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SECURE Act Accelerates Timing of Required Minimum Distributions to Beneficiaries Under Qualified Plans and IRAs

The Further Consolidated Appropriations Act, 2020, signed into law Dec. 20, 2019, includes a division that is known as the SECURE Act,[1] which made major changes to the required minimum distribution (RMD) rules applicable to both qualified plans and individual retirement accounts (IRAs). For purposes of this GT Alert, qualified plan participants and IRA owners are sometimes collectively referred to as "participants."

Under the new rules: (1) the age at which RMDs generally must commence during the lifetime of a participant has been pushed back from 70½ to 72; (2) a beneficiary will not be entitled to stretch the distributions out over his or her life expectancy unless the beneficiary is an eligible designated beneficiary, which is narrowly defined to include only a beneficiary who is: (a) the participant's surviving spouse; (b) the participant's minor child; (c) "disabled"; (d) a "chronically ill individual"; or (e) not more than 10 years younger than the participant, or a so-called "see through trust" established for the sole benefit of an individual eligible designated beneficiary; and (3) death benefits payable to "designated beneficiaries" who do not qualify as "eligible designated beneficiaries" must be paid over a period not longer than 10 years.

[1] The SECURE Act stands for "Setting Every Community Up for Retirement Enhancement."

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Because the new rules are effective in 2020, IRA owners (and participants in qualified plans) who have incorporated the so-called "stretch-IRA" approach into their retirement planning should promptly review those plans and the impact that these new rules may have.

Lifetime RMDs

The new law amends Section 401(a)(9)(C) of the Internal Revenue Code of 1986, as amended (the "Code") to defer the date on which an IRA owner is required to begin to receive RMDs until April 1 of the calendar year immediately following the calendar year in which he or she attains age 72 (as opposed to age 70½ under prior law).[2] Distributions from a qualified plan must begin no later than April 1 of the calendar year immediately following the year in which the participant attains age 72, or, if the participant is not a 5% owner of the employer sponsoring the plan, April 1 of the calendar year immediately following the year in which the participant's employment terminates, if later. This date is referred to as the participant's "required beginning date." Roth IRAs continue to be exempt from the RMD requirements during the participant's lifetime, although Roth accounts in qualified plans continue to be subject to those requirements. This new rule is effective for participants who attain age 70½ after Dec. 31, 2019. Thus, an individual who attains age 70½ in 2019 will still be required to begin receiving RMDs by April 1, 2020.

Distributions After Death but Before Participant's Required Beginning Date

a) Prior Rules.

i. General Rule. Under prior law, if a participant died before his required beginning date, his or her remaining benefits under the plan or IRA were required to be distributed to the participant's beneficiaries by no later than the end of the calendar year that includes the fifth anniversary of the participant's death (the so-called "five-year rule") unless the beneficiary qualified as a "designated beneficiary." For this purpose, a "designated beneficiary" was (and continues to be) broadly defined as "any individual designated as a beneficiary by the employee."[3] As discussed below, the individual beneficiaries of trusts that meet certain requirements will be treated as the designated beneficiaries.

ii. Surviving Spouses. If the "designated beneficiary" is the participant's surviving spouse, distributions are not required to begin until the date that would have been the participant's required beginning date if he or she had survived, and once begun, the distributions can be made over a period not longer than the surviving spouse's life expectancy. That life expectancy can be recalculated each year, which has the effect of further extending the potential pay-out period.

iii. Other Designated Beneficiaries. Under prior law, if the designated beneficiary was a child or grandchild, or any other "individual" designated by the participant, death benefits could be

[2] The new law does not appear to affect the ability of an IRA owner who has attained age 70½ to continue to exclude from income up to $100,000 of IRA assets distributed directly to certain charities (even if the owner's RMD may have been deferred until age 72 under the new law). *See* Section 408(d) of the Code.

[3] To be treated as a designated beneficiary, an individual must be a beneficiary as of the date of the participant's death. However, generally, the participant's designated beneficiary is based upon the beneficiaries who remain as of the Sept. 30 of the calendar year following the calendar year of the participant's death. Thus, beneficiaries who receive the entire amount of their death benefit, or who disclaim entitlement to the death benefit, prior to that subsequent Sept. 30 are disregarded. *See* Treas. Reg. §1.401(a)(9)-4, Q&A 4. Thus, if for example, a trust is the beneficiary, and the beneficiaries of the trust are the participant's descendants and a charity, the participant's descendants could qualify as designated beneficiaries (but not an eligible designated beneficiary under the new rules discussed below) if the charity's interest was cashed out on or before Sept. 30 of the year following the year in which the participant died.

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paid over the life (or over a period not extending beyond the life expectancy) of the designated beneficiary as long as the distributions began within one year after the participant's death.

iv. Trusts as Beneficiaries. If a trust is named as a beneficiary, and certain requirements are satisfied,[4] the beneficiaries of the trust, and not the trust itself, will be treated as having been designated as beneficiaries of the participant for purposes of determining the period over which RMDs must be made. These types of trusts sometimes are referred to as "see-through trusts."

1) Conduit Trusts. As a result of this "see-through trust" rule, if a trust provides that all amounts distributed from the plan or IRA will be paid directly upon receipt to an individual beneficiary, then that individual qualifies as the sole "designated beneficiary."[5] Such a trust has been commonly referred to as a "conduit trust." As a result, if that trust has as its sole beneficiary an individual who qualifies as a "designated beneficiary," the trust also should qualify for the same exceptions to the five-year rule that would be applicable if the benefit was payable directly to that individual.

2) Accumulation Trusts. Trusts in which the trustee has the discretion to accumulate income for future distribution sometimes are referred to as "accumulation trusts." Under prior law, if all of the potential beneficiaries of this type of trust were individuals,[6] then the RMDs would need to be made over the life expectancy of the oldest beneficiary (i.e., the one with the shortest life expectancy). If any potential beneficiary of the trust is not an individual, the trust would be treated as having no designated beneficiaries (and thus the RMDs would need to be made within five years after the participant's death).

b) New Rules.

i. Ten-Year Rule. Under the new rules, as set forth in new Section 401(a)(9)(H) of the Code, generally[7] effective for participants who die after Dec. 31, 2019,[8] death benefits payable to "designated beneficiaries" (as defined under prior law) of participants who die before their required beginning date must be made by the end of the calendar year that includes the tenth anniversary of the participant's death[9] (the "ten-year rule") unless the beneficiary qualifies as an "eligible designated beneficiary." The existing five-year rule continues to apply to

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[4] These requirements are met if (1) the trust is valid under applicable state law, (2) the trust is irrevocable or will become irrevocable upon the death of the participant, (3) the beneficiaries of the trust are identifiable from the trust instrument, and (4) certain documentation relating to the trust is provided to the administrator of the plan. *See* Treas. Reg. §1.401(a)(9)-4, Q&A 5.
[5] For this purpose, a "residuary beneficiary" who is a "mere potential successor" to another beneficiary is disregarded. *See* Treas. Reg. §1.401(a)(9)-5, Q&A 7(c).
[6] *See* Treas. Reg. §1.401(a)(9)-5, Q&A 7(a).
[7] The new rules apply to participants in "governmental plans" as defined in Section 414(d) of the Code, who die after Dec. 31, 2021, and to participants in collectively bargained plans who die after Dec. 31, 2021 (or, if earlier, the later of the date on which the collective bargaining agreement terminates or Dec. 31, 2019). The new rules do not apply to a "qualified annuity" that was a binding annuity contract in effect on Dec. 20, 2019, and at all times thereafter. For this purpose, a "qualified annuity" means a commercial annuity providing for annuity payments over the life (or life expectancy) of the employee or the employee and a designated beneficiary that satisfied the prior RMD rules and pursuant to which the annuity payments to the employee had begun before Dec. 20, 2019 (and the employee has made an irrevocable election as to the method and amount of the annuity payments), or the employee has made an irrevocable election before Dec. 20, 2019, as to the method and amount of the annuity payments to the employee or the designated beneficiaries).
[8] The new RMD rules also would apply with respect to death benefits paid upon the death of a designated beneficiary of the participant after December 31, 2019, even if the participant died on or before December 31, 2019. Thus, if a participant died in 2019, and the participant's designated beneficiary was the participant's son, distributions could be made to the son over the son's life expectancy under the old rules. Upon the death of the son, however, distributions to the son's beneficiaries would need to be made within ten years after the son's death.
[9] The new law permits the distributions to be made at any time during that ten-year period.

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beneficiaries who are not designated beneficiaries (such as charities and trusts that are not see-through trusts for the benefit of designated beneficiaries).

ii. "Eligible Designated Beneficiary." An "eligible designated beneficiary" is narrowly defined under the new law to mean a "designated beneficiary" who is:

the participant's surviving spouse

a "minor" child of the participant, which presumably means a child who has not reached the age of majority under applicable state law

a "disabled"[10] beneficiary

a "chronically ill individual"[11]

a beneficiary who is not more than ten years younger than the participant.

iii. Surviving Spouse. If the participant's surviving spouse is the eligible designated beneficiary, then the prior rules continue to apply to death benefit distributions made to the surviving spouse. Under those rules, the surviving spouse would not be required to commence distributions until what would have been the participant's required beginning date (now age 72), and the distributions could be made over the spouse's life expectancy, which could be recalculated each year. Alternatively, a surviving spouse may "rollover" plan benefits to the surviving spouse's own IRA, and defer the commencement of minimum required distributions until April 1 of the year following the year in which the surviving spouse attains age 72.

iv. Minor Child. In the case of a "minor" child, distributions can be made based upon the child's life expectancy until the child attains majority or dies, and distributions of the balance must be made within ten years after the child attains majority or dies.

v. Disabled or Chronically Ill Individual and Beneficiaries Not More Than Ten Years Younger than Participant. In the case of a "disabled" or "chronically ill individual," or an eligible designated beneficiary who is not more than ten years younger than the participant, distributions can be made over the life expectancy of the beneficiary until the beneficiary's death,[12] and the balance must be distributed within ten years after the beneficiary's death.

vi. Trusts. If, under the new law, the trustee of the trust has the discretion to withhold death benefit distributions for later distribution, the trust generally would not qualify as an "eligible designated beneficiary," because the trust would not be treated as being for the sole benefit of an eligible designated beneficiary. Accordingly, distributions to the trust would be subject to

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[10] For this purpose, a beneficiary will be considered "disabled" if he or she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration.
[11] A "chronically ill individual" is defined to mean an individual who has been certified by a licensed health practitioner as (i) being unable to perform (without substantial assistance from another individual) at least two activities of daily living for a period of at least 90 days due to a loss of functional capacity, (ii) having a disability that under Treasury Regulations is "similar" to the level of disability described in (i) above, or (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. This requirement only will be met if there is a certification that, as of such date, the period of inability is "an indefinite one that is reasonably expected to be lengthy in nature."
[12] The determination of whether a designated beneficiary is an eligible designated beneficiary is to be made as of the date of death of the participant. Thus, if a "disabled" or "chronically ill individual" recovers after the participant's death, that would not appear to affect the beneficiary's ability to continue to be paid death benefits over his or her life expectancy.

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the ten-year rule if all of the beneficiaries were designated beneficiaries, or the five-year rule if any of the beneficiaries are not designated beneficiaries. There is, however, a special rule that applies to trusts in which one or more beneficiaries is "disabled" or a "chronically ill individual." To qualify for this exception, (1) all of the beneficiaries of the trust must be individuals, and (2) under the terms of the trust, either (a) the trust must be divided immediately upon the death of the participant into separate trusts for each beneficiary, or (b) no individual other than a "disabled" or "chronically ill" individual can have any right to the participant's interest in the plan or IRA until the death of all "disabled" or "chronically ill" individuals. If these requirements are met, death benefits payable to the trust that are payable by the trust to the "disabled" or "chronically ill" individual can be paid over the beneficiary's life expectancy. The balance of the death benefit would need to be distributed to the trust within ten years after the death of the disabled or chronically ill individual.

Note that the use of a so-called "conduit trust" for the benefit of an eligible designated beneficiary, such as a surviving spouse, continues to permit stretch payments over the life expectancy (recalculated in the case of a surviving spouse) of the eligible designated beneficiary. However, a "conduit trust" for a designated beneficiary who is not an eligible designated beneficiary (such as an adult child) would require the entire plan to be distributed to the designated beneficiary in the eleventh year following the death of the participant. The reason is that plan distributions during the ten-year period are the RMDs, and a "conduit trust" requires all RMDs to be immediately paid through to the designated beneficiary outright. Therefore, a "see-through" accumulation trust would be preferable and necessary if the goal is to defer distributions to designated beneficiaries who are not eligible designated beneficiaries beyond the ten-year period.

Distributions When Death Occurs After Participant's Required Beginning Date

If the participant dies after his required beginning date, the balance in his or her plan or IRA generally must be made over a period that is at least as fast as annual installments over what would have been the remaining life expectancy of the participant if he had not died. Under prior law, if the participant had no "designated beneficiary," distributions were required to be made at least as fast as the remaining life expectancy of the participant (assuming he or she had not died). This rule does not appear to have been changed by the new law. If, however, the participant had a "designated beneficiary" at the time of his or her death, then distributions could be made over the longer of the remainder of the participant's life expectancy or the remainder of the life expectancy of the designated beneficiary. Under the new rules, distributions to a designated beneficiary would need to be made before the end of the calendar year that includes the tenth anniversary of the participant's death, even if the participant had already attained his RBD and had begun to receive minimum required distributions.

Effect of New Rules on Planning

Many owners of large IRA accounts have incorporated what has been referred to as the "stretch IRA" approach into their estate planning. By designating children and grandchildren (or "see-through" trusts for their benefit) as beneficiaries of their plan or IRA benefits, distributions could be made over the life expectancies of the designated beneficiaries, which in the case of a ten-year-old grandchild, for example, could be as long as 71.7 years.

This planning approach offered three primary advantages. First, it maximized the period over which amounts could be retained in the IRA to grow free of any income taxes. Second, it enabled the taxable distributions to be spread over a longer period, thus potentially reducing the marginal tax rate that would

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apply to each distribution. Finally, by limiting the amount that would be distributed to the beneficiary each year, this approach provided some built-in protection against the beneficiary's squandering the money (and for qualified plans, and IRAs in some states, protection from the creditors of the beneficiaries).

Under the new law, however, distributions to most designated beneficiaries will be subject to the ten-year rule. As a result, for distributions from accounts other than Roth accounts, the taxable income recognition could only be spread over a maximum of ten years. This may result in larger annual distributions over the shortened distribution period that would be taxable at higher marginal tax rates than would have been the case under the old rules. In addition, participants will need to determine alternative ways (such as having the benefits paid to an accumulation trust or a charitable remainder trust, as discussed further below) to address spend-thrift and creditor claim concerns raised by the resulting distributions to beneficiaries at younger ages.

Because the spousal distribution rules are unchanged, planning for stretching out the distributions over the spouse's life expectancy, as recalculated each year, no doubt will remain an important part of a married participant's planning. Some estate plans provide for death benefits equal to the greater of the income of the retirement account or the RMD to be distributed to a QTIP trust that is required to distribute the amount received each year to the participant's surviving spouse.[13] The surviving spouse that is the beneficiary of the QTIP trust under this arrangement should qualify as an eligible designated beneficiary under the new law, and thus the plan distributions should not be subject to the ten-year rule. If, on the other hand, the trustee has discretion to either distribute or accumulate amounts received from the plan or IRA, then the spouse would not be treated as the sole beneficiary of the death benefit (since any accumulated distributions could end up being distributed to another beneficiary after the spouse's death). As a result, under the new rules, distributions to the trust would need to be made within ten years (five years if any of the potential beneficiaries would not be individuals or see-through trusts for their benefit) after the participant's death.

Similarly, participants will want to consider taking advantage of the limited exceptions to the ten-year rule afforded minor children, disabled and chronically ill individuals, and beneficiaries not more than ten years younger than the participant. However, if and to the extent those exceptions are not, or cease to be, available, the ten-year rule will apply, and income tax and financial consideration will need to be given in determining how best to time distributions within the confines of that rule.

Planning Considerations to Address New Rules

Some of the planning ideas that might be considered in light of these new rules would include:

a) Converting some or all of the IRA or qualified plan account into a Roth account during the participant's lifetime, if it is believed that the participant will be subject to a lower tax rate at the time of conversion than the beneficiaries will be at the time of distribution;

b) Having benefits paid into an accumulation trust to provide protection from creditor claims or the imprudence of the beneficiary, notwithstanding that most of the amounts distributed to the trust will be subject to tax at the highest marginal rates.[14] Use of an accumulation trust, instead of a

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[13] *See* Rev. Rul. 2000-2 and Rev. Rul. 2006-26, which indicate that if distributions are structured in this manner, the trust will qualify for the federal estate tax marital deduction under Section 2056(b)(7) of the Internal Revenue Code of 1986, as amended.
[14] Under current law, taxable income of accumulation trusts in excess of $12,950 is taxed at the highest marginal federal tax rate of 37%.

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conduit trust, will avoid having to make distributions to the designated beneficiary before the end of the ten-year deferral period.

c) If an accumulation trust is the designated beneficiary, consider providing the trustee with the discretion to make decisions with respect to the timing of distributions from the IRA, and distributions to trust beneficiaries, within the confines of the new rules, to maximize tax and financial planning flexibility. If all of the beneficiaries of the trust are individuals, this approach has the advantage of allowing plan and IRA distributions to be delayed for up to ten years after the participant's death.

d) If the surviving spouse is a beneficiary, consider designating a conduit trust for the benefit of the spouse, instead of an accumulation trust, so that distributions could be delayed until the participant's RMD and can be paid over the spouse's life expectancy, recalculated each year.

e) Alternatively, consider designating the spouse directly as the beneficiary, rather than a trust for his or her benefit, so that the spouse could rollover the death benefit into his or her own IRA account, or elect to treat the participant's account as his or her own account, for purposes of determining when RMDs would need to commence. This may be particularly effective in stretching out the distribution if the spouse is significantly younger than the participant. This election is only permitted if the spouse is the sole beneficiary of the IRA and has an unlimited right to withdraw amounts from the IRA, and may not be made if a trust is the beneficiary, even if the spouse is the sole beneficiary of the trust.[15]

f) If more than one beneficiary is designated, planning flexibility should continue to be able to be achieved by dividing the account into separate accounts for each beneficiary by no later than the last day of the calendar year following the calendar year of the participant's death. If that is done, then under the rules in effect prior to the SECURE Act, which should continue to be applicable for this purpose, the required minimum distribution rules should be applied separately to each separate account.[16] Thus, for example, the spousal distribution rules should apply to the separate account created for the spousal beneficiary, even though a separate account for a charity would need to be distributed within five years after the participant's death.

g) Designating a "charitable remainder trust," or "CRT," as the beneficiary. Although death benefits payable to a CRT would be subject to the five-year rule, a CRT generally is not subject to federal income tax, and thus would incur no tax upon its receipt of the death benefit. The CRT then could, for example, stretch its payments over a child or grandchild's lifetime, who would be taxable as and when distributions are received under the rules applicable to CRTs. To qualify as a CRT, the value of the remainder interest payable to charity on the death of the lifetime beneficiary would need to be at least 10% of the initial net fair market value of all of the property placed in the trust.

Conclusions

The new rules are effective as of Jan. 1, 2020, and will have a significant impact on those qualified plan participants and IRA owners who have utilized the "stretch IRA" approach as part of their estate planning. Accordingly, those who have done so should promptly consider the effect of the changes upon their estate plans, and make revisions where appropriate. The "stretch IRA" concept remains a viable planning approach. However, the new law generally will require that beneficiaries, other than surviving spouses,

[15] *See* Treas. Reg. 1.408-8, Q&A 5.
[16] *See* Treas. Reg. 1.401(a)(9)-8, Q&A 2&3

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receive larger distributions at younger ages, which may raise tax and spendthrift concerns that must be addressed. These concerns may drive more and more participants to designate accumulation trusts as beneficiaries of their qualified plan and IRA benefits that may be subject to the highest marginal federal tax rates applicable to trusts, or to designate a charitable remainder trust as the beneficiary.

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