

THE LEGAL INTELLIGENCER

Getting SECURE With Recent Changes in Retirement Planning

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The Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act), which became effective Jan. 1, 2020, significantly changed traditional notions of retirement and estate planning. Just when planners began to feel more secure with the SECURE Act, on Feb. 23, the Internal Revenue Service issued proposed regulations that were aimed at clarifying the provisions of the SECURE Act but which surprised many planners with new interpretations of the SECURE Act. While these regulations are just proposed (and additional changes may occur in the future), the proposed regulations should now be considered when engaging in retirement planning.

Individual retirement accounts (IRAs) are not taxed for income tax purposes until assets are distributed from the IRA. As a result, an owner (or plan participant) is generally required to take a required minimum distribution (RMD) from an IRA by Dec. 31 of each calendar year, starting on April 1 in the year after the plan participant turned 72 years (referred to as the “required beginning date” or RBD). Upon the death of the plan participant, a named beneficiary is required to take distributions or RMDs from the inherited IRA depending upon whether the deceased plan participant had reached the RBD and the identity of the beneficiary.

Identifying the Beneficiary

Under the SECURE Act and the proposed regulations, a beneficiary may be an eligible designated beneficiary (EDB), a designated beneficiary (DB) or a nondesignated beneficiary (NDB). The status of the beneficiary is crucial to determining how the IRA will ultimately be paid at the plan participant’s death.

Eligible Designated Beneficiary

An EDB is the plan participant’s spouse, minor child (the proposed regulations define the age of majority to be 21 years), a disabled individual, a chronically ill individual, or a person not more than 10 years younger than the plan participant. An EDB’s status can change over time. Thus, in the case of a beneficiary who is the minor child of the plan participant, a disabled individual, or a chronically ill individual, once an EDB’s status ceases, the EDB will then be treated as a DB and the DB rules discussed below will apply.

Designated Beneficiary

A DB is either an individual (who is not an EDB) named as a beneficiary of the IRA or a “see-through trust.” In order for a trust to qualify as a “see-through trust,” the trust must be valid under state law, the trust must be irrevocable or become irrevocable at the plan participant’s death, all trust beneficiaries must be “identifiable”, and (4) proper documentation must be provided to the plan administrator by Oct. 31 of the year following the plan participant’s death. A see-through trust can either be a conduit trust, meaning that all distributions made from the retirement plan must be distributed to that beneficiary such that the trust is simply a “conduit” for the beneficiary, or an accumulation trust such that distributions from the retirement plan may accumulate in the trust.

When determining “identifiable” trust beneficiaries, the remainder beneficiaries of a conduit trust are disregarded so that only the present beneficiary is considered. In an accumulation trust, however, the proposed regulations clarify that if a contingent beneficiary would receive amounts from the trust solely because of the death of another beneficiary, the contingent beneficiary is disregarded for purposes of determining whether the contingent beneficiary is an identifiable beneficiary.

The proposed regulations also clarify the treatment of powers of appointment in a trust when determining whether a beneficiary is identifiable. Under the proposed Regulations, if a power of appointment is exercised before Sept. 30 of the year following the death of the plan participant, then the appointed beneficiaries are identifiable. If the power of appointment is not exercised by Sept. 30 of the year following the death of the plan participant, then the takers in default of the exercise are the identifiable beneficiaries and not the potential appointees.

The proposed regulations also provide that a see-through trust will not fail to meet the identifiability requirements merely because the trust is subject to a state law that allows the trust terms to be modified after the death of the participant, such as by nonjudicial settlement agreement, a court reformation, a decanting, or otherwise, that would permit a change in the beneficiaries of the trust.

Nondesignated Beneficiary

A NDB is not an individual (such as an estate, charitable organization, or a trust) that does not qualify as a DB.

Determining the Beneficiary’s RMDs

As mentioned above, the SECURE Act and new proposed regulations provide that a beneficiary must withdraw assets from an inherited IRA based upon the identity of beneficiary and whether the plan participant had reached the RBD at the time of the participant’s death.

Eligible Designated Beneficiary

The SECURE Act and the proposed regulations provide special rules when a surviving spouse is the beneficiary of a retirement account. If the plan participant had not yet reached the RBD at the time of the participant’s death, the participant’s surviving spouse may roll over the IRA to his or her own IRA and receive RMDs based upon the surviving spouse’s RBD. Alternatively, the surviving spouse may take RMDs based upon the later of Dec. 31 following the year of the deceased participant’s death, or Dec. 31 of the year of the deceased plan participant’s RBD. If the plan participant had reached the RBD, then the spouse may roll over the IRA or RMDs may be determined based upon the surviving spouse’s life expectancy.

If an EDB is a nonspousal beneficiary and the plan participant had not yet reached the RBD, the EDB may “stretch” out the RMDs from the inherited IRA based upon the EDB’s life expectancy. If the deceased plan participant, however, had reached the RBD, then the EDB may stretch out the RMDs over either the EDB’s life expectancy, or the deceased participant’s life expectancy had the participant been alive (often referred to as the “ghost life expectancy”) so long as the EDB receives the remaining balance at the end of the EDB’s life expectancy (e.g., the EDB was older than the deceased participant).

If an EDB becomes a DB, the EDB rules no longer apply, and instead, the DB rules immediately start. For example, when a minor reaches age 21 and no longer qualifies as an EDB, the minor becomes a DB and the 10 year rules discussed below will go into effect for the now DB.

Designated Beneficiary

If a deceased plan participant had not yet reached the RBD, the IRA must be distributed to a DB by the end of the 10th year following the participant's death. Annual distributions do not need to be taken by the DB, and the DB could take a single distribution of the entire IRA at the conclusion of the 10-year term following the participant's death. In a Roth IRA, because Roth IRAs do not have a RBD, the deceased participant is treated as not having reached the RBD and the DB must receive full distribution of the IRA at the conclusion of the 10-year term.

If a deceased participant had reached the RBD, then under the proposed regulations, the DB must take an annual RMD during the 10-year period following the participant's death, along with a complete distribution of the remaining IRA by the conclusion of the 10-year term. The DB's RMDs are based upon the greater of the DB's life expectancy or the decedent's "ghost life expectancy." Prior to the proposed regulations, practitioners had believed that the SECURE Act only required the DB to withdraw all of the IRA assets by the end of the 10-year term, but the new RMD requirement in the proposed regulations will now require beneficiaries to withdraw a RMD at least annually over the 10-year term.

Nondesignated Beneficiary

If a deceased plan participant had not yet reached the RBD, the pre-SECURE Act rules continue to apply to NDBs—the NDB does not need to take any annual distributions, and the IRA must be distributed in full by the end of the 5th year following the plan participant's year of death. If a deceased plan participant reached the RBD prior to death, then the NDB must continue to receive RMDs based on the deceased ghost life expectancy.

But Aren't These Just Proposed Regulations?

The proposed regulations do not carry the force of law. According to the preamble to the proposed regulations, however, taxpayers must apply the existing regulations and take into account a "reasonable, good faith interpretation of the amendments ..." to the SECURE Act in the proposed regulations. The proposed regulations go on to say that compliance with the proposed regulations will satisfy the reasonable, good faith interpretation requirement. While the proposed regulations could be changed or amended, it would be best practice to comply with the proposed regulations when determining the distribution requirements of an inherited IRA.

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