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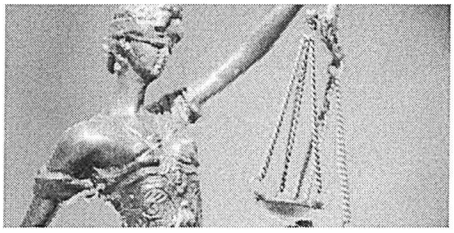

THE SECURE ACT:
Changes to IRA & Retirement Account Rules

FACULTY

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David J. DePinto practices in the areas of trusts, estate planning, asset protection, charitable entities, business and succession planning for closely held businesses, estate and gift taxation, income taxation, elder law, guardianship, probate and administration of trusts and estates, estate litigation and also provides representation to Guardians, Trustees and other fiduciaries.

Mr. DePinto received his LLM Master of Laws degree from NYU Law School, his JD degree from Brooklyn Law School and his Master of Science degree in Taxation, with academic honors, from Long Island University CW Post and his BBA degree from Hofstra University. He is a NYS Certified Public Accountant (CPA) and a (CELA) Certified Elder Lawyer certified by the National Elder Law Foundation as accredited by the American BAR Association. He is the recipient of the Edith Blum Foundation Award for Excellence in Taxation and the professor's Award for Academic Achievement in Taxation. He was recently named to the 2013-2019 list of Super Lawyers®.

He was an adjunct professor in the Masters Program at Long Island University. He has spoken for the New York State BAR Association on complex trust and Estate Planning topics and regularly lectures before the Nassau and Suffolk BAR Association centers for continuing Legal Education, and their committees and sub committees. He is frequently asked to speak on trust topics for (NBI) the National Business Institute and other providers of legal education. He was technical editor for the publication "Fundamentals of Trust Accounting Income and Principal under the Revised NYS Laws" (ABA Publication 2013). Known in the community for his expertise on trusts and related matters, he acts as counsel to many large and small law firms, providing advice and guidance in his areas of concentration.

SECURE ACT AND ESTATE PLANNING

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SECURE Act Basics

SECURE – Setting Every Community Up for Retirement Enhancement

Signed into law on December 20, 2019 by President Trump –Sweeping changes to the retirement tax law.

Congress in new reports said the new law focuses on three main areas: (1) increase age of required minimum distribution (2) expanding retirement plan access and (3) increasing lifetime income options in retirement plans.

They left out the part about how the law will raise $15.7 billion projected revenues due to the Death of the "Stretch" on inherited IRAs.

It does increase the age for Required Minimum Distributions (RMD) by a year and a half - from 70 ½ to 72 years old.

Individuals working past age 70 ½ can now contribute to an IRA.

SECURE Act allows limited Early Withdrawals

Permits withdrawal of up to $5,000.00 (total) in the year of birth/adoption from IRAs and certain other plans to pay expenses for the birth or the adoption of a child without penalty.

Allow the use of tax-advantaged 529 accounts for qualified student loan repayments (up to $10,000.00 annually)

Killing the "Stretch"

Under SECURE, unless the named designated beneficiary of a retirement account qualifies as an Eligible Designated Beneficiary (EDB) then the retirement account must be completely distributed to the named beneficiary within 10 years of the plan holder's death. The 10 year period could be up to 11 years since the account must be distributed by December 31st of the 10th year after death.

Therefore, most children and grandchildren who are beneficiaries of an IRA will not be able to "stretch" an IRA over their individual lifetimes.

Conduit Trusts will also be required to have the balance of an IRA distributed to it within 10 years and in accordance with most standard language in Conduit Trusts, the Trustee would be required to distribute the entire amount coming from the IRA outright to the beneficiary.

There were always three categories of IRA beneficiaries: The EDB is just the new addition to the Designated Beneficiary (DB) definition existing under the old law.

1. Spouse – Delayed start rollover and life expectancy of spouse after 70 1/2 or take over remaining Life Expectancy of the owner. (DELAYED START ROLLOVER AND LIFE EXPECTANCY PAYOUT STILL IN PLACE – BUT LOOK AT CONDUIT QTIPS AND BYPASS TRUSTS IN WILLS FOR SURVIVING SPOUSE)
2. DB – Designated Beneficiary – Individual, See thru Trust – was Life Expectancy of beneficiary (**NOW ITS 10 YEAR RULE** unless an EDB inherits then many variations of Life Expectancy and term payouts) – eg. You

can name a 99 year old parent as a DB and they still get 10 year rule not Life Expectancy.

3. Not a DB: Estates, Non Qualifying Trusts and Charities – 5 year rule if died before the RBD or if after it was the "ghost payout" over remaining Life Expectancy of deceased owner. (DID NOT CHANGE AT ALL)

Eligible Designated Beneficiary (EDB)

All of the below beneficiaries are not required to distribute an inherited IRA within 10 years and in some cases can distribute the IRA over the individual's lifetime.

4. Surviving Spouse – is no longer a DB and only will be qualified as an EDB but not both. This creates an issue with accumulation trusts for spouses discussed later (i.e. credit shelter trusts).
   Spouse still gets life expectancy and rollover. The 10 year period begins on the death of the surviving spouse.
5. Minor Children – Prior to the age of majority, the payout is determined by the minor's life expectancy. Once a child reaches majority, the distribution period begins and they will have ten years to remove the entire principal of the IRA. The term minor is not well defined and is governed by an ERISA definition that says it will be age of majority under state law but if minor did not complete a "specific course of education" (not defined) the age of minority continues but not past age 26. Section 401(a)(9)(E)(ii)(II) says a child is someone who has not reached the age of majority (see supra). In New York majority is generally age 18. Therefore, the child could inherit the entire IRA at 28, regardless of how old they are when the parent dies. THIS EXCEPTION DOES NOT APPLY TO THE PLAN OWNER'S GRANDCHIDREN.

6. Beneficiary Not More Than 10-Years Younger – If the beneficiary is not more than 10-years younger than the plan holder, then they will be permitted to withdraw the plan balance over their life expectancy. The 10 year rule only applies after their death. This is a good option if the owner has a sibling close in age and is the intended beneficiary.
7. Disabled Beneficiary – Gets LE payout – Defined under IRC §72(m)(7) – "… an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof…" If a beneficiary can engage in "any substantial gainful activity" even if it is very limited, that beneficiary will not qualify to stretch the IRA and will be required to distribute the IRA within 10 years (essentially the social security disability standard).
8. Chronically Ill Individual Gets Life Expectancy payout. Defined under IRC §7702B(c)(2) - (A) "…individual who has been certified by a licensed health care practitioner as (i) being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity, (ii) having a level of disability similar (as determined under regulations prescribed by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability described in clause (i), or (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless within

the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements. (B) Activities of daily living For purposes of subparagraph (A), each of the following is an activity of daily living: (i) Eating. (ii) Toileting. (iii) Transferring. (iv) Bathing. (v) Dressing. (vi) Continence. This is also an overly restrictive definition and an individual living with mental, emotional or physical challenges that may limit or prevent gainful employment but they are not incapacitated enough to satisfy the requirements of chronically ill would be required to remove the entire balance of the IRA. Expect regulations on this.

SECURE Act and See Through IRA Trusts

Old law: Allowed Conduit Trusts and certain Accumulation Trusts as a DB– NONE OF THESE RULES CHANGED

Has to meet the Big 4 under Regs §1.401(a)(9)-4

1. Valid under State Law
2. Irrevocable or become Irrevocable at death of Participant
3. Identifiable Beneficiaries
4. Copy of the trust to be sent to Plan Administrator no later than October 31st of the year after death. (fatal flaw if not done per IRS rulings)

The trusts must be transparent so the payouts cannot be further extended "See Through Trusts" and there are really only two eligible types: Conduit Trusts and Accumulation Trusts.

Conduit Trusts – No ability to accumulate assets in the trust. The Trustee is required to invest the IRA, pass out all RMD's paid to the trust directly to the beneficiary each year and under old law made the election to do a Life Expectancy stretch. IRS ignored any other beneficiaries in the trust other than the conduit. Thus you could draft them with a lot of flexibility after death of primary beneficiary.

Examples of Conduit Trusts are properly drafted QTIPs. (for second and later marriages to protect IRA corpus for kids of first marriage) and Bypass Trusts (to allow for State or Federal Estate tax planning on first death). In order to get the spouse as an EDB for a Life Expectancy payout the trust has to have language requiring that the trustees pay the spouse the GREATER of the trust accounting income or **ALL** IRA distributions to the trust. If it was also to qualify as a QTIP it requires the language of RR 2006-26. The issue is that the spouse will have to get all the IRA distributions from the trust and that may not be the goal with a non-first marriage QTIP.

Conduit Trusts also included income only trusts for children or grandchildren to guarantee that the IRA Life Expectancy stretch election was made and not taken in a lump sum by beneficiary. Only worked well for adult children.

Under SECURE Conduit trusts for non-spouses no longer make sense for two reasons. (1) Too much money in too short of time and (2) the tax bracket snag. Also watch the Kiddie tax snare for a DB under age 24 on conduit trust payouts of large amounts.

Accumulation Trusts: Discretionary trust with no forced or mandatory payouts. The best you can get for a DB is 10 years in a trust. IRS looks at both the current beneficiaries AND the remainders for life expectancy under old law and this has

not changed. PLR 2004-38044. This had to be a trust that paid outright to now living person ("OR2NLP"). All these trusts were drafted to be sole benefit trust with no successor or contingents other than the issue of the now living person. The life expectancy of the oldest beneficiary (least favorable) anywhere in the space and time was counted or disqualified the trust (i.e. Estate or Charity as ultimate residual)

My own rules for IRA Accumulation Trusts:

1. No Heirs at Law
2. No Ultimate Residuary
3. No payment to anyone's Estate (watch GST language and 2503(c) trusts)
4. Sole Benefit of a single beneficiary (one trust per benny) – ONLY NECESSARY FOR EDB AND MAYBE BETTER TO NAME MANY DB's IN AN ACCUM TRUST NOW FBO GRANDCHILDREN TO GET LOWER BRACKETS TO MULTIPLE GRANDCHILDREN vs CHILDREN.
5. Only individuals never a further trust, an estate, a non-natural person or charity (This is still crucial to get the 10 year rule. If not, you get 5 year rule or ghost payout).
6. No clause to pay funeral expense or debts of the Estate.
7. Never EVER pour over to another document (trust, will etc.).
8. Never use a separate share breakout into subtrust clause.
9. Never use a LSPOA or Testamentary SPOA.
10. Always pay outright to a now living person to qualify as a DB.

11. Put language in so the Trustee can direct the custodian on all IRA matters.

12. Mandate the trustee to file the trust with the custodian by Oct 31st (Fiduciary duty).

13. Watch standard GST language if the trust is for a grandchild – typically has a GPOA.

14. Add a clause that defines IRA principal and income coming in to avoid loss of DNI deduction on payout to beneficiary. Under NY law if the distribution is not characterized, it's 10% income and 90% principal. (EPTL §11-A-4.9)

15. Give the trustee the power to allocate the RMD's in its discretion between principal and income.

These drafting guidelines are all still relevant but IRA accumulation trusts will only now be maximum payout for 10 years, however the net after tax IRA assets will still be held until distributed or spent.

Open issue – in the prior law the death of the trust beneficiary allowed payout over the remaining life expectancy. It's not clear under the new law if that is still the case for an EDB.

EDB as Trust Beneficiary

It's right in the new law so it is crystal clear that an accumulation trust is allowed for chronically ill and disabled persons. It is not allowed for the spouse or the other EBDs. If an accumulation trust is created for the benefit of a chronically ill or disabled person that has multiple beneficiaries, on the death of the plan holder that trust is divided into separate trusts for each beneficiary, the post-division trust for

the chronically ill or disabled beneficiary will also qualify as an EDB (this overrides the old prohibition against the separate share rule in this limited instance).

Therefore, a chronically ill or disabled person can be the beneficiary of an accumulation trust and allowed to stretch the IRA over the lifetime of the beneficiary. SNT's that are have a sole beneficiary should allow a stretch. In fact, it seems ordinary trusts that include a sole disabled beneficiary will qualify. Therefor any existing "pot" trust with a beneficiary not collecting SSI or Medicaid (i.e. SSD only) should be split off or decanted to a sole benefit trust under the now law.

An EDB who is a spouse or minor child will require a <u>conduit trust</u> to qualify for the special life expectancy payouts as EDBs. Accumulation trusts will not qualify the EDB treatment and the 10 year rule will apply. Conduit trusts for minors make no sense due the fact all the distributions pass right out to the child in a nanosecond after the IRA distribution is made to the trust. However, it is the author's opinion that most people will not have a significant IRA and still have minor children when they die (Hugh Heffner and Charlie Chaplin excluded).

<u>Examples:</u>

Facts: 7 year old grandchild receives an inherited IRA worth $500,000.

Old Law – The 7 year old would be allowed to take the distribution of the RMD over his or her lifetime of almost 76 years.

New Law – The grandchild would have to receive the entire $500,000 IRA before 10 years expired or take $50k per year that will pass to the minor.

*the grandchild can take the distributions at anytime over the next 10 years (all at once in year 10, prorata, etc.) so long as the final distribution of the account is prior to December 31st of the tenth anniversary of the plan holder's death

Income Tax Issues - Same Fact Pattern:

Old Law – The life expectancy of the 7 year old GC is 75.8, so in the first year of distribution, the trust would only be required to take $6,596 of taxable IRA assets. This amount would be taxed in the lowest 10% bracket.

New Law – The best you can do is have the grandchild withdraw 1/10th the value of the account every year as to not get snagged in the highest 37% tax bracket in year ten (or 11). $50,000 in income would automatically place the grandchild in the 22% tax bracket and the payout complicates the state law issues of minor account ownership if it was drafted pre Secure as a conduit trust.

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Drafting issues for Marital/Spousal Planning

QTIP – MUST HAVE RR 2006-26 LANGUAGE TO QUALIFY FOR QTIP ELECTION – (NOT NEW)

"In the event that the principal of this Marital Trust consists of distributions from an Individual Retirement Account ("IRA"), I instruct my Trustees to demand a payment each year from the Custodian of the IRA in an amount equal to not less than the minimum distribution required by law, but subject to the following rights conferred upon my spouse.

I direct that my wife, _____, shall have the power, exercisable annually or more frequently, in her sole discretion, to compel my Trustees to withdraw from any IRA, of which the Marital Trust in this Article is named as a beneficiary, an amount equal to the income earned on the assets held by each such IRA during the year. If my wife exercises such power, my Trustees shall treat distributions from any such IRA for such year as income of the trust to the extent that the distributions represent income generated or deemed to be generated by each such IRA and withdrawn from the account pursuant to my wife's exercise of her power described herein, notwithstanding the treatment of such portion of the distribution under any law concerning the determination of income and principal for trust accounting purposes, and my Trustees shall not charge to income any expense properly chargeable to the nonincome portion of the distribution. The power in this Paragraph shall be exercised by means of a letter signed by my wife and delivered to my Trustees. If my wife does not exercise the power in this Paragraph in any year, such power with respect to the income earned that year shall lapse and may not be carried forward to the following year.

WILL BYPASS TRUST – NEEDS NEW LANGUAGE POST SECURE ACT IF WAS NOT DRAFTED AS CONDUIT

"In the event that the principal of this disclaimer trust consists of distributions from an Individual Retirement Account ("IRA"), I instruct my Trustee to demand a payment each year from the

Custodian of the IRA in an amount equal to not less than any minimum distribution from the IRA and that my Trustee distribute to my spouse annually an amount no less than any distribution from the IRA."

WILL POWER TO ALLOCATE CLAUSES

"To allocate, in the sole and absolute discretion of the trustees, in whole or in part, to principal and income, all receipts and disbursements for which no express provision shall be made under the law of the State governing this Will provided, however, that the income of a trust created under this Will shall include all distributions received by such trust from each qualified retirement plan and Individual Retirement Account, or portion thereof, of which such trust shall be beneficiary to the extent that such distributions represent ordinary income (e.g., interest and dividends) earned in such qualified retirement plan or Individual Retirement Account during the calendar year in which such distributions shall be received by such trust or with respect to which such distributions shall be attributable, notwithstanding the classification of such distributions as principal or income for trust accounting purposes, and further provided that the balance of such distributions shall be deemed principal and that all expenses of such trust allocated to principal, including income tax on such distributions, shall be charged to principal."

DON'T OPT OUT OF UNITRUST AND/OR POWER TO ADJUST

Do not use any variation of this language if IRA is payable to a QTIP –

> "In addition to the investment powers conferred above, my trustees are to administer any such trust in accordance with the trust provisions thereof, and any statute, including but not limited to the Principal and Income/Unitrust Act, requiring certain types of investments, mandatory distributions, etc., shall expressly not apply to any such trust."

PLANNING UNDER SECURE

1. Charity outright – for larger estates, no Estate or Income tax at all and leave the non-qualified assets to the family. Consider a private foundation

2. Attend to ALL Conduit trusts – Recall old law allowed the RMDs paid to the benny which was small under old law and the income was not raising the RMD into the highest tax brackets. We can amend or decant these trusts to make them accumulation trusts or simply redo them since most are revocable and not funded until death.

3. Manage tax brackets – Highest current bracket is 37% BUT DOES NOT KICK IN UNTIL $622,051 MFJ - There are 7 tiers under the latest tax law changes to work with – 10%, 12%, 22%, 24%, 32%, 35% and 37%. You must crunch the numbers so take the excel spreadsheet out. See if you can maximize the current rate brackets and pay some taxes by taking more current annual IRA distributions beyond the RMD, spending those instead

for lifestyle and save after tax income and bank accounts to leave to the children.

4. Out of NY state trust – Leave the entire IRA to a Nevada (or any non-tax state) accumulation trust and let it grow in the trust and the distributions will not be subject to New York income tax. (provided it is not later distributed to a NY beneficiary due to the throwback rules).

5. CRUT – Leave the IRA to a charitable remainder unitrust – you can name the children (or child and spouse) as the CRUT beneficiaries and pick their life expectancy or a term not to exceed 20 years. This can also convert ordinary income to capital gains in later years. DRAWBACK- the Charity must get the entire IRA remaining on death of child or end of term. Consider using a portion of the annual distribution to pay for a cheap 20 or 30 year term life insurance policy on the child once the owner dies to hedge the risk of early death if you choose life expectancy over the 20 year rule in the CRUT.

CRUT EXAMPLE

A $3,000,000 IRA is left to a CRT for a 50 year old child for life. Assuming the child lives the payout is actuarially calculated as 29 years and using to 6% total return the child would receive about $5mm back in annual installments spread over 29 years. If a NIMCRUT were used the child could defer the payments until his or her own retirement age to hedge tax brackets.

If the child earns $200,000 per year in their own occupation, the $300,000 of additional income is heavily taxed.

6. Roth conversions – The IRA can be converted to a Roth IRA if tax is paid now and then the IRA only gets taxed once. e.g. 60 year old spreads tax bracket rate hedge using most of the lower brackets annually over 5, 10 or 20 years etc. so the money that goes to the trust is not going to be taxed or passed out to the child in 10 years. Again crunch the numbers.

7. Spousal Rollover – Typical Plan for spouse under old law was Rollover, elect portability, defer distributions until spouse turned 70 ½ and leave it children or GC to maximize stretch. On the death of the child or GC, the payout was allowed to continue over that DB's remaining life expectancy. It was the goose that continued to lay tax deferred eggs for decades to come. E.g. a $1,000,000 IRA could grow at a 6% total return to over $4mm over this term with a 70 year old owner, a 60 year old spouse and a 40 year old child. If a trust for 5 year old grandchild was named the number goes up to $9.9mm (source - IRA Calcxml.com) and very little tax is paid annually.

Now all of that is still fine but the IRA gets hit with 10 year rule on spouse's death under that typical scenario. Maybe disclaim a portion, say 50% of the IRA, to an accumulation trust and half comes out over spouse's life expectancy then the remainder over next 10 years after spouse dies. (so you get 20 years).

Summary: Under secure we have an obligation as professionals to revisit our client's prior IRA beneficiary planning, all existing IRA trusts and wills with bypass and QTIP trusts that may receive retirement assets. We also have a great opportunity to do new and creative IRA tax planning for our clients.

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