, significant value must be left to the charity, so the participant must have some charitable intent for this arrangement to make sense. See Item 12.b below.

4. Basic Planning Options for Non-EDB (Such as an Adult Child Who Is Not Disabled)

What are the options for leaving retirement plan benefits to adult children, particularly if the owner is concerned with a child "receiving too much, too soon"? There is no way to beat the 10-year rule (without using a charitable remainder trust, which requires substantial charitable intent), so the SECURE Act has made the retirement plan less valuable to the beneficiary than under prior law.

a. **Outright.** The child would be a DB, so the 10-year rule would apply. Distributions will be taxed at individual income tax rates (rather than the compressed trust income tax rates). No limits exist on who can be recipients of the benefits at the child's death.

b. **Conduit Trust**. Using a conduit trust is more protective than leaving benefits outright to the child, because the trustee decides when to withdraw assets from the plan, but then once withdrawn the trustee has to distribute those amounts to (or for the benefit of) the child. The conduit trust is a DB, so the 10-year rule would apply. Benefits are taxed at individual income tax rates. No limits apply on who could be recipients of a power of appointment (as may apply for accumulation trusts).

c. **Accumulation Trust.** The accumulation trust would limit trust beneficiaries to DBs. The accumulation trust is more protective than outright or a conduit trust, because the trustee decides when distributions will be made from the trust to the child. The trust is a DB and the 10-year rule applies; the trustee must withdraw all assets from the retirement plan within 10 years. Assets may be accumulated in the trust, but undistributed income from accumulated trust assets will be taxed at the compressed trust income tax rates. Limits may apply on who can be the recipients of a power of appointment (though the IRS may relax this requirement).

d. **Non-DB Accumulation Trust.** Assets could be left to a trust that is not a valid "see-through trust," and therefore is not a DB. (For example, the trust may allow charitable recipients of a power of appointment.) The 5-year rule/"ghost life expectancy" rule applies instead of the 10-year rule. See Item 1.b above. But that is not as big a disadvantage as when the comparison was 5-year rule/"ghost life expectancy" vs. the child's life expectancy prior to the SECURE Act.

e. **Multiple Beneficiaries.** If the owner has multiple adult children, for example, different approaches could be used for different children or a "pot" trust could be used for all of the children.

5. Surviving Spouse as EDB

a. **Requirements for Surviving Spouse to Qualify as EDB.** To qualify for the spouse exception, the benefits must be payable "to" the surviving spouse, which likely requires that the beneficiary is the surviving spouse outright, or a conduit trust for the surviving spouse (because the conduit trust rules treat the conduit beneficiary as the owner of the trust and plan for purposes of the minimum distribution rules).

b. **Conduit Trust as Beneficiary.** If a conduit trust for the spouse is a beneficiary (or if the spouse is the outright beneficiary), the spouse could take advantage of special spousal rules delaying beginning distributions until the end of the year in which the deceased participant would have turned age 72 (§401(a)(9)(B)(iv)(I), as amended by the SECURE Act) and using the Single Life Table but recalculating the life expectancy annually (Reg. §1.401(a)(9)-5, A-5(c)(2) (first sentence, A-6). If the spouse dies before all benefits are paid, the required minimum distribution for the year of death must be based on the recalculated life expectancy by the end of the year (if it had not previously been distributed that year), and the balance must be paid within 10 years of the spouse's death. (Before the SECURE Act, the benefits could be paid over the spouse's remaining life expectancy, with no recalculation following his or her death.)

c. **Standard QTIP Trust (Accumulation Trust) as Beneficiary.** A standard QTIP trust, that does not require that all retirement plan distributions to the trust be distributed to the spouse, would not qualify for this spousal special treatment (at least pending further IRS guidance), even if it is a valid see-though trust, Reg. §1.408-8, A-5(a). Under the SECURE Act, a standard QTIP trust does not qualify as an EDB, and the 10-year rule would apply after the participant's death. A QTIP trust that also requires such distributions to the spouse of all plan distributions would constitute a conduit trust that is an EDB and would qualify for the spousal special treatment.

d. **Spouse as Outright Beneficiary.** If the spouse is the outright beneficiary, additional alternatives are available (in addition to the option described above if a conduit trust for the spouse is the beneficiary). The spouse can elect to treat the IRA as his or her own, or may roll over the plan benefits into the spouse's own rollover IRA. Advantages include a delayed starting date (until the surviving spouse reaches age 72) and a slower payout (using the Uniform Life Table, rather than the Single Life Table with recalculation). Under the SECURE Act the spouse would no longer have the ability to name a beneficiary who can receive payout based on the beneficiary's life expectancy, but the remaining benefits would have to be paid by the end of the year in which the tenth anniversary of the spouse's death occurs. If a beneficiary is an EDB at the time of the surviving spouse's death, the EDB rules should apply for that beneficiary (because the spousal rollover IRA is treated as the spouse's IRA, §§408(d)(3)(A), 408 (d)(3)(C)(ii)(II)). If the spouse is younger than 59½, he or she may need to use the IRA funds so may instead keep the IRA as an inherited IRA in order to avoid the 10% penalty on early withdrawals and then later make a spousal rollover.

6. Basic Planning Options for Minor Child

a. **Minor Child Exception Not Particularly Helpful.** Natalie Choate believes that the minor child exception is not particularly helpful. Few parents die while a child of the parent still a minor, and even rarer it is for both parents to die with a minor child. Participants with minor children often do not yet have significant retirement benefits. Benefits may have to be withdrawn within 10 years of the participant's death to pay college expenses in any event. Better than jumping through hoops to qualify for an exception that is extremely unlikely ever to apply, young parents should consider

making sure they have a sufficient amount of term insurance (relatively cheap for young adults) to provide for their minor children.

b. **Requirements to Qualify Minor Child as an EDB.** One of the EDB exceptions is for a minor child *of the participant,* not a grandchild or any other person's child (such as a niece or nephew or a stepchild).

The exception applies until the child "reaches majority" within the meaning of a specified unrelated provision (an obscure ERISA rule), which has a regulatory provision treating the child as not having reached majority if the child has not "completed a specified course of education" and is under the age of 26. The 10-year rule applies, beginning when the child "reaches majority." Therefore, this exception could possibly extend to age 36. The meaning of a "specified course of education" is unclear.

In addition, if a minor child becomes disabled before reaching majority, the minority status continues as long as the child is disabled. Reg. §1.401(a)(9)-6, A-15.

This exception applies if the minor child is the outright beneficiary or is the beneficiary of a conduit trust (but not an accumulation trust).

What happens if more minor children are born to the participant after the participant's death is unclear, but the statute says that the determination of whether a DB is an EDB "shall be made as of the date of death of the employee."

c. **Outright.** Leaving benefits outright to the minor child is simple, but may require a legal guardian or custodian under the Uniform Transfers to Minors Act (UTMA). (If the beneficiary designation names a minor outright as the beneficiary of the plan, Section 7(a) of the UTMA appears to allow the plan to make the distribution to a custodian for the minor.) The distributions would be taxed at individual rates rather than at the highly compressed trust tax rates, but an outright distribution is not ideal for a 3-year old.

Distributions could be made over the child's life expectancy as long as the child is an EDB (this also applies if a conduit trust is the beneficiary). Withdrawals over the minor's life expectancy will result in *very* slow withdrawals (and an additional 10 years after the minor child is no longer an EDB). Under the new Single Life Table (effective for distributions on or after January 1, 2021), for example, a 15-year old has a life expectancy of 69.9 years, so the initial withdrawals would be about only 1/70th of the account, or 1.43% of the plan assets. The withdrawal would likely be much less than the interest and dividend income produced by the account, and the account would likely continue to grow during the period the minor qualified for EDB treatment. After the minor "reaches majority," further withdrawals from the account could be halted for 10 years, at which time the entire account would be withdrawn. That could possibly last until the "minor" child is 36 years old before most of the account balance would have to be withdrawn from the plan.

d. **Conduit Trust.** A conduit trust for the child qualifies for the EDB exception. The trust agreement could include facility of payment provisions, allowing the trustee to use plan distributions for the benefit of the child rather than having to distribute them directly to the minor child. Distributions could be made to a custodial account, to parents, or to guardians. (Whether a Section 529 Plan for the minor would qualify is uncertain.) Benefits would be taxed at individual rates (because any withdrawals would immediately be distributed from the trust to the beneficiary). As described in Item 6.c above, benefits could be withdrawn very slowly from the plan (minimizing distributions from the trust to the minor child) until the beneficiary "reaches majority" (up to age 26) plus another ten years. But at that time, all plan benefits would be withdrawn by the trust and distributed to the child.

Whether the exception extends to a conduit trust with multiple "minor children" or to a conduit trust with multiple beneficiaries, only some of whom are "minor children" is unclear even if the trust must be separated into separate conduit trusts for the children at the participant's death. (It is hoped that regulations will provide relief; having four separate conduit trusts for four minor children would make no sense.) Some planners have suggested providing that a conduit trust for a minor child could flip to an accumulation trust after the child reaches majority, but existing trust rules for retirement plan

benefits do not clearly sanction that approach. Another approach could be to provide that if the participant dies before the child has reached majority, the trust will be a conduit trust thereby qualifying as an EDB, but if death is after the child has reached majority, the trust will be an accumulation trust.

e. **Accumulation Trust.** If a trust is used for a minor, accumulation trusts will be used more often than conduit trusts (to avoid having large distributions to the child at some point when the child is between age 28 and 36 (depending on how long the child was in school). The 10-year rule will likely apply (pending IRS guidance allowing an accumulation trust to qualify for EDB treatment for a minor child). The trustee can accumulate funds, but income would be taxed at the compressed trust tax rates.

7. Disabled or Chronically Ill Individuals as EDBs – Overview

The most helpful of the five categories of EDBs is that a modified life expectancy payout applies if the DB is disabled or chronically ill, thus providing favorable treatment for special needs trusts.

a. **Definitions of Disabled and Chronically Ill.** The SECURE Act provides cross references to definitions of disabled (§72(m)(7)) or chronically ill (§7702B(c)(2)) individuals. For example, a person who qualifies for Social Security disability benefits qualifies for this exception. The definitions of both disabled and chronically ill are difficult to apply to minors.

b. **When Status Is Determined.** The beneficiary's status as an EDB is determined at the participant's death. §401(a)(9)(E)(ii)(last sentence). If a DB later becomes an EDB (i.e., is later disabled) before all distributions have been made from the plan, the plan cannot switch to EDB status.

c. **Certification.** Section 72(m)(7) requires proof of disability and §7702B(c)(2) requires certification as chronically ill by a licensed health care practitioner. When such certification must be given is unclear. Rumors surfaced that the IRS might take the position that such certification must be in place at the time of the retirement plan participant's death. ACTEC filed comments with representatives of the Treasury and IRS on March 31, 2020, recommending that no such certification should be required before a reasonable time has passed after the issuance of long-term guidance on the issue, and "that either interim or long-term guidance should provide that no certification will be required until a reasonable and specified amount of time has passed after the death of the employee who has designated the beneficiary, provided of course that the certification confirms that the beneficiary was in fact disabled or chronically ill as of the death of the employee."

d. **Applicable Multi-Beneficiary Trusts (AMBTs).** At the 11th hour of the negotiations in Congress, the need to do more to help disabled and chronically ill individuals who need special needs trusts that can accumulate assets was recognized. A special provision under §401(a)(9)(H)(iv)-(v) for "applicable multi-beneficiary trusts" (or AMBTs) applies if (i) the trust has more than one beneficiary, (ii) all of the beneficiaries are designated beneficiaries, and (iii) at least one of the beneficiaries is disabled or chronically ill.

Some of the special benefits afforded disabled and chronically ill beneficiary EDBs under the AMBT provisions are: (i) A mandated division at the participant's death is given effect, contrary to the result described for retirement plan distributions generally in Reg. §1.401(a)(9)-4, A-5(c) (for example, if some of a single pot trust is divided into a separate trust for a disabled or chronically ill child, that separate trust would qualify for this exception); (ii) A single trust with multiple disabled or chronically ill individuals as beneficiaries qualifies for the exception; and (iii) An **accumulation trust** for disabled or chronically ill beneficiaries qualifies for the exception (whose life expectancy is used in that case is not clear, and the conservative approach, until the IRS gives further guidance, is to have remainder beneficiaries who are no older than the disabled or chronically ill current beneficiary or beneficiaries).

Special rules that apply to AMBTs are discussed in Item 9 below.

e. **Changed Planning Approach.** Prior to the SECURE Act, planning was arranged so that retirement benefits would not pass to disabled children. Now they may be the favored beneficiaries because healthy beneficiaries would generally have a 10-year payout requirement, whereas long-term deferral

is possible for disabled beneficiaries. The people that benefit from this changed approach may include the non-disabled beneficiaries who receive other assets that are not subject to income tax (so additional assets may be left to the disabled person to account for this difference).

8. Disability Planning Issues Generally

a. **General Discussion of Disability Planning Issues.** For a general discussion of planning considerations for disabled individuals, see Item 33 of Heckerling Musings 2020 and Estate Planning Current Developments found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights** and see Items 50-57 of the ACTEC 2011 Fall Meeting Musings summary found **here** and available at **www.bessemertrust.com/for-professional-partners/advisor-insights**.

b. **Medicaid.** Eligibility for Medicaid is no more restrictive than the requirements for Supplemental Security Income (SSI), for which the asset limit is $2,000. Qualifying for Medicaid is especially important because many programs essential to disabled or chronically ill individuals are only available to those who qualify for Medicaid.

Transfer restrictions are severe for SSI qualification; a 5-year look-back period applies, and the 5-year penalty period does not begin until the applicant has spent all of his or her assets, is "otherwise qualified for Medicaid," and has made a formal Medicaid application.

Trusts may or may not be considered a resource. The Social Security Administration Program Operations Manual System ("POMS") contains the policies of the Social Security Administration, and covers eligibility for SSI (and eligible SSI recipients are eligible for Medicaid). The POMS has extensive new rules on trusts that are being applied by federal courts for Medicaid and related benefits cases.

c. **First Party Special Needs Trusts.** Self-settled special needs trusts (created by the beneficiary) must meet several requirements in order for the trust assets not to be counted as resources, as listed in 42 U.S.C. §1396p (d)(4)(A). The requirements include that (i) the beneficiary is under age 65, (ii) the trust is for the sole benefit of the settlor-beneficiary, and (iii) at the beneficiary's death, any trust assets must be used to repay any Medicaid assistance received (excess assets may pass to successor beneficiaries). Including a reimbursement provision is essential in self-settled special needs trusts but is not needed (and generally should not be included) in third party trusts.

d. **Third Party Supplemental Needs Trusts.** Whether assets in a third party trust count as resources for SSI and Medicaid qualification purposes depends on state trust law concepts, federal programs, federal regulations, and state policy rules. "If the individual has the right, authority or power to liquidate the property … it is considered a resource." A third party (created by someone other than the beneficiary) special needs trust does not need to include the three requirements mentioned immediately above for first party trusts.

Three keys to drafting third party special needs trusts are (i) do not impose a duty on the trustee to support the beneficiary (the preference is to give the trustee total discretion as to whether to distribute assets), (ii) do not give the beneficiary the power to access trust principal, and (iii) clearly express the settlor's intention to supplement, but not supplant, means-tested public assistance.

e. **Qualified Disability Trust.** A special type of third party trust that qualifies for certain federal income tax benefits is a qualified disability trust (sometimes referred to as a "QDisT"), as described in §642(b)(2)(c). All current trust beneficiaries must be disabled and have been disabled before the age of 65, and the trust must be funded by a third party (not the beneficiary). The trust remaindermen need not be disabled. The qualifying trust qualifies for a $4,300 exemption for federal income tax purposes (compared to $100 for complex trusts and $300 for simple trusts, and $600 for estates). Most third party supplemental needs trusts can be structured to meet the requirements of QDisTs. The QDisT provisions apply only if the current beneficiaries are disabled, not including chronically ill individuals.

f. **ABLE Accounts.** ABLE accounts were authorized in 2014 legislation. They are tax-advantaged accounts (income on the account is not taxed) that can make distributions for "qualified disability expenses" of the beneficiary, which is limited to individuals with a disability whose disability began before turning 26 years of age. The key is that the account funds are generally not treated as a resources for purposes of SSI and Medicaid eligibility.

Final regulations regarding ABLE accounts under §529A were released October 1, 2020. T.D. 9923, IR-2020-227 (Oct. 1, 2020). The final regulations address a wide variety of requirements, including requirements for establishing ABLE accounts, requirements to be a qualified designated beneficiary, contributions (including limitations on the amount and investment of contributions), changes of the designated beneficiary, and rollovers and program-to-program transfers from one ABLE account to another. The final regulations also provide guidance about the gift and GST tax consequences of contributions, the income, gift, and estate tax consequences of distributions from, and changes in the designated beneficiary of, an ABLE account, and about the recordkeeping and reporting requirements of a qualified ABLE program.

Limits apply to the amount of annual contributions that are allowed (generally $15,000, indexed) and on the overall account size (generally $100,000, but some states have higher limits).

The practical advantage of the ABLE account is that the account can afford a degree of self-control and personal autonomy because the beneficiary can pay directly for some expenses from the account without having to involve the trustee of the special needs trust for every expense that comes up. High-functioning disabled beneficiaries will enjoy that freedom.

9. Planning Issues With Applicable Multi-Beneficiary Trusts (AMBTs)

a. **Rule I: Mandated Divisions Given Effect.** Generally, if a trust that is the beneficiary of a retirement plan (or IRA) benefit divides into separate trusts at the owner's death, they are not treated as "separate accounts" for purposes of determining the applicable distribution period unless the separate subtrusts were each named as beneficiary of the plan benefits. Therefore, all of the beneficiaries of the single trust are considered in determining the payout period (and if the life expectancy payout method applies, the oldest beneficiary's life expectancy is used). Reg. §1.401(a)(9)-4, A-5(c).

Rule I overrides that general rule for the interests of disabled and chronically ill beneficiaries of AMBTs. If the AMBT, by its terms, is to be divided immediately on the owner's death into separate trusts for each beneficiary, the payout rules "shall be applied separately with respect to the portion of the employee's interest that is payable to" any disabled or chronically ill EDB. §401(a)(9)(H)(iv)(I), (v). This apparently means that the beneficiary designation may list a single AMBT that divides at death into separate trusts for disabled and chronically ill individuals and for other DBs. Perhaps the trust could allow the trustee to make a non pro rata division of plan and non-plan assets at the time of the division. Guidance should clarify whose life to use for purposes of the determining the life payout that is allowed to disabled or chronically ill beneficiaries of the divided trust. Guidance on these and other issues is needed regarding the effect of Rule I.

b. **Rule II: Only Disabled or Chronically Ill Individuals Are Current Beneficiaries During Their Lives.** If the terms of the AMBT provide that no one other than a disabled or chronically ill individual has a right to plan benefits until the death of all disabled or chronically ill beneficiaries, then the AMBT may use the life expectancy payout method instead of the 10-year rule. However, the Act is not clear as to whose life governs. The worst case is that the oldest DB (including beneficiaries after the lives of disabled or chronically ill beneficiaries) governs under the traditional see-through trust rules. However, guidance may allow the life expectancy of the older disabled or chronically ill beneficiary to be used.

Drafting Tip: Pending more guidance, use an age restriction or other means to limit the ages of all trust beneficiaries of the AMBT, including DBs who are not disabled or chronically ill beneficiaries.

c. **Special Needs Trusts.** Being able to use accumulation trusts is particularly helpful for special needs trust planning. Further IRS guidance is needed with respect to various issues for special needs trusts. As examples of the need for further guidance, many special needs trusts include a "backstop provision" allowing distributions to other beneficiaries of amounts that would cause the disabled beneficiary not to qualify for government assistance programs or include a provision allowing distributions to other beneficiaries for tax planning in light of the high rates applied to undistributed trust income. How will those provisions impact qualification of a trust as an EDB in light of its disabled or chronically ill beneficiaries? Until further guidance is provided, consider revising special needs trusts to exclude (i) backstop provisions (allowing distributions to other beneficiaries of amounts that would cause the disabled beneficiary not to qualify for government assistance programs), (ii) provisions allowing excess assets to be distributed to non-disabled beneficiaries (for tax planning in light of the high rates applied to undistributed trust income or if the special needs beneficiary no longer qualifies for public benefits), and (iii) provisions allowing the payment of travel expenses of a travel companion for a disabled beneficiary. Include a statement that the settlor intends the trust to qualify as an AMBT. Consider allowing the trustee or some person to reform or amend the trust so that it qualifies as an AMBT in light of future IRS guidance. As discussed in the Drafting Tip above, consider specifying that all remainder beneficiaries are younger than or close in age to the special needs beneficiary.

An outstanding resource regarding planning for the disabled and chronically ill EDB category (and in particular, planning for special needs trusts in light of the SECURE Act) is Nancy Welber, *Security for Disabled and Chronically Ill Beneficiaries*, TRUSTS & ESTATES 40 (April 2020). That article has an excellent summary of changed drafting considerations for special needs trusts (referred to in that article as SNTs) in light of the SECURE Act.

> What should estate planners do before we have guidance from Treasury? The safe course is to assume that the current regulations will apply unchanged. Therefore, draft defensively. The SNT must include only special needs beneficiaries. Don't allow the SNT to terminate during the special needs beneficiary's lifetime if the trust no longer qualifies for public benefits, a "poison pill" that's common in special needs planning in some states. Don't allow the trustee to distribute excess income from a trust that has an inherited IRA payable to it to a beneficiary who isn't special needs. Don't allow payments to a companion for travel with the beneficiary. If any of these strategies are desirable, create a separate SNT for the non-retirement trust assets.
>
> Include a statement of intent in the AMBT that makes clear that the settlor intends that the trust qualify as an AMBT. Consider allowing the trustee to reform the trust, or allow a trust protector to amend the trust, so that the trust can comply with any Treasury regulations or other guidance that you may not anticipate at this time. The trustee or trust protector should be directed to make any changes by Sept. 30 of the year following the year of the account owner's death, which is the date by which the trust beneficiaries must be identified, and the trust must be a see-through trust. Given that we don't know whether the life expectancy of the oldest of multiple special needs beneficiaries of an SNT will be used to determine the payout period of the RMDs, and what happens to the payout period after the death of one of the special needs beneficiaries, it's safer to avoid an SNT with multiple special needs beneficiaries until we have guidance from Treasury. As for the remainder beneficiaries of the SNT, while it appears that if they're all individuals, their life expectancies should be irrelevant, be cautious and err on the side of naming outright beneficiaries who are younger than the special needs beneficiary, or close in age, like siblings or first cousins, so that the special needs beneficiary's life expectancy is more likely to be used. *Id*. at 43-44.

10. Planning for Beneficiaries Not More Than 10 Years Younger Than Participant

A classic example for this exception would be siblings of the participant who are older than the participant or not more than 10 years younger than the participant. Distributions made outright or to a conduit trust for such a beneficiary will qualify for this exception.

Different siblings may be treated quite differently. Distributions to a sibling who is 9 years and 364 days younger than the owner would qualify for the lifetime payout but distributions to a sibling who is 10 years and 1 day younger would have to be paid within 10 years.

11. Post-Mortem Fixes and Considerations After Participant's Death

If appropriate adjustments have not been made before the participant's death, several alternatives exist for making post-mortem adjustments to the plan beneficiaries.

a. **Post-Mortem Reformation.** Despite the IRS's position in PLR 200742026 that it would no longer consider post-death reformations of retirement plan beneficiary designations, Natalie Choate believes that the IRS will accept a reformation if it reflects a reasonable settlement of a bona fide contest or controversy ("but family members have to genuinely hate each other for this to work," Natalie says). In addition, many PLRs have accepted reformations to correct scrivener errors. A lot of reformation proceedings may occur in the future in light of the huge law change for retirement plan minimum distributions under the SECURE Act, but planners cannot just ignore the SECURE Act thinking that they can fix any problems with a post-mortem reformation.

b. **"Clean Up" Before September 30 Finalization Date.** The beneficiaries who are counted in determining the DBs of the plan are "the beneficiaries designated as of the date of death who remain beneficiaries on September 30 of the calendar year following the calendar year of the [participant's] death." Reg. §1.401(a)(9)-4, A-4(a). If certain beneficiaries of a trust would not constitute DBs, they could be removed as beneficiaries prior to the September 30 "finalization date" (1) by making full distribution to that beneficiary of its interest in the plan, (2) by the beneficiary's disclaimer of the plan benefits, or (3) if the appointees under a power of appointment are a problem, by disclaiming the power to appoint to those appointees.

   As an example of possible disclaimer planning, if a participant died before 2020 leaving the surviving spouse as the beneficiary, the benefits can be paid over the spouse's life expectancy under favorable rules (using the Uniform Table with a spousal rollover, etc.). At the surviving spouse's subsequent death (presuming after 2020), however, the 10-year rule will apply and all remaining benefits must be paid within 10 years of the spouse's death. Alternatively, the spouse could disclaim and if the effect of the disclaimer is that the benefits would pass to young beneficiaries (or to a trust using a young beneficiary's life expectancy to determine the payout period), the benefits could be paid over the life expectancy of such young beneficiary (possibly over 50-70 years) since the pre-2020 rules would apply. (If the participant had not received the annual distribution in the year of death, the RMD must be taken by the beneficiary for the year of death. The IRS has ruled that it will not treat the acceptance of that RMD for the year of death as acceptance of plan benefits that would preclude a valid disclaimer of the rest of the plan benefits. Rev. Rul. 2005-36.)

   Consider When to Take Withdrawal. Another important post-mortem consideration is when to take the withdrawal from the plan or IRA. It must be taken by the end of the 10th year (if the plan has a designated beneficiary who is not an EDB). If the benefits are withdrawn soon after the participant's death, the benefits will be taxed at ordinary income rates, all at once, BUT the future growth possibly could be taxed at capital gains rates long in the future (or some could be tax-free if the fixed income portion of the portfolio is invested in municipal bonds). What average growth rate would be required from the investments over the next 10 years for the income tax savings on capital gain rates (plus the 3.8% tax on net investment income) vs. ordinary rates on the growth to overcome the lost time value of the ordinary income tax being paid up front by the time you get to the end of the 10-year period? Or could lower income tax rates be applied if the amount is withdrawn from the plan over a number of years in the first ten years (really 11 taxable years, as mentioned in Item 2.a above)?

   We should be able to calculate what the growth rate of the investments would need to be, over the next 10 years, for the tax savings on capital gain vs ordinary rates on the growth to overcome the lost time value of the ordinary income tax being paid up front by the time you get to the end of the 10-year period.

12. Charitable Planning

A charity is a good beneficiary of a retirement plan, because the plan benefits are taxed as ordinary income on receipt by an individual, but a charitable beneficiary is tax-exempt and pays no income tax.

a. **Mechanics of Naming Charity as Beneficiary**. The preferable way to name a charity as beneficiary of a retirement plan or IRA is to name a donor advised fund of an institutional provider. If a charity is named directly, some IRA providers require massive amounts of information regarding the charity

and all of its directors to comply with the KYC rules under the Patriot Act. Community foundations or other institutions sponsoring DAFs are familiar with complying with those rules.

b. **Charitable Remainder Trust or Charitable Gift Annuity**. A charitable remainder trust (CRT) makes annual annuity or unitrust payments to an individual for the individual's life expectancy or for a term of years (up to a maximum of 20 years). The trust must be structured so that the value of the charitable remainder interest is worth at least 10% of the value contributed to the trust. The IRS has published a sample CRT form. Natalie strongly suggests using the IRS sample form, with a few tweaks suggested in LEIMBERG CHARITABLE PLANNING NEWSLETTERS #80 (by Larry Katzenstein) and #88 (by Richard Fox) in 2006.

The plan benefits could be paid to the CRT immediately following the participant's death, thus satisfying the RMD requirements for the plan. The CRT is a tax-exempt entity, and does not pay income tax on receipt of the plan benefits.

When distributions are made to the individual beneficiary, a "tier system" applies to carry out the income tax attributes of the CRT's assets to the individual beneficiary. Ordinary income is deemed distributed first. As payments are made over the life of the beneficiary, all or almost all of the amounts paid to the individual likely will represent the plan benefits and will be taxed as ordinary income.

The use of the CRT is not primarily a way to beat the SECURE Act and save income taxes.

For a discussion of an alternate arrangement of leaving an IRA to charity for a gift annuity, see Katzenstein, *Testamentary Gift Annuities as Alternative to a "Stretch" Charitable Remainder Trust?*, LEIMBERG CHARITABLE PLANNING NEWSLETTERS #292 (Feb. 10, 2020) (advantages of charitable gift annuity over CRT include possible better income tax treatment, no need of having a separate trust and trustee, and the annuity can be deferred, graduated, or "flexible" by having a deferred annuity and allowing the annuitant to choose to delay the start date, but with a commensurate increase in the annuity amount).

Various excellent articles have explored the use of charitable remainder trusts in light of the SECURE Act provisions. E.g., Matthew Blattmachr, Jonathan Blattmachr, Richard Fox, *Using a Charitable Remainder Trust as the Recipient of Qualified Plan and IRA Interests*, ESTATE PLANNING (May 2020); Jonathan Blattmachr, Matthew Blattmachr, Richard Fox, Martin Shenkman, *Charitable Remainder Trust Economics, and Deciding Whether to Use a CRT, Including for Plan and IRA Distributions*, LEIMBERG CHARITABLE PLANNING NEWSLETTER #296 (June 16, 2020); Bruce Steiner, *Charitable Remainder Trusts Replicate the Stretch IRAs*, TRUSTS & ESTATES 46 (April 2020); Charles Bender, *Using a CRUT to SECURE the Benefits of a Stretch IRA Trust*, TRUSTS & ESTATES 59 (April 2020).

c. **IRA Charitable Rollover.** The SECURE Act does not eliminate the IRA charitable rollover, but the $100,000 limit on qualified charitable distributions from an IRA that can be excluded from income will be correspondingly reduced by any contributions to IRAs after a person has reached age 70½. Changing the age for required minimum distributions from 70½ to 72 will not change the age at which qualified charitable distributions from IRAs will be permitted.

Particularly for nonitemizers, donors over age 70½ should consider making their charitable donations with IRA charitable rollovers at least up to the amount of the minimum required distribution and up to a maximum of $100,000 per year. Even though the nonitemizer donor does not get an income tax deduction, the donor will avoid recognizing income on the distributions. Especially if the donor has reached the RBD (April 1 of the year after reaching age 72 if the person had not reached age 70½ in 2019), the donor will avoid recognizing income on the required distributions from the IRA.

(1) **Reporting.** Box 1 of Form 1099-R from the IRA custodian will show the total amount of distributions from the IRA. The Form 1099-R does not reflect which of the distributions are "qualified charitable distributions." The taxpayer reports the full distribution amount on line 4a of Form 1040, and reports the taxable distributions (for example, the amount that is not a qualified charitable distribution) on line 4b of Form 1040, and should enter "QCD" next to line 4b. The qualified

charitable distribution amount cannot be deducted and will not be entered on Lines 11 or 12, Schedule A of Form 1040.

(2) **Cannot Use Donor Advised Fund.** An IRA qualified charitable distribution cannot be made to a donor advised fund (or to a supporting organization or private foundation).

13. Roth IRAs and Trusteed IRAs

a. **Roth IRAs**. The 10-year rule anti-stretch provisions in the SECURE Act apply to Roth IRAs. The accelerated payments from the Roth IRA following the owner's death would not bear a 37% immediate tax, but the opportunity for future tax-free buildup over a long period of time would be lost. One possible planning alternative would be to leave a Roth IRA to a special needs trust (an accumulation trust) for a disabled beneficiary, so that there would be no concern with the accumulated trust income being taxed at the high trust rates. Because distributions from a ROTH IRA are not treated as ordinary income, the concerns about distributions to an accumulation trust and the compressed trust income tax rates do not apply.

   Roth conversions may still make sense for taxpayers who are in considerably lower income tax brackets (due to lower income, NOLs, loss carryovers, etc.) than the beneficiaries. (If an accumulation trust is the beneficiary, the trust reaches the maximum 37% bracket at a mere $12,950 of taxable income in 2020, so the participant might be in a significantly lower bracket. However, the time period for the tax-free growth would generally be limited to 10 years following the person's death because of the 10-year rule.)

   For a discussion of considerations for making Roth conversions in 2020, see Bernard Kent, *Roth IRA Conversions in 2020*, LEIMBERG EMPLOYEE BENEFITS AND RETIREMENT PLANNING NEWSLETTER #737 (June 9, 2020).

b. **Trusteed IRAs.** The SECURE Act applies to trusteed IRAs the same as custodial IRAs. The only difference is that the plan provider is a fiduciary who has responsibility for investment and distribution decisions rather than just serving as custodian of the IRA. A distinction is that trusteed IRAs are often marketed as a way of getting stretch payouts without the client's having to prepare a separate complicated trust agreement. The nontax advantages of the trusteed IRA arrangement still exist, but not the stretch purpose (except for EDBs).

14. Trust Income-Principal Allocation for Retirement Plans or IRAs

a. **Uniform Fiduciary Income and Principal Act**. Section 409 of the Uniform Fiduciary Income and Principal Act (January 25, 2019) (UFIPA) addresses payments from retirement plans and IRAs (and other similar payments). The "internal income" of the fund for each period is (i) the actual internal income of the fund, (ii) or if the fiduciary cannot determine the internal income of the fund, the internal income is deemed to be [each state is to insert a number between 3 and 5] percent of the value of the fund, (iii) or if the fiduciary cannot determine the value of the fund, it is deemed to equal the present value of the future expected payments as determined under §7520. UFIPA §409(b). Payments from a retirement plan or IRA separate fund are allocated to income to the extent of the internal income of the fund during the period, and the balance is allocated to principal. UFIPA §409(c). Special rules are provided for marital trusts that qualify for the marital deduction under §2056(b)(5) or §2056(b)(7) (both of which require that income be distributed each year) to assure that the internal income of the fund during each accounting period is distributed to the current income beneficiary. UFIPA §409(d). Trusts other than marital trusts that require the distribution of all current income will in each accounting period transfer from principal to income the amount by which the internal income of the fund exceeds the amount the fiduciary receives from the fund. UFIPA §409(e). Changes made in the SECURE Act do not present any particular problems in applying the UFIPA rules.

b. **UPIA and Texas Income-Principal Allocation Provisions**. The Uniform Principal and Income Act, last revised in 2008 (UPIA), has been adopted and is the governing law in many states, including Texas, that have not yet considered replacing their income-principal allocation provisions for trusts

with the UFIPA provisions. Section 409 of UPIA, which governs the income-principal allocation provisions for retirement plans and IRAs (and other similar payments) creates uncertainty for certain trusts in light of the SECURE Act. Those trusts include trusts that do not qualify as EDBs that are

- mandatory income trusts or
- trusts that allow distributions of only income but not principal,

other than marital deduction trusts. The Texas income-principal allocation provision for trusts, in Section 116.172 of the Texas Trust Code, is based on the UPIA provision (but with significant modifications).

(1) **"Required to Be Made" Construction Problems**. The UPIA and Texas provisions are somewhat similar to the general structure of the UFIPA provisions described above, but contain references to payments that are "**required to be made**." That worked well when annual RMDs were required, but under the SECURE Act, distributions to beneficiaries other than EDBs are not required annually but just must be made within 10 years. Before the end of that term, no payments are "required to be made," and all or a huge portion of the fund may not be distributed until the end of that period and may be allocated entirely to principal.

- Payments from the fund that are characterized by the fund as interest, dividend, or a payment in lieu of interest or a divided, are allocated to income, and the balance of the payment is allocated to principal. UPIA §409(b); TEX. TRUST CODE §116.172(b). (This information can usually be determined for self-directed IRAs but often would not be available for other retirement plans or pension plans.)
- If no part of a payment is characterized as interest or dividend, and "all or part of the payment is **required to be made**," UPIA allocates 10% of the required payment to income and the balance to principal. UPIA §409(c). The Texas statute, in that circumstance, allocates such required payment to income to the extent it does not exceed 4% of the fair market value of the "future payment asset" [i.e., the retirement fund or IRA valued as of December 31 of the prior year] less prior payments during that same period that were allocated to income, TEX. TRUST CODE §116.172(c), and the balance of the payment is allocated to principal. TEX. TRUST CODE §116.172(f).
- "If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal." UPIA §409(c)(second sentence); TEX. TRUST CODE §116.172(g).

Payments to EDBs are made under a modified life payment approach, and any payments up to the amount of the required life expectancy payouts are "required to be made" and are clearly addressed in the UPIA and Texas provisions. However, payments that are not made to EDBs are subject to the 10-year rule (or other rules if the beneficiary is not a DB). Because proportionate payments are not required during the 10-year term, payments other than those made in the last year of the term are arguably not "required to be made." If the "required to be made" clause is construed in that manner and if such payments, other than during the last year, are not characterized as interest or dividend from the fund, they would not be covered by UPIA §409(c) (or in Texas Trust Code §116.172(b) or §116.172(c)(the 4% rule, applicable to payments that are "required to be made")), and therefore would be principal under UPIA §409(c) or in Texas under §116.172(f). In the last year of the 10-year period, the entire balance is "required to be made" to the beneficiary, so arguably the 10% rule of UPIA §409(c)(first sentence) or in Texas the 4% rule of §116.172(c) would apply. However, the second sentence of UPIA §409(c) and Texas Trust Code §116.172(g) very specifically cover payments of "the entire amount to which the trustee is entitled," so payments of the entire fund in the last year of the 10-year period would be principal under UPIA *if* the second sentence of §409(c) applies instead of the first sentence, and in Texas *if* subsection (g) of §116.172 applies instead of subsection (c). It's a statutory construction mess.

For payments from a marital trust qualifying the for the marital deduction under §2056(b)(5) or §2056(b)(7), those rules described above under UPIA §409(b)-(c) and Texas Trust Code §116.172(b)-(c) do not apply but special rules under UPIA 409(f)-(g) and Texas Trust Code §116.172(j)-(k) apply. Those rules are similar to the UFIPA rules for marital trusts described above and require that "internal income of the separate fund" be allocated to income (including a 3-5% [4% in Texas] of the fund value rule if the actual internal income cannot be determined).

(2) **"Payment" Construction Problems**. An additional statutory construction problem arises under UPIA for trusts other than marital deduction trusts and in Texas for all trusts. The various income-principal allocation provisions apply to "payments" and a "Payment" is defined in UPIA §409(a)(1) (and Texas Trust Code §116.172(a)(2)) in two alternative sentences.

- Under the first sentence, a "payment" means "a payment that a trustee may receive [*clause 1*] over a fixed number of years or [*clause 2*] during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments." Clause 2 does not apply to typical distributions from plans or IRAs and clause 1 arguably does not apply under the SECURE Act if the 10-year rule applies, because the payments are not made periodically over a fixed number of years.
- The second sentence defines "payment" as "a payment made in money or property from the payer's general assets or from a separate fund created by the payer." The clause may apply to payments from an employer's general retirement plan, but would not apply to a self-directed IRA because the IRA is not created by the payer of the payment–the plan custodian.

Is a voluntary withdrawal or other non-periodic payment from a retirement plan or IRA under the 10-year rule of the SECURE Act a "payment"? If such withdrawals are not "payments" and therefore are not covered by §409 (or §116.172 of the Texas Trust Code), are they characterized as income or principal? Would they be allocated entirely to principal under the principal default rule in UPIA §404 or Texas Trust Code §116.161?

The "payment" construction problem is solved in UPIA for marital trusts because the last sentence of §409(a)(1) says that for marital deduction trusts, the definition "includes payment from any separate fund, regardless of the reason for the payment," and "separate fund" is defined in §409(a)(2) to include an IRA and a pension, profit-sharing, stock-bonus, or stock-ownership plan." That sentence is not included in the Texas statute.

(3) **Significance**. Fortunately, these problems do not exist for many trusts, even in light of changes made by the SECURE Act. They do not apply to trusts that are treated as EDBs of retirement plans or IRAs. The "required to be made" construction problems do not apply to marital deduction trusts, and apply to non-marital deduction trusts only if the trusts require mandatory income distributions or allow distributions only from income. That is unusual for trusts that are not marital deduction trusts.

The "payment" construction problem does not arise in UPIA states for marital deduction trusts (§409(a)(3rd sentence) or for any trust that is the recipient of payments from a general retirement fund (§409(a)(2nd sentence). In Texas, the exception for marital deduction trusts does not apply generally (because the third sentence of UPIA §409(a) was not adopted in Texas), but the "payment" construction problem does not apply in Texas for marital deduction trusts that are treated as EDBs (see Item 5.c above), and does not apply for any trust that is the recipient of payments from a general retirement fund (§116.172(a)(2)(2nd sentence)).