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THE SECURE ACT

AND OTHER RECENT DEVELOPMENTS

IN ESTATE PLANNING FOR

RETIREMENT ASSETS

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THE SECURE ACT

**AND OTHER RECENT DEVELOPMENTS IN ESTATE
PLANNING FOR RETIREMENT ASSETS**



Topics

DESIGNATION OF INDIVIDUALS AS BENEFICIARIES OF QUALIFIED PLANS/IRAS

LEAVING RETIREMENT ASSETS TO TRUSTS

ESTATE PLANNING IN LIGHT OF THE SECURE ACT

MISCELLANEOUS PROVISIONS FROM THE SECURE ACT PROPOSED REGULATIONS

CREDITOR ACCESS TO INHERITED IRAs

IRA OWNERS/RETIREMENT PLAN ADMINISTRATORS BEHAVING BADLY

NAMING CHARITY(S) AS BENEFICIARY OF THE IRA

LIFETIME GIFTS OF QUALIFIED RETIREMENT BENEFITS TO CHARITY

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**THE SECURE (“SETTING EVERY COMMUNITY UP FOR
RETIREMENT ENHANCEMENT” OR “SENDING
EVERYONE COWERING UNDER REDUCED
EXPECTATIONS”) ACT AND OTHER RECENT
DEVELOPMENTS IN ESTATE PLANNING FOR
RETIREMENT ASSETS**

A Presentation for the Indiana Continuing Legal Education Forum

Digital Seminar

October 27, 2022

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ENHANCEMENT” OR “SENDING EVERYONE COWERING UNDER REDUCED
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I. INTRODUCTION

A. If you take a step back and honestly assess the portion of total estate planning time spent for a client on planning for the client's retirement benefits, do you feel it is proportionately appropriate?

B. Prior to 2010, one could argue that, due to the relative estate/gift tax rates and exemptions then applicable and the number of clients to which the estate/gift tax applied, the majority of our planning time was necessarily focused on estate and gift tax planning techniques, to the potential detriment of appropriately considering the planning options with respect to retirement benefits.

C. I wish to make the case that, in the current tax law environment, especially with the enactment of the new tax law, planners should spend a disproportionate amount of planning time with respect to clients' retirement benefits.

1. According to the Urban-Brookings Tax Policy Center, the current estate and gift tax rates and exemptions impact only .15% of the U.S. population in general (and this was prior to the TCJA of 2017).

2. To the contrary, almost every client we encounter in the planning context has a retirement plan interest of sufficient size to warrant a greater amount of our attention.

D. Let us remind ourselves why retirement benefits are so unique so as to warrant a disproportionate amount of our planning time.

1. During a participant's life, retirement plan assets, while enjoying terrific income tax deferral options, remain "pregnant" with future income tax liability.

2. Maximum funding of retirement plan assets is a very effective asset protection technique.

3. The mere completion of a beneficiary designation form, which happens on too many occasions with the assistance of someone who provides no tax or planning advice whatsoever, may greatly impact the amount and the timing of income taxation on the distribution of these benefits.

4. Unlike any other asset, directing retirement benefit assets to a trust involves a myriad of complicated rules and planning implications, as well as potential non-sensical income tax results (albeit a different set of implications under the SECURE Act).

5. Unlike most items of inheritance, every dollar distributed from a qualified retirement plan to a non-charitable beneficiary is subject to income tax.

6. In some states, a beneficiary's interest in a deceased participant's retirement plan can continue to enjoy creditor protection.

7. Retirement plan benefits open the door for a variety of proactive charitable planning techniques (especially after the SECURE Act!)

E. In February of this year, Treasury issued proposed regulations addressing some of the issues presented by the SECURE Act.

F. All references in this outline to an IRA shall be deemed to refer to a non-Roth IRA, unless specifically provided otherwise.

II. DESIGNATION OF BENEFICIARIES OF QUALIFIED PLANS/IRAS

A. You Must Follow the Literal Guidelines of the Retirement Plan Document in Completing a Qualified Plan Beneficiary Designation (however, reformation is not out of the question).

1. In Ruiz v. Publix Super Markets, Inc., Case No. 8:17-cv-735-T-24 TGW, the U.S. District Court of the Middle District of Florida held that substantial compliance with plan requirements for designation of a beneficiary of a qualified retirement plan was not good enough to constitute an effective beneficiary designation.

2. The District Court relied heavily on the principles of the Supreme Court decision in Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, 555 U.S. 285 (2009). A recent Fifth Circuit Court of Appeals decision affirms these basic principles in Kinder Morgan Incorporated v. Crout, (No. 19-20037, 05/18/2020).

3. In a slip opinion which does not include the background facts, the Appellate Division of the New York Supreme Court reversed the decree of the Surrogate's Court of New York County and allowed a reformation of an IRA beneficiary designation. This changed the beneficiary from a "philanthropic fund" to the decedent's spouse of thirty-nine (39) years. *Matter of Sukenik*, 2018 NY Op. 04658 (June 21, 2018).

B. Distribution Rules During Life and After Death.

1. Distributions During the Taxpayer's Lifetime

a. In order to advise your client in structuring his or her IRA beneficiary designation, you have to be familiar with the minimum distribution rules. The required minimum distribution ("RMD") rules specify how long a taxpayer (and after the taxpayer's death, the beneficiary(s)) may defer withdrawals from retirement accounts. IRC § 401(a)(9).

b. During life, the taxpayer must generally begin taking withdrawals by April 1 of the year after the taxpayer reaches age 72. This date is referred to as the required beginning date ("RBD"). (For certain employees, the RMDs do not have to begin until the calendar year of retirement if the employee retires after age 72).

c. An IRS table that takes into account the taxpayer's life expectancy sets the RMD amount the taxpayer must withdraw in each year after the RBD. Treas. Reg. § 1.401(a)(9)-5.

(1) Unless the account owner's spouse is more than ten (10) years younger than the account owner, then the account owner will use the "Uniform Lifetime Table." Treas. Reg. § 1.401(a)(9)-9(A-2).

(2) If there is a spouse more than ten (10) years younger, then the account owner uses the "Joint and Last Survivor Table." Treas. Reg. § 1.401(a)(9)-9(A-3).

d. Distributions from qualified retirement plans that are taken before the taxpayer reaches the age of 59 ½ are subject to an additional 10% "early withdrawal" tax, unless the distribution falls within a statutory exception. IRC § 72(t).

(1) Code §72(t) was amended recently to expand the "Public Safety Employee" exception to the general rule of requiring a 10% additional tax on early distributions. Specifically, the Defending Public Safety Employees Retirement Act (H.R. 2146) was enacted after being signed by President Obama on June 29, 2015. One aspect of this legislation allows retired federal public safety officers to access their Thrift Savings Plan funds at age 50 without incurring the 10% early withdrawal penalty.

e. Recently, the courts have clarified under what circumstances this 10% tax will be imposed.

(1) In Kott v. C.I.R., T.C. Summ.Op. 2015-42 (2015), a taxpayer who was younger than age 59 ½ and delinquent in his mortgage payments withdrew funds from his 401(k) plan account in order to use such funds to avoid foreclosure. The Tax Court held that the taxpayer was liable for the 10% early distribution penalty as the Code does not include an exception for a general “financial hardship.” While the Tax Court noted Reg. § 1.401(k)-1(d)(3)(iii)(B)(4), which allows for distributions to be made to employees for payments necessary to prevent eviction from the employee’s principal residence or foreclosure, the Tax Court held that this exception only permitted the hardship distributions be made, and does not exempt the distributions from the 10% additional early distribution tax.

(2) In Adams v. Commissioner, the taxpayer lost his job with the Department of Defense and immediately filed suit for wrongful termination based on discrimination. Because he could not find another comparable job, the taxpayer took out over \$220,000 from his IRA; he was under 59½ years old at the time. He reported all but \$70,000 as income, and did not self-assess the premature withdrawal penalty. Upon examination by the IRS, Adams claimed that the penalty should not apply, as the withdrawals resulted from discrimination at work and were needed for medical care and “to fight for justice.” The Service said fine, please

provide receipts and other documentation. Adams never provided any documentation, and the Tax Court held that the 10% premature withdrawal penalty applied (as well as the other penalties for underreporting income).

(3) In *In re Bradford*, 2015 WL 4549603 (Bankr. M.D. Ga., July 20, 2015), a Georgia bankruptcy court indicated that the early distribution tax imposed by §72(t) is an excise tax, and not a punitive tax measure, for purposes of bankruptcy.

(a) In examining the legislative history behind §72(t) of the Code and several relevant Supreme Court cases, the court held that this tax was enacted to deter debtor conduct rather than to support the government. Specifically, the court believed that the tax sought “to prevent retirement plans from being treated as savings accounts, to recapture a measure of tax benefits that have been provided prior to the withdrawal, and to deter the use of retirement funds for nonretirement purposes.” *In re Cassidy*, 983 F.2d at 164.

(b) Next, the Court determined whether the penalty was entitled to priority as compensation of the government’s actual pecuniary loss. After finding that the government sustains little loss if any when the tax recoups a loss to the government incurred through the taxpayer’s deferment of income and that the losses claimed by the IRS do not constitute actual pecuniary loss, the Court held that Code § 72(t) is not entitled to priority.

(c) Ultimately, the court found the exaction was neither a tax, as it was not enacted to support the government, nor a penalty in compensation for actual pecuniary loss under Code § 507(a)(8). Therefore, the 10% exaction was not entitled to priority in the debtor's bankruptcy case.

f. How to reduce your clients RMDs.

(1) Your client can buy a qualified longevity annuity contract inside his or her IRA. This contract does not start paying the client an annuity until the client attains age 85. The funds used to purchase the annuity will have many years to accumulate and grow, so the income eventually received will be larger. Normally, such a delayed annuity is not permitted for IRAs, as the minimum distribution rules require RMDs no later than the RBD. The IRS has made an exception for qualified longevity annuities with up to \$125,000 of the IRA balance, or 25% of the IRA owner's total IRA balance if it is less than \$125,000.

(2) If a client is still working after attaining age 72, he or she may be entitled to reduce compensation income by tax deductible contributions to some type of retirement plan. These tax deductible contributions provide a current tax deduction reducing the income tax effect of his or her RMDs from other IRAs. If the client is self-employed, the client can adopt a SEP-IRA, to which such contributions may be made.

(3) If your client works for a non-profit entity, or a for-profit company if the client has less than 5% ownership in that company, and such entity has a qualified retirement plan that accepts rollovers from IRAs, the client can rollover his or her IRA into the company plan and then not have to take RMDs from that plan until actual retirement from that employer.

(4) If the client participates in an employer's qualified retirement plan, and has "after-tax money" in that plan, then upon retirement from that company the client should request that the plan send a direct rollover of all pre-tax money to a traditional IRA and the after-tax money to a Roth IRA. In essence, this is a tax-free Roth IRA conversion.

(5) Of course, there is always the plain old Roth conversion of the client's traditional IRA, as Roth IRAs do not require RMDs during the owner's life. However, the client must be willing to pay tax on the amount converted as though it were distributed from the plan at that time.

(6) We also have the ability to make a Qualified Charitable Distribution, discussed in more detail later in this outline.

2. Distributions After Death if the Spouse is Beneficiary.

a. The concept of a spousal rollover was NOT changed by the SECURE Act. We are all familiar with the rules enabling a spouse to roll over retirement benefits upon the death of his or her spouse, and they will not be repeated

here. However, there are a few recent developments in this area that are worth discussing.

b. In 2009, the ACTEC Estate Planning for Employee Benefits Committee initially requested that the IRS issue a revenue ruling with respect to spousal rollovers of qualified plan and IRA benefits when an estate or trust is named beneficiary of a decedent's interest.

(1) This request was repeated in 2010 and every year thereafter, and guidance on this issue has been requested in connection with the ACTEC recommendations for the IRS Guidance Priority Plan in each of the last several years. So far, this has fallen upon deaf ears.

(2) Several hundred favorable private letter rulings have been issued over the last ten years, and it makes no sense for taxpayers to expend the filing fee required for a private ruling.

(3) As an example, in PLR 201511036, the IRS allowed spousal rollover treatment when the decedent's estate was named as beneficiary of several IRAs, and the spouse was the executor of the estate, the Trustee of decedent's trust, and was the income beneficiary and had a general power of appointment over the trust which was ultimately to receive the IRA proceeds.

(4) The most recent rulings in this regard include PLR 201821008, wherein the "default" beneficiary was the IRA owner's estate, and

the surviving spouse was the personal representative of the decedent's estate and the sole beneficiary of the estate. This favorable ruling was issued even though the IRA provider withheld taxes on the IRA distribution prior to paying the net amount over to the estate. The spouse received good advice, as she deposited the amount of the net proceeds plus the amount of the taxes withheld into a spousal rollover IRA in her name. In PLR 201831004, the IRS approved a spousal rollover when the beneficiary was the decedent's "Survivor's Trust" under a joint spousal trust, under which the surviving spouse was the sole income and principal beneficiary and had an unlimited power of appointment over the Trust. A similar result was more recently obtained in PLR 201923002.

(5) PLR 201839005, wherein the decedent did NO estate planning, the IRS examined a ruling request involving decedent's retirement plan under which the decedent failed to designate any post-death beneficiary. The plan provided that, in such event, the plan benefit was payable to decedent's estate. Under applicable state law, decedent's estate would be split between surviving spouse and children. The children all executed valid disclaimers of their interests in the decedent's estate, leaving spouse as the sole beneficiary of the estate. The IRS blessed spousal rollover treatment, after all of these timely post-death maneuvers.

(6) PLR 201901005 involved similar facts as PLR 201839005, except a Trust was named as IRA beneficiary. Trust timely disclaimed

its interest, and then son and two grandchildren all timely disclaimed their respective interests in decedent's estate, leaving only the spouse as a beneficiary of the estate. IRS again blessed spousal rollover treatment.

(7) PLR 201944003 reached a similar result with respect to a Survivor's trust share of a joint community property trust.

c. The immediate spousal rollover is not always the best strategy.

(1) If the surviving spouse is under 59 ½ years of age, he or she should consider **delaying** the rollover until he or she attains the age of 59 ½ years. In that manner, he or she can take some distributions prior to that date of attainment without paying a premature withdrawal penalty.

(2) If the surviving spouse is older than the decedent, who died before attaining age 72, then the survivor can continue tax-free deferral and do a delayed rollover.

d. The Impact of the Windsor Ruling.

(1) As we all know, on June 26, 2013, the U.S. Supreme Court held in U.S. v. Windsor, 133 S.Ct. 2675 (2015) that Section 3 of the Defense of Marriage Act "DOMA" is unconstitutional.

(2) The IRS issued follow-up guidance for same-sex marriages in Revenue Ruling 2013-17 and Notice 2014-19.

(3) Generally, participants and their spouses who are in same-sex marriages must be treated as married for all purposes under a qualified retirement plan as of June 26, 2013.

(a) A sponsor of a qualified retirement plan may elect to recognize same-sex marriages as of a date that is prior to June 26, 2013, for some or all purposes under the plan. A plan amendment would be required to implement this optional retroactive effective date.

(b) If a qualified plan defines “spouse”, “legally married spouse”, “spouse under federal law”, etc. in a manner consistent with Windsor, or does not define those terms, then the plan does not need to be amended so long as the plan has been properly administered.

(c) However, if the plan’s definitions of these terms are not consistent with the holding in Windsor, then the plan must be amended.

(4) For ERISA, Internal Revenue Code, and DOL Regulation purposes, the following is true:

(a) The term “spouse” includes an individual married to a person of the same gender IF he or she is lawfully married under state law (including foreign jurisdictions).

(b) The term “marriage” includes a marriage between individuals of the same gender.

(c) The term “spouse” does not include an individual in a registered domestic partnership or a civil union, and the term “marriage” does not include a registered domestic partnership or a civil union.

(d) A same-sex marriage validly entered into in a state or foreign jurisdiction that permits same-sex marriages will be recognized regardless of whether the couple moves to or lives in a state that does not permit or recognize same-sex marriages.

(5) In Schuett v. FedEx Corporation, et al., No. 15-CV-0189, N.D. Calif., 2016 U.S. Dist. LEXIS 224, the Federal District Court in the Northern District of California applied Windsor retroactively, allowing a lesbian widow to pursue her claim to spousal benefits under her deceased spouse’s pension plan. This same sex couple was married on June 19, 2013, and one of the spouse’s passed away one (1) day later. Six (6) days later, the United States Supreme Court issued its decision in Windsor.

e. The impact of the Obergefell holding.

(1) Following in the wake of Windsor in 2013, on June 26, 2015, the United States Supreme Court in Obergefell v. Hodges, 135 S.Ct. 2584 (2015) held that same-sex married couples are entitled to equal protection under the laws of every state, and that their marriages must be recognized

nationwide. As such, any state prohibitions against the recognition of a same-sex marriage were held to violate the 14th Amendment and were invalidated.

(2) Because state laws banning same sex marriage are effectively invalidated, after Obergefell, same-sex couples are afforded the same spousal rights that other couples enjoy. Spousal rights that occur independent of proactive planning and that are now equally granted to same-sex couples include, among others, (i) spousal survivorship rights under state pension or other retirement benefits, even in states that previously did not recognize same-sex marriage and the ability to file tax returns as a married couple and (ii) take advantage of the married couple's state estate tax exemption where applicable.

(3) After Windsor, same-sex married couples are to receive equal treatment under federal law and are to be treated the same as any other married couple for federal tax purposes and for other benefits under federal law (including spousal rights under ERISA, etc.). Now, in the aftermath of Obergefell, same-sex couples have been elevated to equal stature with other marriages and are entitled to equal protection under the laws of every state.

3. Distributions After Death if a Non-Spouse is Beneficiary (Non-Spouse Rollovers)

a. If someone other than the spouse is the beneficiary, under the SECURE Act, the beneficiary's RMD now depends on whether there is a (1)

“Designated Beneficiary” (“DB”), (2) “Eligible Designated Beneficiary” (“EDB”), or (3) “non-Designated Beneficiary” (“non-DB”) of the account.

b. The term “Designated Beneficiary” is specifically defined in Treasury Regulation § 1.401(a)(9)-5, and was not changed by the SECURE Act. Although individuals qualify as Designated Beneficiaries, estates, states, charities, and business entities do not qualify as Designated Beneficiaries for these purposes. Treas. Reg. § 1.401(a)(9)-4. As discussed in more detail later in this outline, only certain trusts qualify as a Designated Beneficiary.

c. The term “Eligible Designated Beneficiary” has been introduced by the SECURE Act. An Eligible Designated Beneficiary is:

(1) The surviving spouse of the participant.

(2) A minor child of the participant (not just any minor child). The life expectancy payout applies to the child until the child attains the age of majority.....then the ten year rule starts. There was lots of uncertainty created by the SECURE Act itself as to when the age of majority is reached. The proposed regulations provide a bright line rule that age 21 is the age of majority.

(3) A disabled individual (as defined in Internal Revenue Code Section 72(m)(7)). The life expectancy payout applies to the disabled individual, and upon his death, the ten year rule starts.

(4) A chronically ill individual (as defined in Internal Revenue Code Section 7702B(c)(2)). The life expectancy payout applies to the chronically ill individual, and upon his death, the ten year rule starts.

(5) An individual who is less than ten years younger than the participant. The life expectancy payout applies to this beneficiary, and upon his death, the ten year rule starts. The proposed regulations modify this provision by basing the less than ten years younger determination on actual dates of birth.

d. A trio of 2016 private letter rulings illustrate the rigidity of the Designated Beneficiary rules. In each of these letter ruling fact patterns, the taxpayer had designated a beneficiary on his IRA showing three separate trusts, each of which qualified as a Designated Beneficiary. Later that year, the taxpayer's financial advisors joined another firm and became affiliated with a different custodian, which required new IRA documents. At that time, the custodian had the taxpayer sign new beneficiary forms, which named the taxpayer's estate as the primary beneficiary. Upon the owner's death, this error was discovered and the trustees of the trusts petitioned the local probate court to reform the beneficiary designation retroactive to the time before the mistaken form was executed by the decedent which relief was granted by the local court. However, in each of these rulings, the IRS refused to recognize the reformed designations, and held that the

estate was the beneficiary at the time of the taxpayer's death, and therefore, none of the IRAs had a Designated Beneficiary.

e. If there is a Designated Beneficiary -

(1) If the taxpayer died before the taxpayer's RBD, then the beneficiary's interest must be withdrawn within ten (10) years after the participant's death. The proposed regulations confirm that the "ten-year rule" shall be applied in the same manner as the older "five-year rule." There is NO requirement of annual distributions, as long as the entire interest is paid out by the end of the calendar year which includes the tenth anniversary of the participant's death.

(2) If the taxpayer died after the taxpayer's RBD, the proposed regulations provide that BOTH (i) the ten (10) years after the participant's death rule applies; and (ii) the taxpayer's life expectancy from the Single Life Table, based on the taxpayer's age in the calendar year of the taxpayer's death ("the ghost life expectancy") rule applies. In other words, the designated Beneficiary must take annual distributions based on the "ghost life expectancy" beginning in the year following the year of the participant's death, AND in any event, the entire account must be distributed by the end of the tenth year. In a very confusing twist, the proposed regulations further provides that in applying the "ghost life expectancy,"

the denominator is the greater of the participant's remaining life expectancy, or the beneficiary's life expectancy.

f. If there is an Eligible Designated Beneficiary –

(1) For most of the Eligible Designated Beneficiaries, a life expectancy payout may still be taken, using existing IRS life tables. Upon the death of the Eligible Designated Beneficiary, the ten-year payout rule then ensues. However, the proposed regulations provide that annual distributions are required during the ten year period!

(2) The proposed regulations provide that an Eligible Designated Beneficiary of a participant who dies before his or her RBD can elect to use the 10 year rule in lieu of the life expectancy payout.

(3) For a minor child of the participant, a life expectancy payout is used until the earlier of the death of the child or the child attaining the age of majority. Thereafter, a ten-year payout rule is used.

(4) For a “disabled” or “chronically ill” beneficiary, the documentation of such status is a critical issue.

(a) If the named beneficiary has already been determined disabled for purposes of Social Security disability benefits purposes, the beneficiary does not need to convince the IRS of his or her disability. An individual who has attained age 18 as of the participant's death is “disabled” if, as of that date,

such individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result on death or be of long-continued and indefinite duration.

(b) If such individual is under age 18, he or she is disabled if that person has a medically determinable physical or mental impairment that results on marked and severe functional limitations and can be expected to result on death or be of long-continued and indefinite duration.

(c) TO QUALIFY AS AN EDB, the beneficiary who is either disabled or chronically ill must provide the plan administrator documentation of the disability or chronic illness no later than October 31 of the year following the year of the participant's death, and for chronically ill beneficiaries, such documentation must also include a certification from a licensed health care practitioner.

(d) Many disabled beneficiaries do not qualify for "SSDI", and therefor do not have an SSDI determination.

(e) ACTEC has made a couple of key recommendations for revising these proposed regulations in this regard. First, we suggest the usage of the regulations under the "ABLE" tax law in lieu of the SSDI determination. Second, we suggest that the determination of disability of a minor be deferred until the minor attains the age of 21 years.

g. If there is no Designated Beneficiary –

(1) If the taxpayer died before the taxpayer's RBD, then the beneficiary must withdraw all of the retirement account within 5 years of the taxpayer's death.

(2) If the taxpayer died after the taxpayer's RBD, then the beneficiary's RMD is based on the Single Life Table that takes into account the deceased taxpayer's life expectancy immediately before death ("the ghost life expectancy").

h. The beneficiary may withdraw more than the RMD in a given year, but the beneficiary must withdraw at least the RMD each year to avoid IRS imposition of a penalty.

(1) Although payouts other than lump sum distributions in IRAs are common, not all IRAs offer this option.

(2) Many qualified plans typically require a lump sum distribution upon death.

(3) However, the Pension Protection Act of 2006 added Code § 402(c)(11), which now allows a non-spouse Designated Beneficiary to rollover a qualified plan account into an IRA by a trustee to trustee transfer.

4. Sixty (60) day rollover for inherited retirement benefits.

a. A participant, IRA owner or spousal beneficiary may take distributions of qualified plan or IRA assets and roll them over into another qualified plan or IRA within sixty (60) days of such distribution. However, any other non-spousal beneficiary cannot do such a rollover, but may do a direct trustee-to-trustee transfer.

b. Recent Private Letter Rulings have addressed specific scenarios that allow for a waiver of the 60-day rollover requirement:

(1) In PLR 201529016, the IRS, pursuant to Code §402(c)(3)(B), waived the 60-day rollover requirement where the taxpayer's failure to timely rollover funds was due to her medical and emotional condition following her spouse's death that impaired her ability to manage her financial affairs.

(2) In PLR 201529017, pursuant to Code §408(d)(3)(I), the IRS waived the 60-day requirement where the taxpayer's failure to timely rollover funds was due to the financial institution's failure to follow the taxpayer's instructions to keep those funds in his IRA.

(3) In PLR 20152901, again, pursuant to Code § 408(d)(3)(I), the IRS waived the 60-day rollover requirement where the taxpayer's failure to timely rollover funds was due to the bank making unauthorized distributions from his retirement accounts.

c. Rev. Proc. 2016-47, issued on August 24, 2016 establishes a “self-certification” procedure enabling the taxpayer to complete a rollover without the expense and hassle of a private letter ruling request.

(1) Prior to this Revenue Procedure, you could obtain a waiver of the 60-day rollover deadline only by making application to the IRS, paying a \$10,000 filing fee, and waiting at least a year to get an answer.

(2) To qualify for this new self-certification approach, you must satisfy three requirements.

(a) You must not have been previously denied a waiver by the IRS for this particular distribution.

(b) You must have been unable to complete the rollover due to one or more of the eleven reasons listed below; and

(c) You must complete the rollover as soon as practical after you are no longer prevented from doing so due to the reasons you have certified.

(3) The following eleven (11) reasons are “blessed” by the IRS as justifying a waiver:

(a) An error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates.

(b) The distribution was made in the form of a check which was misplaced and never cashed.

(c) The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan.

(d) The taxpayer's principal residence was severely damaged.

(e) A member of the taxpayer's family died.

(f) The taxpayer or a member of the taxpayer's family was seriously ill.

(g) The taxpayer was incarcerated.

(h) Restrictions were imposed by a foreign country.

(i) Postal error.

(j) The distribution was made on account of a levy under Internal Revenue Code Section 6331 and the proceeds of the levy have been returned to the taxpayer.

(k) The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

(4) Be careful! If the taxpayer's return is audited, and a material misstatement was made in the self-certification of the rollover of an IRA distribution or one of the other requirements for self-certification was in fact not met, the IRS can still disallow the waiver, which will lead to income taxes, plus interest, plus penalties.

C. Separate Accounts and Multiple Beneficiaries.

1. If there are multiple beneficiaries of a retirement account, it is still important in some situations to establish separate accounts on a post-mortem basis. Treas. Reg. § 1.401(a)(9)-5, A-7(a)(1).

2. If separate accounts are "established" for multiple beneficiaries prior to December 31 of the year after the calendar year of the taxpayer's death, then the RMD rules will apply separately to each such separate account. Treas. Reg. § 1.401(a)(9)-4, A-5(c); Treas. Reg. § 1.401(a)(9)-8, A-2(a)(2).

a. To establish separate accounts, the beneficiaries' interests must be fractional (i.e. not pecuniary). In addition, some affirmative act is required to establish the separate accounts (i.e., a physical division of a single account into completely separate accounts, or using separate account language on the beneficiary designation form).

b. Whenever possible, it is best to create the separate accounts with appropriate language directly on the beneficiary designation form,

especially after the SECURE Act, vis a vis potential Eligible Designated Beneficiaries.

3. Is separate account treatment available when a trust is the beneficiary of an IRA?

a. Treas. Reg. § 1.401(a)(9)-4, A-5(c) clearly provides that the separate account rules are not available to individual beneficiaries of a trust with respect to the trust's interest in the participant's retirement plan.

b. PLR 201503024 provided a lesson to the effect that, you should not believe every word you read in IRS regulations! This PLR involved an IRA wherein the decedent's trust was named as beneficiary, and such trust provided for ultimate distribution of its residuary to five (5) individual beneficiaries.

c. A similar result was recently obtained in PLR 201924013, and recent PLRs 201909003 and 201927009 extended this rationale and result to the context of an estate with multiple individual beneficiaries.

d. However, the proposed regulations provide that separate account treatment is not allowed for multiple trust shares under a single trust UNLESS the separate trust shares are named directly as the IRA or plan beneficiaries (with an important exception for disabled and chronically ill beneficiaries)..

D. Eliminating Unwanted Beneficiaries Prior To September 30th.

1. The deadline for determining who the initial beneficiaries of a retirement account is the date of the taxpayer's death.

2. However, between the taxpayer's death and September 30th of the year following the year of the taxpayer's death, sometimes called the Beneficiary Determination Date ("BDD"), non-individual beneficiaries may be removed by a disclaimer of the interest, creating separate accounts, or eliminating them as beneficiaries by distributing their benefits outright to them in full. Treas. Reg. § 1.401(a)(9)-4, A-4(a). This is still true under the SECURE Act!

E. Roth IRAs

1. Although we do not have near as much heartburn about the structure of beneficiary designations on Roth IRAs, the above-described RMD rules apply to the beneficiaries of a Roth IRA, and the RMD is computed as though the decedent had died before his RBD. Treas. Reg. § 1.408A-6, Q&A (14)(b).

2. As you know, contributions to a Roth IRA have already been taxed, and therefore, qualified distributions from such Roth IRAs are not subject to income tax. Nonetheless, it is still important to be able to defer distributions from the Roth IRA as long as possible, so that the assets inside the Roth IRA continue to appreciate income tax free. Accordingly, it is still critical for the beneficiary of a Roth IRA to be considered a "Designated Beneficiary" or an "Eligible Designated Beneficiary".

3. If the Roth IRA owner is interested in generation-skipping planning with adult grandchildren, naming the adult grandchildren as the beneficiaries of the Roth IRA will be a more efficient utilization of the GST exemption than naming them as beneficiary of a traditional IRA (since parts of the traditional IRA proceeds will be consumed by income tax liability).

F. What if the IRA owner is incapacitated, and there is no or an inadequate beneficiary designation in place?

1. An agent under a durable power of attorney will need to be specifically empowered to make a new beneficiary designation.

2. Here is suggested sample language –

“To make contributions to and withdrawals from, rollovers, voluntary contributions, or any elections with respect to any retirement plans, including an individual retirement account, and to designate beneficiaries for any rollovers consistent with my overall estate plan;”

3. If there is no general durable power of attorney in place, then a court-appointed conservator (guardian in some states) will need specific court authority, and the acceptance of the IRA custodian, in order to make an effective beneficiary designation.

III. LEAVING RETIREMENT ASSETS TO TRUSTS

A. Situations In Which Trusts Are Crucial

1. In some situations a trust must be named as beneficiary, such as when (i) the beneficiary is a special needs child that relies on government benefits, (ii) the beneficiary is a second spouse whom you want to have limited access to the trust principal, (iii) the beneficiary is a minor, (iv) the beneficiary is a spendthrift, has substance abuse problems, etc., and (v) when retirement account assets must be used to fund a credit shelter trust. (discussed below).

2. In these situations, the client may decide the reasons for naming a trust as beneficiary of the IRA outweigh the potential of lost income tax deferral, or may decide a look-through trust is appropriate.

B. What Are Look-Through Trusts, or See-Through Trusts?

1. A trust that qualifies as a Designated Beneficiary is often referred to as a “look-through trust” or “see-through trust”. This has not changed under the SECURE Act. The proposed regulations officially adopt certain terminology that we have used in some fashion for some time. A “see-through trust” is a trust that is treated as a DB for required minimum distribution purposes. A “conduit trust” (discussed below) is one kind of a see-through trust. An “Accumulation trust” is any qualified see-through trust that is not a conduit trust.

a. If a taxpayer names a see-through trust as the beneficiary, then the trust will qualify as Designated Beneficiary (same as the old law), and **may** qualify as an Eligible Designated Beneficiary.

b. In essence, for these purposes, the trust is ignored and the beneficiaries of the trust are treated as the beneficiaries of the retirement account. This analysis remains important under the SECURE Act.

2. An Accumulation trust must satisfy five tests to qualify as a Designated Beneficiary. These rules were not changed by the SECURE Act.

a. The first four tests are as follows: (i) the trust must be valid under state law, (ii) the trust must be irrevocable or become irrevocable at the taxpayer's death, (iii) the trust beneficiaries must be identifiable, and (iv) certain documentation must be provided to the plan administrator or IRA custodian by October 31 of the year after the taxpayer's death.

b. If these four tests are met, then the trust is a Designated Beneficiary.

c. There is, in essence, a fifth test for the trust to be a Designated Beneficiary, as all of the beneficiaries of the trust must be individuals the oldest of whom can be identified. Herein lies our time-honored dilemma in drafting see-through trusts.

d. What Trust Beneficiaries Can Be Ignored?

(1) It has historically been a challenge to draft a trust that only has individual beneficiaries and where it is possible to ascertain the oldest beneficiary (especially when the IRS has not told us which contingent beneficiaries can be ignored!).

(2) The current official regulations provide that if the first four tests above are met, then the beneficiaries of the trust are considered beneficiaries of the retirement account. The question is, which beneficiaries must be considered?

(3) The current official regulations provide two rules in this regard.

(i) The general rule is that with respect to determining if there is a beneficiary of the trust that is not an individual (which would disqualify the trust as a Designated Beneficiary), and determining who is the oldest beneficiary, a “contingent beneficiary” must be taken into account.

(ii) The second rule provides that, a person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee’s beneficiaries after that beneficiary’s death. However, the preceding sentence does not apply to a person who has any right (including a

contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death.

(iii) This rather unhelpful regulation tells us that a "contingent beneficiary" must be taken into account, but a "mere potential successor" beneficiary can be ignored. However, it does not bother to define these terms!

e. Recent private IRS letter rulings have not been terribly helpful in providing additional guidance as to which contingent remainder beneficiaries can be ignored.

(1) Under the IRS's analysis in these rulings, if a trust is to distribute the assets outright to a beneficiary upon a life income beneficiary's death, then the only remainder beneficiaries that must be counted are the individuals that would receive those assets, provided those individuals are alive on the taxpayer's death and they have already attained the required age to receive the assets outright.

(2) This ruling is not helpful to dynasty trusts or lifetime trusts with periodic principal distributions or withdrawal rights, as the beneficiary may never be required to take outright ownership of the trust assets.

f. PLR 201633025, published in mid-August of 2016, shed very important light on the IRS' then current thinking on this issue.

(1) In this ruling, a trust was named as beneficiary of an IRA. Under the terms of the trust, the Trustee is to distribute all of the net income of the trust to the decedent's child, and the trustee also has discretion to make principal distributions to the child or the child's issue for health, education, support or maintenance. When the child attains age fifty (50), the trust will terminate and all remaining income and principal will be distributed to the child.

(2) If the child dies prior to attaining age fifty (50), the trust provided that the trust will terminate and will be distributed to the children of the child. If the child and all of the child's issue are deceased prior to the final distribution of the trust assets, the trustee shall distribute the remaining trust assets to the decedent's siblings. If the child, all the child's issue, and the decedent's siblings are all then deceased, then the rest of the trust shall be distributed to various charitable organizations.

(3) The IRS ruled that the only beneficiaries which must be taken into account are the child and the child's children for purposes of determining whether the trust qualifies as a "Designated Beneficiary" for RMD purposes. Therefore, the trust qualified as a "see-through" trust and the trust may receive minimum distributions after the owner's death based on the child's life expectancy. All other potential recipients of the trust were deemed to be mere potential successors! Of course, under the new SECURE Act, this ruling only allows

the usage of a ten year period instead of a five year distribution period in a similar fact pattern.

g. PLR 201840007 is a great recent example of post-mortem maneuvering in order to achieve “see-through” trust treatment and resulting stretching of an IRA payable to decedent’s revocable trust.

(1) Decedent’s trust was named as the primary beneficiary of decedent’s 401(k).

(2) Upon decedent’s death, the trust splits into three (3) separate describing trusts for each of decedent’s three (3) oldest children.

(3) After decedent’s death, the Trustee of the trust engineered a severance agreement which split each of the three children’s trusts into a Trust A and Trust B. Each Trust A and Trust B has different sets of descendants as default remainder beneficiaries.

(4) Each discretionary trust has that child as primary beneficiary. Upon the death of such child, if he or she has attained age thirty (30), such child has a broad special power of appointment, with the potential appointees including any person or charity, other than the child’s estate, the creditors of the child, or the creditors of the child’s estate.

(5) On September 30 of the year following the decedent’s death, as to the Trust share receiving the IRA, each of the three children

executed a Partial Release of Power of Appointment, whereby each released his or her right to appoint to any charity or any individual other than an individual younger than the oldest child.

(6) The IRS ruled that each of the subtrusts qualified as see-through trusts, and RMD's may be stretched over the life expectancy of the oldest child. Under the SECURE Act, this successful see-through ruling under these facts would only buy a ten-year stretch.

h. The proposed regulations under Section 401(a)(9) provide some additional guidelines in determining "countable" beneficiaries.

(1) First, certain "specified beneficiaries", or any beneficiaries who could receive amounts in the trust representing the participant's interest in the plan or IRA that are neither contingent upon, nor delayed until, the death of another trust beneficiary, are always "countable".

(2) Second, certain "secondary beneficiaries", or a beneficiary who could receive amounts in the trust representing the participant's interest in the plan or IRA that were not distributed to the "specified beneficiaries," are NOT countable in the case of conduit trusts, but almost always countable in the case of see-through trusts.

(3) Third, a third category of beneficiaries are those who could receive amounts from the trust that represent the participant's interest in

the plan or IRA solely because of the death of a secondary beneficiary. This third category of beneficiaries are NOT countable. However, if a beneficiary qualifies as both a secondary beneficiary and in the third category of beneficiary, he is characterized as a secondary beneficiary.

i. The proposed regulations still leave uncertainty in this area, as the example in the proposed regulations is very simplistic, leaving open the consequences of dynastic trusts and “spray” trusts. Again, ACTEC has suggested additional examples that provide more clarity in result for these trusts.

C. “Conduit Trusts”

1. Fortunately, the 401(a)(9) regulations do provide a type of safe harbor trust, a “conduit trust”, where a beneficiary will be treated as a Designated Beneficiary. And now, the proposed regulations officially bless the label, “conduit trust”!

a. A conduit trust requires the trustee to distribute all of the retirement account withdrawals to the beneficiary.

b. The trustee may use conduit trust assets to pay expenses attributable to such assets.

c. As the trust may not accumulate any assets withdrawn from the retirement account, the IRS allows the trust beneficiary to be treated as the Designated Beneficiary of the retirement account.

2. Although conduit trusts have the advantage of certainty as they are specifically described in the treasury regulations, they also have a major disadvantage.

a. A conduit trust cannot withdraw retirement account proceeds and accumulate them inside of the trust.

b. This is often contrary to the intent of the client, who may be using a trust to prevent the retirement account assets from being distributed to the beneficiary for one reason or another.

3. In PLR 201902023, the IRS ruled that, when a revocable trust named as IRA beneficiary establishes a subtrust with conduit trust provisions to hold any retirement plan benefits payable to the revocable trust, such structure achieves the status of a conduit trust and a Designated Beneficiary.

4. Under the SECURE Act, depending directly on how an existing conduit trust is drafted, it may very well tie the hands of the individual beneficiary by either forcing the entire IRA to be paid out in the tenth year, or forcing the IRA to be paid out in ten annual installments. To the contrary, an accumulation trust which qualifies as a Designated Beneficiary allows the Trust to take out the distributions at any time within the ten-year period. Accordingly, the usage and drafting of a conduit trust must be carefully evaluated going forward.

5. Nonetheless, a conduit trust will be very important for preserving Eligible Designated Beneficiary status for a trust for certain beneficiaries.

a. A conduit trust for a spouse, unlike an accumulation trust, results in the spouse being considered the sole beneficiary of the IRA, the trust not having to begin minimum distributions until the end of the year in which the decedent would have attained age 72, the spouse's life expectancy, recalculated annually, being the applicable distribution period, and ten year rule will not apply while the spouse is alive.

b. A conduit trust for a minor child will allow a modified stretch, until the child reaches the age of majority, followed by a ten year distribution period.

6. Proposed Regulation Section 1.401(a)(9)-4(f)(1)(ii)(A) removes any uncertainty that a conduit trust is permitted to have multiple current beneficiaries.

D. Other Issues Applicable to Accumulation Trusts

1. The compressed income tax brackets of a trust lead to a significant tax cost to the usage of an Accumulation trust.

a. A trust pays the highest rate of tax after the first \$13,450 in income.

b. If significant amounts will likely be accumulated, the income tax cost is a significant detriment to consider before utilizing this type of trust.

2. Naming an Accumulation trust for an Eligible Designated Beneficiary as IRA beneficiary can be problematic.

a. Despite the fact that the primary beneficiary of an Accumulation trust is an Eligible Designated Beneficiary, other countable beneficiaries of the trust are not Eligible Designated Beneficiaries, and thus the general rule is that the trust will not qualify as an Eligible Designated Beneficiary. An Accumulation trust for either a spouse or a minor child may NOT qualify as an Eligible Designated Beneficiary.

b. An exception under the SECURE Act allows an accumulation trust for a chronically ill or disabled beneficiary to qualify as an Eligible Designated Beneficiary, despite the existence of future other trust beneficiaries. The trust will be considered an “applicable multi-beneficiary trust” (“AMBT”) if such trust has more than one beneficiary, each of which qualify as Designated Beneficiaries, and at least one of such beneficiaries is either a disabled or chronically ill beneficiary. If the applicable multi-beneficiary trust is required by the terms of the instrument to be divided immediately upon the death of the participant into separate trusts for each beneficiary, and all post-death distributions,

gains and losses shall be shared ratably between the separate trusts, the revocable trust will qualify as a “Type I AMBT”. As long as there is no beneficiary other than a chronically ill or disabled beneficiary who has any right to the IRA until the death of all chronically ill or disabled beneficiaries, then this specific trust share will qualify as a “Type II AMBT” and a stretch over the life of the chronically ill or disabled. The proposed regulations provide a roadmap for qualification of an Type I AMBT and a Type II AMBT.

c. The proposed regulations bring additional relief, a safe harbor, in drafting for minor beneficiaries. If the trust requires complete distribution of the plan or IRA to an individual on or before the end of the tenth calendar year following the calendar year in which the minor attains the age of majority, or the end of the calendar year after the year of the minor’s death if earlier, any beneficiary who receives nothing UNLESS a the minor dies before that point is not a countable beneficiary. This creates a safe harbor trust (now popularly referred to a an “Age 31 Trust”) possibility for a participant’s minor children, which will qualify as an EDB, EVEN IF a non-DB is a remainder beneficiary of such trust.

d. This safe harbor structure in fact is not limited to minor children. Any accumulation trust for any individual who is younger than 31 which provides for complete distribution of the plan or IRA to the individual beneficiary no later than his or her 31st birthday, can have its remainder beneficiaries not

counted as beneficiaries for RMD purposes. For example, if the accumulation trust meets the above test, then the remainder beneficiaries who would take if the individual dies before attaining age 31 can include charities, and the trust will STILL be characterized as a DB (or an EDB).

3. Post-Death Changes to Trusts Which Are Beneficiaries of QRPs or IRAs.

a. Powers of appointment. What if the trust which is named as a beneficiary of a QRP or IRA provides that, upon the life income beneficiary's death, the life income beneficiary has a power of appointment over the remaining trust property. The proposed regulations provide that the existence of such a power of appointment will not cause the trust to fail the requirement that the individual beneficiaries be "identifiable". However, the remainder of the proposed regulation in this regard illustrates a fundamental misunderstanding of powers of appointment (i.e., what constitutes an exercise of a power of appointment, the function of "takers in default", etc.). If the power of appointment is exercised by the power holder on or before the Beneficiary Determination Date ("BDD") of September 30 of the year following the year of the participant's death, then those individuals named in such exercise are treated as the remainder beneficiaries designated under the plan. Additionally, if in lieu of an exercise of the power of appointment, before the BDD,

the power-holder has “restricted” it so that the power can be exercised at a later time in favor of only two or more identifiable beneficiaries, the those individuals are treated as the “countable” remainder beneficiaries designated under the plan. If by the BDD, the power of appointment is not exercised or restricted, then the takers in default under the trust instrument are treated as the beneficiaries designated under the plan. If the power holder exercises such power of appointment AFTER the BDD, then a prospective change to the minimum distribution schedule may need to be made. This section of the proposed regulations, while helpful in some respects, need more work! ACTEC has recommended a couple of additions, along with illustrative examples; first, inserting a certification requirement by the IRA provider as of the Beneficiary Determination Date, and a requirement of an updated certification upon any changes to the “exercise” of the power of appointment.

b. Post-death modification of the trust. First of all, the proposed regulations make clear that the mere possibility of post-death modification does not prevent the trust from being a DB. If a post-death reformation or decanting of a trust occurs, the turns will need to be RE-evaluated for RMD purposes, and if the distribution period is accelerated, or the trust no longer qualifies as a DB, then the RMD is prospectively recomputed, so in any event, a complete re-computed distribution is not required until the next calendar year.

E. Marital Trusts

1. We are all aware that one of the major requirements for a marital trust (either a general power of appointment trust or a QTIP trust) is that the surviving spouse be entitled all income of the Trust, at least annually.

2. Rev. Rul. 2006-26, 2006-1 C.B. 939, considered whether the “all income” requirement of I.R.C. §2056 and Treas. Reg. §§20.2056(b)-5(f)(1) and 20.2056(b)-7(d)(2) was satisfied in three fact situations. In each, a marital deduction trust held an IRA or a defined contribution plan.

a. Assuming that a QTIP marital trust was governed by the law of a state that had adopted the 1997 version of the Uniform Principal & Income Act (“UPIA”), the ruling concluded that the trust may not meet the “all income” requirement if: (1) the trust language did not require the trustee to distribute to the spouse the greater of all the income of the IRA (considered as if the IRA were a separate trust) or the annual required minimum distribution under I.R.C. §408(a)(6), and (2) the governing law included §§409(c) and (d) of the 1997 version of the UPIA.

(1) This was because UPIA §409(c) provided that a required minimum distribution from the IRA was allocated 10 percent to income and 90 percent to principal of the recipient trust, whereas the view of the IRS was that such an apportionment between principal and income was not based on the total

return of the IRA and did not reflect a reasonable apportionment of the total return between income and remainder beneficiaries.

(2) If the trust language did not require the distribution of at least the income of the IRA when the spouse exercised the spouse's right to direct a withdrawal and UPIA §409(c) applied, the "all income" requirement may not be satisfied, according to the ruling.

(3) Although §409(d) of UPIA 1997 states that a trustee must allocate a larger portion of any distribution to income to the extent that doing so is necessary to qualify for the marital deduction, the Service in Rev. Rul. 2006-26 stated that this provision was ineffective to reform an instrument for tax purposes, analogizing the statute to a savings clause in a document that would be ineffective to reform the document for federal tax purposes.

b. This ruling set forth a "safe harbor" that would apply if a QTIP election were made over both the trust and the IRA or retirement plan and the spouse had the power exercisable annually to compel the trustee to withdraw the income earned on the IRA or retirement plan and to distribute that income and all income earned on the other trust assets to the spouse.

c. The ruling concluded that marital trusts governed by §§409(c) and (d) of UPIA 1997 could not qualify for the safe harbor.

3. The Uniform Law Commission considered Rev. Rul. 2006-26 and made the changes discussed below to permit trusts governed by the 2008 version of the UPIA to qualify for the above-described safe harbor.

a. The 2008 UPIA §409 retains a 90/10 allocation for trusts other than QTIP and general power of appointment marital trusts.

b. However, for trusts intended to qualify for the estate tax marital deduction, the trustee is required to separately determine the income of each “separate fund” in such a trust for each accounting period. Separate funds include annuities, IRAs, pensions, profit sharing and bonus sock funds and stock ownership plans.

(1) All distributions received by a trust from such a separate fund are considered income until the income determined in this manner is reached. Distributions in excess of that amount are considered principal.

(2) If the distributions are less than this amount, the 2008 UPIA §409 states that the spouse may require that the trustee allocate principal from a source other than the separate fund to income, to make up the difference.

(3) Subsection (f) of the 2008 UPIA §409 requires that a trustee demand that the person administering the fund distribute the internal income to the trust upon the request of the surviving spouse.

(4) Under UPIA 2008, if a trustee cannot determine the income of a separate fund, the trustee is to apply a percentage between 3 and 5 percent, depending on the adopting state's choice, to the fund's value to determine the income.

(5) Further, if the value of the separate fund cannot be determined, the trustee is to compute an income equivalent by multiplying the I.R.C. §7520 rate by the present value of the payments, based on the §7520 rate.

4. The Service has published no new guidance on this issue since the 2008 revisions to the UPIA.

a. A new revenue ruling replacing Rev. Rul. 2006-26 and concluding that the "all income" requirement is satisfied by marital trusts governed by the laws of a state adopting §409 of UPIA 2008 is needed.

b. ACTEC has formally requested that the Service to issue a revenue ruling concluding that marital trusts governed by UPIA 2008 that hold IRAs or defined contribution plan benefits satisfy the "all income" requirement. (The UPIA was further amended in the summer of 2018 by the Uniform Law Commission, specifically in Sections 102(19)(C), 203(e)(1) and 309(b), placing limits on a Trustee's power to adjust between income and principal, so as to avoid marital deduction qualification issues.)

F. Separate Accounts for Trusts

1. Treasury Regulations provide that the separate account rules are not available to beneficiaries of a trust with respect to the trust's interest in the employee's benefit.

a. The IRS now takes the position that separate account treatment is not available when a single trust is named as beneficiary.

b. Under the IRS's interpretation, if all of the separate trusts created under a revocable trust are look through trusts, then the RMDs of all such separate trusts will be based on the oldest beneficiary of all of the separate trusts together, not the oldest beneficiary of each trust share at issue.

c. Therefore, on the beneficiary designation form, it is best to directly name the separate trusts to be created, as opposed to naming the funding trust. For example, instead of naming the "John T. Smith Revocable Trust" as the beneficiary, designate each separate share of the John T. Smith Revocable Trust as fractional beneficiaries.

2. However. . . see PLR201503024 (release January 16, 2015), which in effect allowed separate account treatment in part for a trust which paid out equally to five children.

G. Outright to Spouse Versus a Marital Trust

1. Due to the powerful benefits of the spousal rollover, leaving qualified retirement assets outright to the surviving spouse is usually the best tax

strategy, as long as it fits within the client's objectives.

2. On many occasions, a client is extremely reticent to leaving retirement assets outright to a spouse, for a variety of reasons, including the existence of a second marriage, asset protection concerns, spendthrift concerns, or disability concerns.

a. A "QTIP" Trust for a surviving spouse has the following consequences:

(1) The surviving spouse cannot rollover the IRA, and therefore distributions from the IRA must begin in the calendar year after the first spouse's death, instead of being deferred until the surviving spouse attains the age 72. Therefore, if the surviving spouse is younger than 72 years old, a tremendous tax deferral opportunity will be lost.

(2) Minimum distributions during the spouse's life will be based on a single life expectancy table. If the benefits were left outright to the surviving spouse, then once the spouse begins distributions of her rolled over IRA, she uses the Uniform Lifetime Table, which is based on the joint life expectancy of the surviving spouse and a hypothetical new spouse who is ten years younger. Thus, the QTIP trust beneficiary designation forces larger annual distributions and less income tax deferral.

(3) If the intention is for the QTIP Trust to qualify for

the estate tax marital deduction, then the trust must receive the greater of the minimum distribution amount, or the amount of income earned by the IRA. If the income earned by the IRA exceeds the minimum distribution amount, then greater amounts must be distributed from the IRA and less deferral is achieved.

b. As an alternative to the QTIP Trust technique in second marriage situations, I have been successful in persuading clients to instead leave a fractional amount to the surviving spouse and fractional amounts to the children of the first marriage.

c. Another alternative is to leave the total retirement asset amounts to the surviving spouse, and “compensate” the children of the first marriage with non-retirement assets.

d. If asset protection, spendthrift protection, or some other disability protection is the objective motivating the client to consider a trust for the spouse, we must make sure that the client understands the real cost in naming a trust versus naming the spouse outright.

IV. ESTATE PLANNING IN LIGHT OF THE SECURE ACT

A. Initial steps for the Estate Planner

1. Sending a client alert to everyone.....a quick concise notice aimed at getting their attention and inspiring them to contact us for possible new planning.

2. A more targeted outreach to those high net worth clients with large IRAs or QRPs.

3. Have your assistant globally search your client data base for certain key words, like “conduit trust”.... “special needs trust”

B. Immediate Issues to Address

1. Existing conduit trust planning in place

2. Taking steps to preserve “Eligible Designated Beneficiary” status.

a. Review plans where a spousal trust is the named beneficiary of an IRA.

b. Trusts for Minor children as IRA beneficiaries must be re-evaluated.

c. The designation of a special needs trust as IRA beneficiary should be reviewed and tweaked in light of the SECURE Act.

3. The immediate concerns to convey to our clients.....

a. The real post-death value of our clients’ IRA and QRP interests have been potentially diminished significantly.

b. How will this income tax increase be paid?

c. A new reason for the ILIT wealth replacement concept?

d. More customized beneficiary designations!

C. Charitable Planning

1. Such a change will provide even more incentive for benefitting charity with IRAs upon death.

2. Funding a CRT with an IRA will achieve some of the deferral lost with the limited availability of the IRA stretch technique.

a. This should only be considered by the charitably inclined.

b. Computations specific to your fact pattern must be made in order to ascertain the real stretching benefit of this approach.

D. This law change will add more fuel to the fire in Roth IRA conversion planning.

E. If generation skipping planning is a major objective of a client, utilizing IRAs to push taxable inheritance down to lower bracket beneficiaries should be strongly considered.

F. The planner should anticipate to the extent feasible the possible use of disclaimers by designated beneficiaries of the IRA, in the structuring of the IRA owner's beneficiary designation, as such beneficiaries attempt to do their own post-death income tax planning.

G. Consider adding new boilerplate to your revocable trust forms.

1. Consider a springing separate share for a trust beneficiary who turns out to be disabled or chronically ill at the decedent's death

2. Consider a savings clause which precludes any non-disabled beneficiaries and any non-chronically ill beneficiaries from being eligible to receive any trust benefits during the life of the disabled or chronically ill beneficiary of an accumulation trust, to preserve Eligible Designated Beneficiary treatment.

3. Limit the class of potential appointees under a power of appointment to the extent necessary to preserve Eligible Designated Beneficiary treatment of an accumulation trust for disabled or chronically ill beneficiaries.

4. Consider inserting an elective process, by a trustee or trust protector, whereby either a conduit trust or accumulation trust becomes effective on or before the Beneficiary Determination Date for a separate Trust share.

H. Trusteed IRAs should see increased utilization.

I. You can find the SECURE Act as a new subparagraph (H) to Internal Revenue Code Section 401(a)(9), along with new definitions in Code Section 401(a)(9)(E).

V. MISCELLANEOUS PROVISIONS FROM THE SECURE ACT PROPOSED REGULATIONS

A. SECURE ACT Effective Date Issues.

1. Generally, the SECURE Act is effective as of January 1, 2020. Ironically, it beat the pandemic by about seventy-five (75) days....

2. What about pre-SECURE deaths, followed by deaths of those beneficiaries whose decedent died before 2020?

a. If a sole DB dies after 2019 (while enjoying a life expectancy payout), the ten-year rule applies.

b. If there are more than one DBs enjoying a life expectancy payout, the proposed regulations provide that the ten-year rule is activated by the death of the oldest of the participant's designated beneficiaries IF such oldest DB survived the effective date of SECURE. (If such oldest DB died before January 1, 2020, the ten-year rule will never be activated.) If the pre-2020 DB was a Trust with multiple beneficiaries, the same rules apply.

c. If a sole DB who was enjoying a life expectancy payout dies before January 1, 2020, the successor beneficiaries continue taking distributions over the DB's ghost life expectancy.

VI. CREDITOR ACCESS TO INHERITED IRAs

A. It is always big news when an "estate planning" topic is addressed by the U.S. Supreme Court, and it happened most recently in the summer of 2014 in Clark v. Rameker, 573 U.S. ____, 134 S.Ct. 2242 (June 12, 2014).

1. In Clark, the United States Supreme Court granted *certiorari* to resolve a conflict between the Circuits on the issue of whether a beneficiary of an

inherited IRA can claim a federal bankruptcy exemption from creditors for such inherited IRA.

2. The federal bankruptcy law provides an exemption for “[r]etirement funds to the extent that those funds are in a fund or account that is exempt from taxation under §§ 401, 403, 408, 408A, 414, 457 or 501(a) of the Internal Revenue Code of 1986.” 11 U.S.C. §§ 522(b)(3)(c), 522(d)(12) (It is noteworthy that an “inherited IRA” is an IRA classification specifically recognized by Code Section 408(d).)

3. In a unanimous decision, the Court first defined “retirement funds” as funds set aside for the day when an individual is no longer working, and then cited three (3) characteristics which, in the view of the Court, prevents inherited IRAs from being considered “retirement funds.”

a. First, the holder of an inherited IRA may never make contributions thereto, as opposed to traditional IRAs and Roth IRAs which receive tax incentives for the accumulation of additional funds for retirement.

b. Second, a holder of an inherited IRA is required to withdraw money from such account, without regard to how far away that person is from retirement.

c. Third, the holder of an inherited IRA may withdraw all of the funds at any time without penalty, and use them for any purpose, while the owner

of a traditional IRA or a Roth IRA must wait until attaining age 59½ in order to withdraw funds from such accounts without penalty.

4. In a crowning blow, the Court stated that nothing about an inherited IRA's legal characteristics prevents or discourages an individual from using the entire balance immediately after bankruptcy for purposes of current consumption.

B. The history behind Clark.

1. Remember that IRAs belonging to the original account owner are generally exempt from the account owner's creditors in federal bankruptcy and otherwise.

2. One major source of confusion in this area is, although bankruptcy law is federal law decided in federal bankruptcy courts, many states opt out of the federal bankruptcy scheme, thus activating the application of state exemption statutes in federal bankruptcy cases (some states, like Texas, allow a debtor to select state or federal exemptions). The majority of states opt out, and thus the bankruptcy exemptions are decided under state exemption laws.

3. Prior to Clark, there were twelve (12) reported cases dealing with beneficiaries of inherited IRAs within the federal bankruptcy context.

a. Eight of these courts (all of which are in "opt-out" states, except for Texas) found that the inherited IRAs were not exempt from the bankrupt

estate in federal bankruptcy, including: *In re Sims*, 241 B.R. 467 (Bankr. N.D. Okla. 1999); *In re Greenfield*, 289 B.R. 146 (Bankr. S.D. Cal. 2003); *In re Navarre*, 332 B.R. 24 (Bankr. M.D. Ala. 2004); *In re Taylor*, Bank. No. 05-93559, 2006 WL 1275400 (Bankr. C.D. Ill. May 9, 2006); *In re Kirchen*, 344 B.R. 908 (Bankr. E.D. Wis 2006); *In re Jarboe*, 365 B.R. 717 (Bankr. S.D. Tex. 2007); *Robertson v. Deeb*, 16 So. 3d 936 (Fla. 2d DCA 2009); and *In re Chilton*, 2010 WL 817331 (Bankr. E.D. Tex. March 5, 2010).

b. Four of the courts found that the inherited IRA was exempt in federal bankruptcy, those being: *In re McClelland*, Bank No. 07-40300, 2008 WL 89901 (Bankr. D. Idaho Jan. 7, 2008); *In re Nessa*, 2010 Bankr. Lexis 931 (B.A.P. 8th Cir. Apr. 9, 2010); *In re Tabor*, 2010 105 AFTR 2d (Bankr. M.D. Pennsylvania June 18, 2010); and *In re Hamlin*, 465 B.R. 863 (BAP 9th Cir. 2012).

c. The Nessa decision (in a non-opt-out state) led many district courts, in unreported decisions, to allow the inherited IRA to be an exempt asset, until Clark came along.

C. Clark is NOT the Last Word!

1. In some opt-out states, the interpretation of existing statutes with broad exemption language may allow the exemption of inherited IRAs for state exemption purposes, and state exemptions are recognized under U.S. Bankruptcy Code § 522(b)(3)(A).

a. The state of Kansas has such a broad statute which could arguably be construed to exempt inherited IRAs.

b. However, in Mosby v. Clark (In Re Mosby), 15-5193-JWL (D Kan. Oct. 30, 2015), the Kansas District Court held that an inherited IRA is not exempt under the Kansas exemption statute. The very recent case of In Re: Todd, Case No. 15-11083 (U.S. Bankr., NDNY 2018), held that the applicable New York exemption statute was not intended to include inherited IRAs within the exemption from bankruptcy.

2. In my home state of Missouri, along with Alaska, Arizona, Delaware, Florida, Nevada, North Carolina, Ohio, South Carolina, Texas, West Virginia and Wyoming, the Clark holding is completely irrelevant, as these states have statutes which specifically exempt inherited IRAs for state exemption purposes and have opted to use the state exemptions for federal bankruptcy law purposes. Idaho has case law to this effect.

3. In a post-Clark decision, the federal Bankruptcy Court in New Jersey held that a debtor's inherited IRA was not property of the bankruptcy estate under New Jersey law. In re Andolino, 525 B.R. 588 (Bankr. D.N.J. 2015). The Bankruptcy Court stated that the question of inclusion in the estate must be reached first, before the Clark analysis of the application of an exemption can be made. (The

Todd decision in New York also rejected an Andolino argument regarding inclusion of the inherited IRA.)

4. In another post-Clark decision, the federal Bankruptcy Court in Tennessee held that an IRA account was protected from creditors, even though the IRA owner had used part of the funds during the 60 day rollover period to purchase a home, as the owner ultimately deposited the exact amount eligible for rollover into the IRA. The In Re: Chaundry court rejected the bankruptcy trustee's contention that the rollover was not qualified unless the IRA owner deposited the exact same funds received from the predecessor plan.

5. In October of 2019, the appellate court affirmed the Bankruptcy Court in Minnesota's ruling that a divorced former spouse who had received one-half of his ex-spouse's 401(k) and IRA upon the divorce could not claim an exemption in bankruptcy for such retirement assets. In Re: Lebakken, (No. 18-6018, 8th Circuit Court of Appeals). The courts relied on Clark in reaching this decision.

D. Use of spendthrift trusts as an alternative asset protection device.

1. If you are in a state where the applicable exemption is either indefinite or not existent, you should consider naming a spendthrift trust for the benefit of any beneficiary with creditor issues as the beneficiary of the IRA.

2. However, if the RMD amount received by the trust must be distributed from the trust (i.e. in a conduit trust), the Uniform Trust Code reverses

the common law spendthrift protection for this type of a distribution interest and allows any creditor to attach the RMD amount from a spendthrift trust.

3. As an alternative, consider a “Trusteed IRA.” If the provider offers a Trusteed IRA, and the Trusteed IRA agreement contains a spendthrift clause, then creditor protection should be accomplished.

VII. IRA OWNERS/RETIREMENT PLAN ADMINISTRATORS BEHAVING BADLY

A. Prohibited transactions disqualifying an IRA from recognition as such.

1. As discussed previously, IRAs are tax exempt as well as exempt from bankruptcy proceedings. However, when an IRA engages in a prohibited transaction, those exemptions are lost. One prohibited transaction occurs when an IRA is transferred to, or used by or for the benefit of, a disqualified person.

2. In Ellis v. Commissioner, Decision No. 14-1310, (8th Cir. June 5, 2015), the 8th Circuit affirmed a Tax Court holding that an IRA owner engaged in prohibited transactions under Code §4975(c) by directing his IRA to acquire a membership interest in an LLC with the expectation that the LLC would employ him (and in fact he received wages from the LLC). The facts of this case arose out of a business established in Harrisonville, Missouri, wherein Mr. Ellis invested almost his entire rollover IRA (\$321,253) in a 98% membership interest

in an LLC, under which Ellis served as General Manager. As a result of these transactions, the IRA lost its status as an individual retirement account and its entire fair market value was treated as taxable income as of the date of its establishment.

3. A different result was reached in *In re Nolte*, 2015 Westlaw 2128670 (Bankr. E.D. Va. 2015). At Nolte's instructions, the IRA investment advisor invested \$100,000 out of the IRA in a 5% interest in an LLC. Nolte later served on the Board of the LLC but received no compensation. In a bankruptcy proceeding, a creditor objected to the debtor's discharge on the basis that the IRA had lost its exemption because Nolte had engaged in a prohibited transaction under Code §4975. In this case, the Bankruptcy Court found that merely investing in a 5% interest in an entity in which the IRA owner served on the Board was not a prohibited transaction, and the IRA was not disqualified.

4. In contrast to *Nolte*, Mr. Kellerman's IRA was found not to be exempt due to actions taken by Mr. Kellerman. *In re Kellerman*, 2015 Westlaw 3377907 (Bankr. E.D. Ark. 2015). Kellerman formed a partnership between his self-directed IRA and another LLC which was wholly owned by Kellerman. Kellerman ordered the IRA custodian to sell a substantial portion of the assets of the IRA and purchase a tract of land, in which the LLC and his IRA owned undivided interests. After finding that the IRA had engaged in prohibited

transactions, the Court held the IRA had been disqualified and was not entitled to a bankruptcy exemption.

5. In McGaugh v. Commissioner, T.C. Memo. 2016-28, the taxpayer's IRA custodian initially refused to purchase shares in a closely-held entity since it was not on the custodian's approved buy list. The taxpayer then instructed the custodian to wire IRA funds directly to the corporation whereupon shares were issued by the Corporation in the name of the IRA which were then delivered by the taxpayer to the IRA custodian. Despite the fact that the taxpayer "pulled all strings" and controlled the wired funds in the transaction, the Tax Court held that the taxpayer was merely acting as a conduit for the custodian and that this transaction did not constitute constructive receipt of IRA proceeds. However, in Vandenbosch v. Commissioner, T.C. Memo. 2016-29, the taxpayer moved funds from his IRA to a joint account, followed by a move from the joint account into the taxpayer's personal account, followed by the taxpayer wiring the funds directly to a borrower, in exchange for a note from the borrower payable to the taxpayer and not the taxpayer's IRA. Here, the court held that the taxpayer was not a mere conduit in the same manner as in McGaugh, and the court held constructive receipt of IRA funds had occurred.

6. In Marks v. Commissioner, the taxpayer used the prohibited transaction rule to his advantage, in a very interesting outcome. In 2005, the

taxpayer loaned funds from her IRA to a relative, and received two separate promissory notes. In 2013, while trying to execute a rollover of the IRA, the taxpayer failed to get the notes re-titled in to the new IRA. The IRS issued a deficiency for approximately \$100,000 in taxable income, alleging that the full value of the promissory notes must be included in taxpayer's 2013 income as distributions from the IRA. The taxpayer successfully argued that a prohibited transaction occurred in 2005, rendering the IRA unqualified in that year, and thus no taxable distribution occurred in 2013. AND, the statute of limitations had run on the 2005 income tax year, when the prohibited transaction occurred. Marks v. Commissioner, T.C. Memo 2018-49 (April 2018).

B. Claim of Breach of Fiduciary Duty against Plan Trustees

1. In Tibble v. Commissioner, 135 S.Ct. 1823 (2015), retirement plan participants brought suit against the plan for investing in mutual funds with high fees as opposed to low-cost mutual funds. The 9th Circuit had found that the statute of limitations of six years after "the date of the last action which constituted a part of the breach or violation" was a bar to this suit, because the mutual funds in question were purchased more than six years before the suit was instituted. However, the Supreme Court reversed this decision, holding that the plan trustees engaged in a continuing breach of their duty of prudence in failing to monitor the

investments, and remanded the case to the trial court for determination of whether that issue was timely raised.

C. Loss of Bankruptcy Exemption

1. In Running v. Miller, 77 F.3d 711 (8th Cir. 2015), the taxpayer purchased an annuity from Minnesota Life Insurance Company for a lump sum purchase payment of \$267,319. Miller used funds from his IRA to make this payment. Miller later filed for bankruptcy and claimed that the annuity was exempt from the bankruptcy estate as an individual retirement account. The bankruptcy trustee objected, and the bankruptcy court overruled her objection. The bankruptcy trustee had claimed that, because Miller had used the IRA funds to purchase an annuity with a lump-sum premium, the funds thus became property of the bankruptcy estate.

VIII. NAMING CHARITY(S) AS BENEFICIARY OF THE IRA

A. If a client indicates a desire to leave funds to charity(s) upon his or her death, the first words out of our mouths should be to consider making such at-death gifts from qualified retirement plans or traditional IRAs.

1. If the client's estate plan contemplates benefits both to charity and to children or other individual beneficiaries, the most efficient income tax planning is accomplished by satisfying the charitable gifts with retirement plan assets, and using other assets to leave to the individual beneficiaries. While the

charity will not pay income tax on any inheritance it receives, including retirement plan benefits, individual beneficiaries will pay income tax on the distribution of a retirement plan interest, and will not pay income tax on almost all other forms of inheritance.

2. In addition to satisfying the client's charitable desires, a variety of charitable giving techniques involving retirement benefits will help realize additional estate planning objectives as well.

3. With this planning, charitable intent should be more important than tax savings!

4. In contrast, since Roth IRAs pass to the designated beneficiary without any income tax liability, naming charity as beneficiary of the Roth IRA is not tax efficient.

B. There are various techniques for leaving retirement benefits to charity(s) upon a taxpayer's death.

1. The easiest way to leave retirement plan benefits to charity(s) is to name the charity(s) as a direct beneficiary of one hundred percent (100%) of the benefits payable upon the taxpayer's death.

a. A properly completed beneficiary designation form in this regard is easy to accomplish.

b. Although all of the income associated with retirement benefits will be included in the income of the charitable organization named as beneficiary, such charity's income tax exemption will make the retirement plan benefit distribution not taxable.

c. In addition, the deceased taxpayer's estate will receive a dollar for dollar estate tax charitable deduction for the estate tax value of the retirement plan interest.

2. In many instances, the client will want to leave a specific dollar amount to one or more charities, with the balance of the retirement plan interest passing to other individual beneficiaries (i.e., his or her lineal descendants, per stirpes).

a. This usually requires an attachment to the beneficiary designation form setting forth the specific amount gift, and a description of the residual beneficiaries.

b. In my experience, you should be sure at the planning stage that the retirement plan administrator will accept and honor this attachment!

c. In order for the individual beneficiaries to be able to use separate accounts and a deferred payout, it will be necessary to be sure that the charity(s) are "cashed out" (i.e., fully paid from the retirement plan) before September 30 of the year following the year of the taxpayer's death.

d. Be careful doing this through a trust vehicle!

(1) In PLR 201438014, decedent's Trust was named as beneficiary of his IRA, and the Trust provided for payment of pecuniary bequests to two charities and the residue to be distributed to individuals.

(2) A state court ordered a reformation of the Trust, providing that either the Trust's transfers to the charities were to be treated as direct bequests of the IRA amounts to the charities, or such transfers were to be considered to be made out of the trust's gross income pursuant to the terms of the governing instrument.

(3) The IRS ruled that the Trust must treat the payments to the charities as sales or exchanges (since the IRA is being used to satisfy a pecuniary legacy), and the Trust must include in its gross income the amount of the IRA used to satisfy the charitable legacies. Further, the Trust is not entitled to a charitable income tax deduction for these distributions. The bottom line was, because the purpose of the reformation was not to resolve a conflict but merely to obtain tax benefits, then the IRS will not respect the reformation and treat it as part of the governing instrument. PLR 201438014.

e. Careful drafting will be necessary when an IRA is designated to be distributed to a Trust, which contains residuary charitable bequests.

(1) Chief Counsel Memorandum 200848020 (July 28,

2008), provides that a Trust is denied a charitable income tax deduction after it receives taxable IRA distributions and then distributes some of those amounts to charities.

(a) CCM 200848020 involved a decedent who left his IRA payable to his Trust upon his death, which benefited his six children and several charities. The Trust received distributions from the IRA, and the Trustee immediately paid those amounts to the charities, leaving the six children as the only remaining beneficiaries of the Trust. The Chief Counsel's Office concluded that the Trust had taxable income from the IRA distribution, but was not entitled to claim an offsetting charitable deduction (remember only an estate may claim an income tax charitable "set aside" deduction").

(b) In order for the distribution of IRA proceeds to charity to be deductible by the Trust, the Trust must meet the legal requirement for a trust to claim a charitable income deduction. In order to claim a charitable income tax deduction, the charitable payment must be traced to income and must generally be made pursuant to the terms of the governing instrument specifically requiring income to be paid to a charity. IRC § 642(c).

(c) In the Trust involved in CCM 200848020, there was no specific instruction to distribute income to a charity, just a general provision for a percentage of the residuary to be paid to several charities. Therefore,

the Trust could not claim the charitable income tax reduction.

(2) Ostensibly, one solution would be to include a clause in the Trust document that instructs all residuary charitable gifts to be made, to the extent possible, from property that constitutes “income in respect of the decedent” as that term is defined under the U.S. income tax laws.

(a) However, Treas. Reg. § 1.642(c)-3(b)(2) provides that instructions in a trust instrument to distribute specific types of income to a charity will not be respected for federal income tax purposes unless the instruction has an “economic effect independent of income tax consequences”.

(b) The examples in this Regulation provide that, unless the amount to be paid to charity is dependent upon the type of income from which it is to be paid, the above-described ordering provision is considered to not have economic effect independent of income tax consequences.

(3) Interestingly, in PLR 201444024, where the Trust was named as the beneficiary of decedent’s IRA and the Trust provided that, after two pecuniary bequests to individuals, the residue shall be immediately distributed to charity, the IRS held that the Trust may re-title the name of the IRA to reflect the name of the charity in a non-taxable transfer, and the charity, not the trust, will include the taxable amount of the IRA distributions in charity’s income for tax purposes, as if the charity were the direct beneficiary.

(4) The alternative answer at the planning stage is to draft the beneficiary designation of the IRA so as to mirror the dispositive provisions of the Trust (i.e., list the children and the charities and their respective percentages on the IRA designation itself, rather than sending the IRA to the decedent's Trust).

(5) In addition, the will and/or revocable trust of the decedent must provide that no estate taxes are to be charged against or paid out of the charity's share of trust assets.

f. Charitable Remainder Trusts. This technique involves a charitable remainder trust ("CRT") as that term is defined in IRC § 664.

(1) Income tax consequences

(a) Since a charitable remainder trust is exempt from income tax, the distribution of all the retirement benefits to a charitable remainder trust results in no current income tax liability.

(b) The individual beneficiaries of the charitable remainder trust will receive their lifetime interest earned from the entire amount, as opposed to an after-tax amount, of the distributed retirement benefit interest.

(c) However, the tax-deferred income received by the CRT must be "booked" from day one by the CRT, and will gradually "leak out" to the individual beneficiaries with the distribution of each lifetime

payment. Under the “tiered” approach to income taxation of CRT distributions, the distribution to the individual lifetime beneficiary is deemed first to be derived from ordinary income earned in all prior years and the current year, to the extent such amount has not already been allocated to a prior distribution.

(d) Although an individual IRA beneficiary is entitled to a Section 691(c) income tax deduction for the portion of federal estate taxes attributable to retirement plan benefits, this deduction is rarely if ever available to an individual beneficiary of a CRT, as all of the tiers of ordinary income, capital gain income and tax-exempt income would need to be exhausted before any CRT distribution would carry out the use of the IRD deduction.

(2) Estate tax consequences

(a) The decedent’s estate is entitled to a federal estate tax charitable deduction for the actuarial value of the charitable remainder interest at the time of the decedent’s death.

(b) The actuarial value of the charitable remainder interest must be at least ten percent (10%) of the date of death value of the trust in order for the CRT to be qualified.

(c) Because the non-charitable actuarial interest in the CRT is taxable in the decedent's estate, the decedent's tax clause in his or her will or revocable trust will need to provide for payment of any estate tax attributable to the non-charitable CRT interest from other sources of the decedent's estate.

(3) Leaving a retirement plan interest to a CRT is not a good idea in all situations.

(a) If the individual beneficiary or beneficiaries are young enough, the actuarial value of the charitable interest may not exceed ten percent (10%) of the total value of the trust, and the trust will not qualify as a CRT. However, a term of years could be used to make the CRT work in this situation.

(b) If the CRT will receive a large amount of retirement benefits, it is possible that there will not be enough non-retirement assets to pay any estate tax due because of the actuarial value of the non-charitable interest in the CRT.

(4) With the severe limitation of the "stretch IRA" technique as a result of SECURE, a designation of a charitable remainder trust will allow some "stretching" to still occur.

4. Charitable Lead Trusts

a. Since a charitable lead trust ("CLT") is the theoretical opposite of a charitable remainder trust (i.e., the initial stream of payments is paid

to a charity for a term of years, with the remainder passing to one or more individuals at the end of the term), this seems on its face to be a viable technique.

b. However, the charitable lead trust has one important characteristic which is different from a CRT; the CLT is not exempt from income tax. Therefore, when all of the retirement benefits are distributed to the CLT, the trust must pay income tax on the entire amount of benefits distributed.

c. Because of the drastic income tax consequences, one should not advise leaving retirement benefits to a CLT.

IX. LIFETIME GIFTS OF QUALIFIED RETIREMENT BENEFITS TO CHARITY

A. Lifetime Gifts From Retirement Plan Distributions

1. For some of our clients, the most readily available funds with which to make lifetime charitable gifts are their retirement plan funds.

2. Except for the charitable IRA rollover discussed below, the only way for this client to make such a gift is to withdraw funds from the qualified plan or IRA and then gift such funds to the charity.

a. This of course results in the immediate taxation of the distributed assets from the plan on the donor's income tax return.

b. One would hope that the income tax charitable deduction will result in a “wash” of this income for income tax purposes. However, there are some circumstances which will prevent a complete wash of the income.

(1) If the charitable donations exceed the applicable percentage of AGI limits, then a complete wash will not result.

(2) For high income taxpayers, there is an automatic reduction of itemized deductions under Code § 68 which could also prevent a complete wash of the income.

(3) Of course, if the taxpayer is under age 59½ at the time of the withdrawal, he or she will suffer a ten percent (10%) penalty on the distribution. The charitable deduction will not in any way reduce this penalty.

(4) If the taxpayer resides in a state that does not allow a charitable deduction in computing its state income tax, then a complete wash will not be possible.

(5) Of course, any individual who does not itemize deductions would not achieve a wash of the income since he or she would not be itemizing the charitable deduction. There will be many more non-itemizers under the new tax law, with the increase of the amount of the standard deduction!

B. Gifts of RMD Amounts to Charity(s)

1. A taxpayer who is already receiving RMDs from his or her IRA or qualified plan may use the distributed amounts for charitable giving.

2. Although the above-described obstacles may prevent a complete wash of the income, since the taxpayer is required to receive the RMD in any event, he or she may as well attempt to receive some income tax relief through charitable giving.

C. There are Potential Charitable Gifts of Unique Retirement Plan Benefits That Can Be Beneficial During Life

1. An individual under age 59½ may avoid the ten percent (10%) premature withdrawal penalty through implementing a “series of substantially equal periodic payments” from a retirement plan, and such taxpayer could use those payments to make offsetting charitable gifts.

2. In certain limited circumstances, wherein a distribution is made from a qualified plan of employer stock which includes “net unrealized appreciation”, the taxpayer is not immediately taxed on such net unrealized appreciation at the time of the plan distribution. Instead, taxation of this unrealized appreciation is deferred, and may be completely avoided through certain future charitable gifts.

3. A lump sum distribution from a qualified plan to a participant who is born before January 2, 1936 (or to the beneficiaries of such a participant)

may exclude the distribution from the recipient's gross income and is taxed under a different rate schedule. In some circumstances, the distributee may give the distributed amount to charity, and effectively deduct the gift from his or her other income, since the lump sum distribution is taxed at a much lower rate.

4. "Qualified replacement property" received by a business owner who has sold his or her stock to an ESOP, wherein the owner did not have to pay income tax on the sale, may be gifted to charity to avoid permanently some or all of the tax on such sale.

D. IRA Charitable Rollover

1. Congress has had an on-again/off-again love affair with the IRA Charitable Rollover.

a. The 2006 Pension Protection Act first established the "IRA Charitable Rollover" concept. After being allowed to expire in 2008, this provision was renewed temporarily two more times, and expired again on January 1, 2014.

b. The "Public Good IRA Rollover Act" was introduced in the Senate on November 21, 2013, which sought to renew and make permanent the IRA Charitable Rollover. Comparable legislation was introduced in the House in early 2014, and passed on July 17, 2014. Finally, on December 16, 2014, the Senate signed off on several "extenders," including this provision, which was signed into

law by the President on December 19, 2014. Unfortunately, the IRA Charitable Rollover provision expired again as of January 1, 2015!

c. After months of watching two separate bills which proposed to enact the IRA Charitable Rollover on a permanent basis sit idle in the House of Representatives, action finally came in December, 2015. President Obama signed the “Protecting Americans from Tax Hikes Act” into law on December 18, 2015. Among other things, this Act finally makes the IRA Charitable Rollover permanent.

2. What constitutes an “IRA Charitable Rollover”?

a. A “Qualified Charitable Distribution” is an otherwise taxable distribution from an IRA (not including an ongoing SEP or SIMPLE IRA) owned by an individual who is at least age 70½ (yes, this age limitation was NOT changed by the SECURE ACT), and that is paid directly from the IRA to “eligible charitable organizations.”

b. A taxpayer can exclude from gross income up to One Hundred Thousand Dollars (\$100,000) of a Qualified Charitable Distribution made for a given year.

(1) The Qualified Charitable Distribution can be used to satisfy any required minimum distributions from the IRA for that year.

(2) Likewise, the amount of the Qualified Charitable Distribution excluded from gross income is not shown as an itemized deduction for a charitable contribution.

c. An eligible charitable organization for these purposes includes a public charity, other than a donor advised fund or supporting organizations. Individuals can make a Qualified Charitable Distribution to a private operating foundation or to a private foundation that elects to meet certain conduit rules in the year of the distribution.

d. The donor must instruct their IRA administrator to make the contribution directly to the eligible charity.

3. TRAP CREATED BY THE SECURE ACT

a. A working individual who is 70 ½ or older can make tax-deductible contributions to a traditional IRA (in 2021, the maximum deductible contribution for anyone 50 years of age or older is \$7,000)

b. Under the SECURE Act, if such an individual ever makes a tax-deductible contribution to a traditional IRA after attaining age 70 ½, then the amount of a qualified charitable distribution from an IRA that can be excluded from taxable income is reduced by that amount.

c. If your client wants to make charitable gifts from his or her IRA, they should never make a tax-deductible contribution to their IRA after attaining age 70 ½.

4. Who really benefits from this continued IRA Charitable Rollover technique?

a. A high income donor who itemizes deductions and whose charitable contribution deductions are reduced by the percentage of income limitation (otherwise, such individuals who receive a distribution from their IRA and make a corresponding charitable contribution, must count the entire distribution as income and receive a charitable deduction for a lesser amount).

b. Individuals who do not itemize their deductions.

c. Individuals in certain states where the operation of the state income tax law would offer greater benefits as a result of a charitable rollover.

d. Those rare individuals who already exceed their percentage of income limitation in terms of charitable contribution limits (i.e., more than 50% of their adjusted gross income for gifts of cash to public charities).