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Proposed Regulations on SECURE Act Changes in Required Minimum Distributions

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A. Introduction

An article on the proposed regulations under the SECURE Act (Probate Practice Reporter, May 2022, Boehmcke, Bush and Kanaga, *An Analysis of the Proposed SECURE Act Regulations*), with a final heading "Conclusion" states in its first sentence: "The Proposed Regulations, complex as they may be, should be required reading for all estate planners dealing with retirement benefits." This is a substantial burden and is asking too much. These regulations take up more than 60 pages of the Federal Register of February 24, 2022 in a Notice of Proposed Rulemaking on Changes in IRC Sec. 401(a)(9) made by the SECURE Act (the "Act") which includes updating existing regulations. We suggest a different approach which is to read an article discussing the Act which emphasizes trust matters. The article quoted above is such an article. A second starting place would be the heading "Trust as Beneficiary" on pages 10510-10515 of the Federal Register for February 24, 2022.

A June 15, 2022 teleconference public hearing on the proposed regulations ("PR") was held. The hearing is published in Tax Analysts Doc. No. 2022-19585 and will be referred to later. Written comments were filed with the IRS before and after the hearing and are also discussed later in this article. For readers who wish additional references for an analysis relating to trust matters, see *ACTEC Scrutinizes Proposed Regs on Required Minimum Distributions*, Tax Analysts Doc. No. 2022-17274. A part of the ACTEC submission is included as Appendix A.

B. Summary of Major Points

1. Commencement Age

The commencement age for required minimum distributions ("RMDs") is changed from 70-1/2 to 72. In addition, the rule that prevented individuals over age 70-1/2 from making further contributions to individual retirement accounts is repealed.

2. New Class of Beneficiaries (EDBs)

A new class of beneficiaries called "eligible designated beneficiaries" ("EDBs") is created. This class consists of surviving spouses, minor children (until they reach the age of majority), disabled and chronically ill beneficiaries and any individual less than 10 years younger than the plan participant. See IRC Sec. 401(a)(9)(E)(ii). The term "designated beneficiary" ("DB") remains in effect. An example of a designated beneficiary who is not an eligible designated beneficiary is an adult child of the plan participant.

"Age of majority" refers to the child's 21st birthday. PR §1.401(a)(9)-4(e)(3). "Disabled" refers to a medically determinable physical or mental impairment resulting in marked and severe functional limitations that can be expected to result in death or be of long-term and indefinite duration. PR §1.401(a)(9)-4(e)(4). In addition, a safe harbor is provided under which a beneficiary will be deemed to be disabled if, at the participant's death, the beneficiary is disabled under 42 U.S.C. §1382c(a)(3).

Requirements for proving that a beneficiary is disabled or chronically ill are imposed. See PR §1.401(a)(9)-4(e)(7). These requirements were mentioned in the hearing. A witness said:

Plan administrators and IRA providers are not experts in determining trust instruments, and cannot reasonably be expected to do so. For this reason, final regulations should eliminate the rule that allows the trust documentation requirements to be satisfied merely by providing a copy of the trust instrument to the plan administrator, or IRA provider, for them to review and interpret. Instead, the regulations should retain only the other option for satisfying the documentation requirements. Namely, the employee, beneficiary, or trustee must provide certain representations to the plan administrator, or IRA provider.

In addition, that documentation rule should be expanded to permit plan administrators and IRA providers to require, and to rely upon additional representations from an employee, beneficiary, or trustee, regarding how the RMD rules apply to a particular trust. Such as whether, or when, the 10-year rule applies, and based on whose death.

We also urge the adoption of a similar approach that would allow plan administrators and IRA providers to rely on certifications from beneficiaries regarding whether they are disabled or chronically ill.

3. Applicable Denominator

The PR use a new term "applicable denominator" ("AD") in the computation of RMDs. An RMD is calculated by dividing the account balance (as defined in the PR) by the AD. See §1.401(a)(9)-5(a)(1)). They differ based on whether the participant died prior to, or on or after, the participant's required beginning date ("RBD"). If the participant died on or after the RBD and the beneficiary is not an EBD, annual RMDs are to be made during the five- or ten-year period with a "balloon" of the remaining plan assets at the end of the period.

4. New Ten-Year Period

Except for EDBs, the previously used life expectancy payout period is changed to a 10-year period as defined in the PR.

If the participant dies before his or her RBD and has no designated beneficiary, all benefits are to be distributed by the end of the year containing the fifth anniversary of the owner's death. IRC Sec. 401(a)(9)(B)(ii). Under this rule, the entire account is to be distributed by the end of the year that contains the fifth anniversary of the owner's death and no distributions are required prior to that year. The belief was that the new ten-year rule would be the same as the five-year rule. In a surprise, the PR provide that the Act did not repeal IRC Sec. 401(a)(9)(B)(i) with the result that the ALAR (at least as rapidly as) rule still applies.

Under the quoted rule, if the DB or EDB is younger than the decedent, the minimum distribution will be determined using the beneficiary's life expectancy, but this payout will end in the tenth year.

Many comments on the PR criticized the decision. At the hearing, testimony was given by Kurt Johansen, counsel for Ameriprise Financial. He stated in simple terms the case for an unlimited 10-year rule:

I will now turn to the 10-year rule. I would like to start by providing some background related to the SECURE Act and the rules that previously permitted beneficiaries to stretch payments over their lifetime. SIFMA members generally would oppose removing the ability for beneficiaries to stretch their IRA distributions because it permitted our clients to provide a legacy for their children that could be taxed gradually over their lifetime. However, it became clear that members of Congress view the stretch provisions costly and not directly related to the purpose of retirement vehicles, which are supposed to provide for the individual's retirement.

Understanding that removal of stretch provisions was inevitable, SIFMA focused its advocacy on ensuring any new rules would simplify what were already very complicated rules related to RMDs. This is especially important because the RMD rules impact individuals over 70-1/2 or with the new SECURE Act rules, 72, and also those who have recently lost a loved one. These are not groups of people that anyone wants to throw an overly complicated regulatory regime at. In fact, many provisions of the SECURE Act were intended to make the complicated RMD rules simpler. Moving the retirement age from 70-1/2 to 72, as opposed to moving it to 71-1/2, or 72-1/2, simplified things. Who on earth knows when their half birthday is anyway?

So, replacing lifetime payments with the 10-year rule modeled off the existing five-year rule, met everyone's desire for simplification. Unfortunately, the proposed regulations do not contain a 10-year rule for designated beneficiaries who inherit after the planned participant or IRA owner attained their required beginning date. Instead, the proposed regulations have implemented a 10-year cap.

The 10-year rule is a rule that says that you have to take full distribution of your account within 10 years. That is not what the proposed regulations require for anyone who inherits after the plan participant or IRA owner reached their required beginning date. Instead, the proposed regulations would change the simple, easy to administer 10-year rule into a 10-year cap that overlays the existing RMD rules.

Furthermore, the proposed regulations throw in some other new caps as well. Like the cap for older eligible designated beneficiaries who no longer get to take RMDs over the descendant's full life expectancy. And they take away rights from spouses by forcing a new deadline on when a spouse can elect to treat an IRA as his or her own. These changes were not required by the text of the statute and they were not intended by the legislators who voted for the SECURE Act.

We ask that the Department reconsider and move towards a simpler regime in the final regulations. That simpler regime would do what Congress intended and the statute specifies. It would replace lifetime payments with the 10-year rule for designated beneficiaries. Older beneficiaries whose life expectancy is less than 10 years, would see a small windfall. While younger beneficiaries whose life expectancy may have been 30 or more years, would see a much shorter payout period. Spouses would be left alone under the same rules they had before. This is what Congress intended and the statute provides for.

Stated simply, the final regulations should provide that the "at least as rapidly" ("ALAR") rule under IRC Sec. 401(a)(9)(B)(i) would not apply even if the participant dies after his or her RBD.

In a letter dated July 1, 2022, the American Institute of Certified Public Accountants (AICPA) stated a complete case for the 10-year rule not being subject to the ALAR rule. See Tax Analysts Document No. 2022-21953. A copy of this statement is in Appendix B. However, we believe the most compelling case is attributable to one word: "simplification."

C. Trusts *

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*A discussion of trusts is also in the "Supplementary Information" section of the PR on pages 10510-10513.

1. Classification

The PR define three types of trusts, (i) a see-through trust, (ii) a conduit trust and (iii) an accumulation trust. A trust must be a see-through trust to avoid the 5-year rule. The requirements for a see-through trust are, in large part, the same under the PR as under the current regulations. An important requirement is that the beneficiaries of the trust interest must be "identifiable."

PR §1.401(a)(9)-4(f) states:

Special rules for trusts—(1) *Look-through of trust to determine designated beneficiaries*—(i) *In general*. If the requirements of paragraph (f)(2) of this section are met with respect to a trust that is designated as the beneficiary of an employee under a plan, then certain beneficiaries of the trust that are described in paragraph (f)(3) of this section (and not the trust itself) are treated as having been designated as beneficiaries of the employee under the plan, provided that those beneficiaries are not disregarded under paragraph (c)(2) of this section. A trust described in the preceding sentence is referred to as a see-through trust.

(ii) *Types of trusts*. The determination of which beneficiaries of a see-through trust are treated as having been designated as beneficiaries of the employee under the plan depends on whether the see-through trust is a conduit trust or an accumulation trust.

For this purpose—

(A) The term *conduit trust* means a see-through trust, the terms of which provide that, with respect to the deceased employee's interest in the plan, all distributions will, upon receipt by the trustee, be paid directly to, or for the benefit of, specified beneficiaries; and

(B) The term *accumulation trust* means any see-through trust that is not a conduit trust.

A QTIP trust may be a conduit trust or an accumulation trust. The advantage of being a conduit trust over an accumulation trust is that there is only one designated beneficiary of a conduit trust, namely, the spouse., whose life expectancy can be used to determine annual RMDs. With an accumulation trust, the remainder beneficiaries succeeding the spouse's interest need to be considered., and the result may be to require distribution of plan benefits over a period shorter than the spouse's life expectancy.

The minimum distribution rules depend on who is the owner's beneficiary. To determine what rules apply, it is necessary to look through a see-through trust and determine whether its countable beneficiaries are "individuals." The determination of which beneficiaries of a see-through trust are treated as having been designated as beneficiaries of the owner depends on whether the see-through trust is a conduit trust or an accumulation trust. Also, it is necessary to determine the "countable" beneficiaries of a conduit trust or accumulation trust. These rules obviously produce complexity.

A three-tier system is used to determine which trust beneficiaries count. The first tier includes all beneficiaries eligible or entitled upon the owner's death and include "any beneficiary who could receive amounts in the trust representing the employee's interest in the plan that are neither contingent upon, nor delayed until, the death of another trust beneficiary." PR §401(a)(9)-4(f)(3)(i)(A). The second tier includes a beneficiary "that could receive amounts in the trust representing the employee's interest in the plan that were not distributed to the beneficiaries described in the first tier." The third tier includes individuals "who could receive amounts from the trust that represent the employee's interest in the plan solely because of the death of another beneficiary." The individuals included in the second and third tiers are not entirely clear and the examples in the PR are not sufficient to provide needed clarity. A "presumptive" remainderman who would receive trust property if it terminated immediately is apparently a second tier beneficiary, while a more remote remainderman is in the third tier. In determining RMDs, first-tier beneficiaries are always counted. Second-tier beneficiaries are disregarded in a conduit trust, but counted in an accumulation trust. Third-tier beneficiaries are always disregarded except that if a beneficiary qualifies as both second tier and third tier, he or she is classified as second tier.

The determination of a trust beneficiary's status may be complex and uncertain, as is indicated by the testimony in the hearing of David Sennett who said:

The submitted comments serve as my outline. They center around the proposed regulations classification of beneficiaries of an accumulation trust, to determine a defined contribution accounts payoff period, following the account creator's death. The classification scheme definitely improves the rules in the existing final treasury regulations. However, the preamble to these regulations, in my view presages the proposed classification scheme, and gave the term near [mere] potential successor a proper, and much needed, burial. My submitted comments detail an explicit classification scheme.

In summation, Class A and Class B Trust Beneficiaries, which are my terms, derive from respective paragraphs in one portion of the proposed regulations. They are treated as "Designated." Meaning they count, for purposes of determining an account's — accounts period.

A Class C Trust Beneficiary, who stands as a Class B's default beneficiary, is "Disregarded" in this determination. But this summary's not the full story.

The proposed regulations create exceptions to the original classifications, if certain facts exist. One exception arises when the terms of the trust provide a Class B trust beneficiary, but then entitlement granted to a Class A Trust Beneficiary.

The Class C Trust Beneficiary, initially disregarded, moves into designated status. This transformation is not fully addressed in the proposed regulation and preamble, and may create issues requiring further clarification in private rulings. A path, we believe, no one wants to traverse.

Very thoughtful comments from the American College of Trust and Estate Counsel, sometimes referred to as ACTEC, also touch on this issue.

Let's turn to the general scenario, highlighting the challenge. It deals with discretionary distribution of trust assets, including the account creator's interest in the retirement plan, to any beneficiary whose interest is, "Neither contingent upon, or delayed until the death of another trust beneficiary."

The preamble expands the scope of this phrase by adding the words, "Upon — other than the death," of someone who is a Class A Trust Beneficiary. To illustrate, consider this common fact pattern, more fully stated in my written comments and further developed in ACTEC's comments and recommendations, including examples. The Class A Trust Beneficiary, for example, a child, receives the Trust's net income, and may request discretionary distributions of principal. During the life of a Class A Trust Beneficiary, a Class B Trust Beneficiary, for example, a grandchild, also has the right to request discretionary distributions. The Trustee must review, and then approve or deny the request. The authority to make discretionary distributions, creates a condition or contingency that does not rest on the death of a beneficiary, treated as designated.

The right to discretionary distributions poses this question: Does the Class C Trust Beneficiary acquire designated status if the terms of the trust give a Class B beneficiary this entitlement?

The text of the proposed regulations, in preamble, possibly, and I say possibly, imply the answer is, "Yes." But I strongly believe the correct response is, "No." While the standard for authorizing the discretionary distribution may be broad, or narrow, the terms of the trust vest complete control over this decision, in the trustee. Therefore, the presence of this condition/contingency, should not, by itself, elevate a Class B trust beneficiary into Class A status. And simultaneously reclassify a Class C trust beneficiary as designated.

The final regulations should expressly address discretionary distributions, and state the trustees discretion plays no role in classifying trust beneficiaries. Modification of the classification scheme, involving discretionary distributions, implicates a related subject, discussed in ACTEC's comments and recommendations. The essential facts are, a Class B Trust Beneficiary holds a residual interest in the continuing trust following the Class A Trust Beneficiaries' death. The Class B Trust Beneficiary will receive the entire residual interest upon attaining a specified age. If this beneficiary dies prematurely, the trustee shall distribute the remaining assets to a charity.

The implied result, without further examples, is that the Class C Trust Beneficiary, may have shed his — may have shed his disregarded status. So if a charity, or other non-individual, effectively holds Class B Trust Beneficiary status. The Trust does not have a designated beneficiary, an individual, potentially minimizing the account's payout period.

In my view, the text of the proposed regulation, as currently written, provides the answer without requiring further examples. At the account payer's death, the terms of the trust establish the trust beneficiaries' classification, even if the trust continues for a Class B Trust Beneficiary. This beneficiary remains, in proposed regulation speak, a secondary beneficiary. And it's no clear power, absent language in the governing instrument, to compel distributions representing the deceased's account (inaudible) interest in the retirement plan.

As the Class C Trust Beneficiary inherits the Trust residue, solely by virtue of the Class B Trust Beneficiaries' death, its disregarded status never changes. But here's the deal, folks: As surely as the Washington Commanders win next years' Super Bowl, this issue will generate private letter of the law requests. Possibly foreshadowing this result, ACTEC urges that the final regulations create one, or more, examples, to confirm or clarify the standing of a charity, initially the Class C Trust Beneficiary. Their conclusion validates my thinking, also driven, in part, by existing and much, much criticized, private letter ruling. As a Wells Fargo Risk Manager, I initiated, over substantial internal resistance, submission of a private letter ruling, whose facts, collectively, closely tracked examples 10A and 10B (inaudible) the ACTEC and page 15 of the comments and recommendations, the requests ought to preserve the existing pay off period, based on individual life expectancy, by disregarding a secondary beneficiaries' potential successor and estate. Should this beneficiary not attain the age for determination and outright distribution. The IRS, in private LTR 201633025, which cannot be cited as precedent, ignored potential discretionary distributions to grandchildren, the secondary beneficiaries, and their death prior to attaining the age for termination, without right disregard the grandchild's estate as a (inaudible) beneficiary. The proposed regulations again, in my view, fully embrace this result. Yet reasonable comment urges that the proposed regulations include further examples to flesh out this scenario.

This alleged urgency, whether real or non-existent, suggests that, absent further examples, the IRS may face a torrent of private letter ruling requests. So, to stem the flow, build the flood wall now by creating a requested example.

2. Powers of Appointment

The PR provide new rules concerning powers of appointment, which are often used to provide flexibility in a disposition. If, by September 30 of the year after the year of the participant's death, a power of appointment is exercised:

(a) exercise in favor of one or more identifiable beneficiaries, then only those individuals in whose favor the power was exercised are treated as beneficiaries; or

(b) restricted by the powerholder so that the objects of the power are one or more identifiable beneficiaries (presumably a narrower class than the original objects of the power), then only those individuals in whose favor the power could be exercised at a later date are taken into account when determining the beneficiaries of retirement benefits payable to the trust, ignoring the takers in default of the power's exercise. PR §§1,401(a)(9)-4(f)(5)(ii)(A); and 1.401(a)(9)-4(f)(6)(iv) (Example 4).

If a power of appointment is not exercised or restricted by the date referred to, takers in default of the power's exercise are treated as beneficiaries and potential appointees are not. However, the PR also provide new rules as to additions to the class of trust beneficiaries. If a beneficiary is added after the prescribed date (including by exercise of a power of appointment), the beneficiary will be taken into account in determining whether there is a beneficiary who is not a designated beneficiary and for purposes of the rules relating to multiple beneficiaries, and for purposes of determining the oldest designated beneficiary. If state law permits trust modification (including judicial reformation and decanting) which could result in a change in trust beneficiaries, the proposed regulations provide that the trust will not fail to satisfy the identifiable beneficiary requirement. They also state that if a beneficiary is removed by such a modification, the removed beneficiary will be disregarded as a trust beneficiary for purposes of determining the beneficiaries.

3. Identifiable Beneficiaries

The PR provide that if it is possible to identify each person designated by the participant as eligible to receive a portion of the participant's interest through the trust, a trust will not fail to have identifiable beneficiaries because (i) the trust names a class of beneficiaries or (ii) an individual has a power of appointment over a portion of the participant's interest in the plan held by the trust. PR §1.401(a)(9)-4(f)(5)(ii)(A). Rules are provided for which trust beneficiaries are treated as beneficiaries under the plan.

4. Applicable Multi-Beneficiary Trusts

The term "applicable multi-beneficiary trust" was added by the Act. It provides two methods for an accumulation trust with multiple beneficiaries, one or more of whom must be chronically ill or disabled and meet the requirements of an EDB. The two types are Type I and Type II. A Type I trust is divided immediately on the participant's death into separate trusts for each beneficiary. A Type II trust is one that continues to have multiple beneficiaries but provides that the disabled or chronically ill beneficiaries are the only beneficiaries who can receive distributions from the participant's plan interest until the death of the last to die of the beneficiaries. See PR §1.401(a)(9)-4(g)(1)(ii)(3). The PR also state that one of the separate trusts created from a Type I trust can be a Type II trust.

PR §1.409(a)-4(e)(2) states:

(2) *Multiple designated beneficiaries*—(i) *In general*. Except as provided in paragraphs (e)(2)(ii) of this section (providing a special rule for children), (g)(3)(ii) of this section (relating to applicable multi-beneficiary trusts), and §1.401(a)(9)–8(a) (relating to separate account treatment), if the employee has more than one designated beneficiary, and at least one of those beneficiaries is not an eligible designated beneficiary as determined in accordance with paragraph (e)(1) of this section, then the employee is treated as not having an eligible designated beneficiary.

(ii) *Special rule for children*. If any of the employee's designated beneficiaries is an eligible designated beneficiary because the beneficiary is the child of the employee who had not reached the age of majority at the time of the employee's death, then the employee is treated as having an eligible designated beneficiary even if the employee has other designated beneficiaries who are not eligible designated beneficiaries.

This rule should not apply when a separate trust is created for each beneficiary instead of having a single trust for all designated beneficiaries.

5. Marital Deduction Trusts

Stated simply, the discussion of marital deduction trusts in the PR is incomplete.

A marital deduction trust must satisfy two sets of requirements, namely, those of the estate tax and those of the income tax for qualified plans.

A trust often used in estate planning is one qualifying for the marital deduction under IRC Sec. 2056(b)(7). It is often called a QTIP trust for "qualified terminable interest property." IRC Sec. 2056(b)-7. Example 2 of PR §1.401(a)(9)-4(f)(6)(iv), commencing on page 10532 of the Federal Register, is a marital deduction QTIP trust.

The PR describes the facts related to the trust as follows:

Under the terms of Trust P, all trust income is payable annually to B, and no one has the power to appoint Trust P principal to any person other than B. A's sibling, who is less than 10 years younger than A (and thus is an eligible designated beneficiary) and is younger than B, is the sole residual beneficiary of Trust P. Also, under the terms of Trust P, if A's sibling predeceases B, then, upon B's death, all Trust P principal is distributed to Charity Z (an organization exempt from tax under section 501(c)(3)). No other person has a beneficial interest in Trust P. Under the terms of Trust P, B has the power, exercisable annually, to compel the trustee to withdraw from A's account balance in Plan X an amount equal to the income earned during the calendar year on the assets held in A's account in Plan X and to distribute that amount through Trust P to B. Plan X includes no prohibition on withdrawal from A's account of amounts in excess of the annual required minimum distributions under section 401(a)(9). In accordance with the terms of Plan X, the trustee of Trust P elects to take annual life expectancy payments pursuant to section 401(a)(9)(B)(iii). If B exercises the withdrawal power, the trustee must withdraw from A's account under Plan X the greater of the amount of income earned in the account during the calendar year or the required minimum distribution. However, under the terms of Trust P, and applicable state law, only the portion of the Plan X distribution received by the trustee equal to the income earned by A's account in Plan X is required to be distributed to B (along with any other trust income). (Emphasis added.)

The trust is an accumulation trust, as described above, because under applicable state law, the spouse B is not entitled to receive all of the Plan X distributions made to the trust. The terms of the trust give the spouse the power, exercisable annually, to compel the trustee to withdraw from the account balance an amount equal to the income earned during the calendar year on the assets held in the account, with distributions of that amount through the trust to the spouse. However, the trust does not require that the spouse receive an amount equal to the RMD if the RMD exceeds the income. Because of this failure, the trust cannot meet the requirements of a conduit trust.

The reference in Example 2 to Plan X being invested "only in productive assets" creates uncertainty as to whether the words are a "governing instrument" requirement for obtaining an estate tax marital deduction. Hopefully, the answer is "no," but the point should be clarified. Remember, the holder of the Plan may not be the trustee of the trust. The minimum distribution rules are not the appropriate place to impose estate tax marital deduction requirements for a plan or IRA, which are currently set forth in Rev. Rul. 2006-26, 2006-1 CB 939. The failure in the Supplementary Information section of the PR to discuss, or at least to mention, the revenue ruling is puzzling.

Although Example 2 does not grant a testamentary power of appointment over the trust to the spouse, such a power would not be inconsistent with the trust being a conduit trust. Also, the spouse could receive additional trust property in the discretion of the trustee without losing its characterization as a conduit trust.

In its submission, ACTEC requests that the final regulations treat as a conduit trust a QTIP trust over which the spouse is given a power of withdrawal over an amount equal to the greater of the income or the RMD in each year. Its submission on this point would apply to two different types of powers of withdrawal. In one type, the power would not terminate but would continue to exist throughout the spouse's remaining life. In the other type, the power would terminate within a certain period of time, say 30 days, after the end of each year. The ACTEC submission does not discuss how the trust would be treated after the death of the spouse.

The AICPA, in a June 14, 2022 letter to the Treasury and the IRS, provided comments on the proposed required minimum distribution regulations. See Tax Analysts Doc. No. 2022-20117. Comment 5 states:

Marital Trust with Surviving Spouse as Beneficiary

Most qualified terminable interest property (QTIP) trusts provide income to the spouse for life with the remainder to the children. Under pre-SECURE regulations, such a trust was considered an accumulation trust, but the beneficiary could take RMDs based on the spouse's life expectancy from the Single Life Table in the existing regulations (as updated).

Under the proposed regulations, instead of life expectancy, the 10-year rule applies unless the trust agreement provides for a definition of income that is greater than the requirements under state law. That means every QTIP trust will need to specify that trust accounting income must include 100% of the RMD if that is greater than trust income. So, if the major trust asset is an IRA, it will be highly taxed in 10 years and leave much less for the next generation. Also, if it is a second marriage and the survivor can invade principal, there may be nothing remaining for the children of the first marriage.

We think it is likely every family will be worse off because the IRA owner used a trust to preserve benefits for children. That's why we are referring to it as the death of the QTIP.

Further, the proposed regulations state that both first- and second-tier beneficiaries must be considered when determining the RMD for a marital trust. For example, if a surviving spouse is the first-tier beneficiary and a non-designated beneficiary (i.e., charity) is the second-tier beneficiary, the 5-year rule applies if before the IRA owner's RBD and the At Least As Rapidly (ALAR) rule under section 401(a)(9)(B)(i) applies if on or after the IRA owner's RBD. If a surviving spouse is the first-tier beneficiary and a non-EDB (i.e., deceased IRA owner's 50-year-old nondisabled child) is the second-tier beneficiary, the 10-year rule applies. In addition, if a surviving spouse is the first-tier beneficiary and an EDB (i.e., individual not more than 10 years younger than the decedent) is the second-tier beneficiary, the lesser of the 10-year rule or At Least As Rapidly (ALAR) rule under section 401(a)(9)(B)(i) applies. The example in the proposed regulations indicates that a better solution is found if the surviving spouse disinherits the children in favor of a sibling.

AICPA recommends that in the final regulations, Treasury and IRS provide the option for a marital trust with a surviving spouse as the first-tier beneficiary to be treated similar to a conduit trust with a surviving spouse as the first-tier beneficiary. The trust would be treated as if the surviving spouse was the sole beneficiary, allowing the spouse to obtain RMDs using life expectancy with the 10-year rule beginning upon the survivor's death. Allowing this treatment will help taxpayers that have not planned appropriately and would treat surviving spouses similarly whether they are a sole beneficiary or a multiple beneficiary of a trust.

Under the ACTEC approach, a power of withdrawal would make a QTIP trust a conduit trust. Under the AICPA approach, any QTIP trust would be treated as if a conduit trust. We agree with either of these approaches, but believe they are unlikely to be adopted, because they are inconsistent with the fundamental approach of the PR to trusts that can accumulate benefit payments for future distribution to a secondary beneficiary or remainderman.

D. Conclusion

A significant defect in the PR is the failure to provide a clear understanding of what is needed under the Act to satisfy the designated beneficiary rules for a marital deduction QTIP trust. This failure should be eliminated in the final regulations.

After charitable remainder trusts were created in the Tax Reform Act of 1969, forms were published illustrating what was needed to create such a trust. It would be helpful for the same process with annotations (explanations) to be followed in connection with marital deduction QTIP trusts which receive qualified plan distributions. The first example should be the simple case of a QTIP trust with a remainder interest to two children who are not EDBs.

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Appendix A.

8. Treasury Should Clarify that a Beneficiary's Unilateral Withdrawal Right is Equivalent to a Mandatory Distribution from a Conduit Trust.

ACTEC observes that some individuals choose to structure trusts that, in lieu of mandating distributions, provide the beneficiary with an unlimited withdrawal right over the intended portion of the trust. This leaves it up to the beneficiary to choose between taking current distribution from the trust and leaving assets in the trust.

This flexibility enhances the beneficiary's interest in the trust by allowing the beneficiary to leave in the trust some or all of the amounts that might otherwise be distributed, where these amounts will continue to benefit from other valuable non-tax estate planning objectives, including continued management of the assets by the trustee, continued creditor protection in some jurisdictions, protection from divorce in some jurisdictions, and protection from spousal elective share rules in some jurisdictions. Depending on the non-tax estate planning objectives that are intended, a trust may provide either (i) that the withdrawal right does not expire until the beneficiary's death, or (ii) that the withdrawal right for a given year may expire if the beneficiary has not exercised the withdrawal right after some reasonable period of time. One time period that is commonly provided in this regard is the time period ending at the later of thirty days from when the withdrawal right arises or thirty days after the beneficiary attains age 21.

ACTEC observes that there is interest among employees when naming Conduit Trusts as beneficiaries of Plan benefits to provide the flexibility of such a withdrawal right in lieu of mandatory conduit trust distributions, and that clarification of this point will ease the burdens of compliance and enforcement, and will reduce the need for private letter ruling requests.

Accordingly, ACTEC requests that Treasury add examples such as the following to these regulations in order to clarify whether a see-through trust is a Conduit Trust if the trust provides (i) that whenever the trustee receives a distribution from the deceased employee's interest in the Plan, one or more specified beneficiaries shall have the unilateral right to withdraw all of such Plan distribution, (ii) in one case, that the withdrawal right does not expire until the beneficiary's death, and in another case, that the withdrawal right expires after the later of thirty days from when the withdrawal right arises or thirty days from when the beneficiary attains age 21, and (iii) that for so long as any amounts of such Plan distribution remain in the trust, such amounts are to be held for the exclusive benefit of such one or more specified beneficiaries for so long as any one or more of them are living.

Example 8A. Employee E dies at age 65, naming Trust X for the benefit of her nephew Y, who is age 40 but not disabled or chronically ill, as beneficiary of her Plan. Trust X provides that, whenever the trustee receives a distribution from E's Plan benefit, Y shall have the right to withdraw any part or all of such Plan distribution. Trust X provides that each such withdrawal right does not expire until Y's death, and that for so long as any amounts of such Plan distribution remain in the trust, they are to be held for the exclusive benefit of Y for so long as Y shall live.

Example 8B. Same facts as Example 8A, except that Trust X provides that each such withdrawal right expires after thirty days from when the withdrawal right arises.

ACTEC's Analysis of Examples 8A and 8B: ACTEC believes that both versions of Trust X described in Examples 8A and 8B satisfy the requirements under §1.401(a)(9)-4(f)(1)(ii)(A) to be a Conduit Trust because (i) Y's unfettered right to withdraw any part or all of each distribution from the Employee's interest in the Plan is equivalent to being entitled to such Plan distributions, and (ii) to the extent Y elects to take distribution of less than all of a given distribution, such distribution remains in the trust where it continues to be held for Y's exclusive benefit for so long as Y shall live, and no one else.

Multiple tax authorities support treating a trust beneficiary as owning the trust assets that the beneficiary has a right to withdraw. In the income tax area, the beneficiary of a trust is treated as the owner of the trust assets under Code section 678 if the beneficiary holds a withdrawal right. See Treas. Reg. §1.678(a)-1(a) and Rev. Rul. 74-43, 1974-1 C.B. 285. See also Code section661(a)(2), which treats the beneficiary of a trust essentially as the owner of income that a trustee has credited to the beneficiary, effectively creating a withdrawal right for that beneficiary.

In the estate tax area, one of the requirements for a trust to qualify for the marital deduction for estate tax in a decedent's estate under either Code section 2056(b)(5) or 2056(b)(7) is that the decedent's spouse must be entitled to all trust income for life. Treas. Reg. §20.2056(b)-5(f)(8) explains that that this requirement is satisfied if the trust either mandates distributions of the trust income or provides the spouse with a withdrawal right over the trust income, stating". . . under the terms of the trust the income referred to must be currently . . . distributable to the spouse or . . . she must have such command over the income that it is virtually hers." This regulation specifically approves such a withdrawal right that expires if unexercised, causing the income not withdrawn to be added to corpus. Treas. Reg. §20.2056(b)-5(f)(8) also applies to marital trusts described in Code section 2056(b)(7). Treas. Reg. §20.2056(b)-7(d)(2).

A spouse's withdrawal right over the undistributed income in an IRA was specifically recognized and approved as satisfying the "entitled to all income" requirement of Code section 2056(b)(7) in the context of an IRA designated at death to a qualified terminable interest property ("QTIP") marital trust in both Rev. Rul. 2006-26, 2006-1 Cum. Bul. 939, May 4, 2006, and its predecessor Rev. Rul. 2002-2, 2000-1 Cum. Bul. 305, January 5, 2000 (modified and suspended by Rev. Rul. 2006-6).

For purposes of Code section 401(a)(9), the QTIP marital trusts described in Rev. Rul. 2006-26 resemble the trust described in Reg. §1.401(a)(9)-5, A-7(c)(3) Example 1. These trusts provide the spouse the right to compel the trustee to withdraw undistributed income from the employee's Plan interest and to distribute it to the spouse. Because such trusts do not require that all amounts distributed from Employee's Plan interest are to be paid directly to the spouse, when these trusts are analyzed under §1.401(a)(9)-4(f)(1)(ii), they would be classified as Accumulation Trusts and not Conduit Trusts. Rev. Rul. 2006-26 contains the following statement regarding the determination of designated beneficiaries, which reflects the appropriate treatment for a trust that is not a Conduit Trust:

Taxpayers should be aware, however, that in situations such as those described in this revenue ruling in which a portion of any distribution from the IRA to Trust may be held in Trust for future distribution rather than being distributed to [the spouse] currently, [the spouse] is not the sole designated beneficiary of [the Employee's] IRA. As a result, both [the spouse] and the remainder beneficiaries must be taken into account as designated beneficiaries in order to determine the shortest life expectancy and whether only individuals are designated beneficiaries. See A-7(c) of §1.401(a)(9)-5.

However, to the extent that the spouse's withdrawal right results in distribution directly to the spouse, these statements show how a spouse's withdrawal right is recognized as equivalent to ownership for purposes of determining those trust beneficiaries who are treated as the employee's designated beneficiaries for an Accumulation Trust.

It is reasonable to conclude that withdrawal rights should also be recognized as equivalent to ownership for purposes of determining whether a see-through trust is a Conduit Trust, which supports ACTEC's conclusion that each trust described in Examples 8A and 8B satisfies the requirements under §1.401(a)(9)-4(f)(1)(ii)(A) to be a Conduit Trust. Note that any taxable income associated with an amount that is to be distributed to a beneficiary or that is subject to a withdrawal right in the hands of that beneficiary will be taxed to the beneficiary in either case. ACTEC recommends that Treasury include the Examples 8A and 8B in defining Conduit Trusts in §1.401(a)(9)-4(f)(1)(ii)(A).

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Appendix B.

I. Minimum Distribution Requirements for Designated Beneficiaries when Death of the Employee or IRA Owner Occurs After the Required Beginning Date

Overview

Section 401(a)(9)(H) was added to the Internal Revenue Code (IRC or Code) by the SECURE Act to change the requirements for RMDs for plans and IRAs that apply after the employee or IRA owner's death. The new rules apply to distributions from account balance type retirement arrangements made to designated beneficiaries, other than eligible designated beneficiaries (a new category of designated beneficiary created by the SECURE Act). The new rules apply to designated beneficiaries (including eligible designated beneficiaries) of employees or IRA owners who die after December 31, 2019.

Under section 401(a)(9)(H), if the plan is a defined contribution plan, distributions are required to be made within 10 years of the death of the employee/IRA owner. The rules governing distributions after death are contained in two separate locations in the proposed regulations, which parallel the organization of the rules in the current final regulations, as follows:

- Proposed Reg. §1.401(a)(9)-3 provides rules applicable to determining RMDs in the case of the account owner's death prior to the required beginning date (RBD);
- Proposed Reg. §1.401(a)(9)-5 contains rules applicable to determining the lifetime minimum distributions to an employee or IRA owner, and the RMDs after the death of the employee or IRA owner if death occurs after the RBD.

Proposed Reg. §1.401(a)(9)-3 contains rules for implementing the new 10-year rule added by the SECURE Act in cases where the employee/IRA owner dies prior to the RBD. Under Prop. Reg. §1.401(a)(9)-3(c)(3), the entire interest must be distributed by the end of the tenth calendar year following the death of the employee/IRA owner. Proposed Reg. §1.401(a)(9)-3 does not require any amount to be distributed in any year following the year of death, until the tenth year following death. In cases when death occurs after the RBD, the distribution requirements are set forth in Prop. Regs. §1.401(a)(9)-5(d) and (e). Prop. Reg. §1.401(a)(9)-5(d)(1)(i) requires the designated beneficiary to take a distribution in each year following the death of the employee/account owner. In addition, Prop. Reg. §1.401(a)(9)-5(e) provides that if the designated beneficiary is not an eligible designated beneficiary, any remaining interest must be distributed in the tenth year following the year of death. The requirement for the designated beneficiary to take annual distributions each year between the year of death and the tenth year following death is the main difference in the rules that apply in cases of death before the RBD and death after the RBD for account-type plans.

Recommendation

The AICPA recommends that Treasury and the IRS eliminate the requirement in Prop. Reg. §1.401(a)(9)-5(d)(1) mandating that a designated beneficiary who is not an eligible designated beneficiary take distributions in each of the 10 years following the death of the employee. We also recommend that the final regulations follow the rule set forth in Prop. Reg. §1.401(a)(9)-3 requiring only that the entire interest is to be distributed no later than by the end of the tenth year following the death of the employee/IRA owner.

Analysis

The requirements of Prop. Reg. §1.401(a)(9)-5(d)(1) do not reflect the statutory language related to the changes made to RMDs by the SECURE Act.

After-death RMD Requirements Prior to the SECURE Act

Prior to the SECURE Act, the rules governing RMDs after the death of the employee/IRA owner were fully contained in section 401(a)(9)(B). The rules that applied depended on when the employee/IRA owner's death occurred relative to the RBD. If the employee/IRA owner's death occurred after RMDs had begun, section 401(a)(9)(B)(i) applied. Under this rule, distributions were required to be made at least as rapidly ("at least as rapidly" rule) as under the method of distributions being used during the employee's or IRA owner's lifetime. Section 401(a)(9)(B)(i) did not provide further details on how to satisfy the "at least as rapidly" rule, (i.e., how to calculate the minimum amount of distribution necessary each year). The details for how to comply with this rule in the case of defined contribution plans are set forth in Treas. Reg. §1.401(a)(9)-5, Q&A-5(a). The final regulations provide that if the beneficiary qualifies as a designated beneficiary, they may calculate RMDs by using either the designated beneficiary's life expectancy, or the decedent's life expectancy, whichever is longer. If the beneficiary does not qualify as a designated beneficiary, the distributions are calculated by reference to the decedent's life expectancy in the year of death.

If death occurred prior to the RBD the general rule for distributions was set forth in section 401(a)(9)(B)(ii). Under this rule, prior to the changes made by the SECURE Act, the entire interest was required to be distributed within 5 years (5-year rule) from the death of the employee/account owner. Under the 5-year rule, distributions were not required to be made between the year of death and the end of the fifth year following the year of death. Rather, the entire interest was required to be distributed no later than the end of the fifth year following the year of death.

As an alternative to the 5-year rule, section 401(a)(9)(B)(iii) permitted a designated beneficiary to use the life expectancy rule which allowed the designated beneficiary to take distributions over his or her life expectancy as determined in the year following death. To use the life expectancy rule, distributions must commence no later than the year following the employee/account owner's death.

Prior to the SECURE Act, a designated beneficiary was able to receive distributions over his or her life expectancy regardless of when death occurred. If death occurred after the RBD, the "at least as rapidly" rule was the exclusive rule. If death occurred prior to the RBD, the 5-year rule applied, unless a designated beneficiary opted for the "life expectancy" rule. Under both rules, distributions were made over the designated beneficiary's life expectancy.

Distributions under both the "at least as rapidly" rule and "life expectancy rule" are determined by using the same formula. The distribution in the first year is equal to the prior year's account balance divided by the designated beneficiary's life expectancy in that year, determined from IRS tables. In subsequent years, the RMD is equal to the balance at the end of the year, divided by the original life expectancy, reduced by one for each year. The ability of a designated beneficiary to take distributions over the designated beneficiary's life expectancy is a "stretch" distribution, which allows the beneficiary to be assured of retirement assets for life expectancy.

Changes Made by the SECURE Act

The SECURE Act changed the beneficiary distribution rules for account balance type plans by prospectively eliminating "stretch" distributions for most designated beneficiaries. This change is applicable to designated beneficiaries of employees/IRA owners who died after December 31, 2019. The rules remain unchanged for defined benefit plans.

The limited nature of the change to these rules appears to be the basis in which Congress drafted the statute, leaving section 401(a)(9)(B) (which are the rules for defined benefit plans and beneficiaries of decedents who die prior to 1/1/2020) unchanged. The statute added section 401(a)(9)(H) to the IRC, which modifies section 401(a)(9)(B)(ii) for defined contribution plans with respect to decedents who die after 12/31/2019. New section 401(a)(9)(H) functions as an overlay on top of section 401(a)(9)(B).

Section 401(a)(9)(H)(i) provides that except in the case of a beneficiary who is not a designated beneficiary, section 401(a)(9)(B)(ii) shall be applied by substituting "10 years" for "5 years." The distribution requirements of the 5-year rule mandate that the full distribution must be made at the end of the period and does not require annual distributions. Section401(a)(9)(B)(ii)(I) modifies the period from 5 to 10 years, however, no changes were made to the operating requirements of the rule as set forth in final regulations. Additionally, Congress would have explicitly stated in the statute, if they had intended to change the operating requirements of the 5-year rule or 10-year rule, to require annual distributions.

The Proposed Regulations Governing RMDs for Designated Beneficiaries of Employees and IRA Owners who Die After the Required Beginning Date Are Not Reflective of the Statutory Changes Made by the SECURE Act

The statute, providing for the 10-year rule, does not require annual distributions, the treatment of which is identical to the 5-year rule. The change made by the SECURE Act from 5 years to 10 years only extends the period of time and makes no other changes.

The proposed regulations mandate that in the case of a designated beneficiary of an employee/IRA owner who dies after the RBD, distributions must be completed by the end of the tenth year following death. However, they also require the designated beneficiary to take distributions in each year following the year of death. In order for there to be such a requirement, one of the following statements must be true:

- The 10-year rule requires a distribution to be made in each of the years prior to the tenth year based on life expectancy, with a full distribution by the end of year 10; or

- The 10-year rule applies simultaneously with the "at least as rapidly" rule, and the "at least as rapidly" rule continues to apply.

Since the 10-year rule does not require annual distributions between the year of death and the tenth year following death, thus eliminating the first alternative above as a basis for requiring annual distributions.

The second alternative above also is not correct, as the "at least as rapidly" rule has been rendered inoperative by section 401(a)(9)(H). Section 401(a)(9)(H)(i)(II) states that subparagraph (B)(ii) (i.e., the 5-year rule that is changed to 10 years) "shall apply whether or not distributions of the employees' interest have begun in accordance with subparagraph (A)" (i.e., whether or not the death occurred prior to the RBD or after). Therefore, the 10-yearrule also applies if death occurs after distributions have "begun." The language does not specifically indicate that the "at least as rapidly" rule continues to apply. Therefore, the "at least as rapidly" rule does not apply, making the 10-year rule the only rule applicable.

The "at least as rapidly" rule is inconsistent with the 10-year rule. The "at least as rapidly" rule requires distributions to be made on an annual basis, while the 10-year rule does not. Since the language of the statute states that the 10-year rule "shall apply" whether or not distributions have begun, Congress intended for the 10-year rule, and only the 10-year rule to apply.

Our conclusion is further supported by the legislative history of the SECURE Act. House Report 116-65 explains the revisions to section 401(a)(9) as follows:

Under the provision, the five-year rule is expanded to become a 10-year period instead of five years ("the 10-year rule"), such that the 10-year rule is the genera lrule for distributions to designated beneficiaries after death (regardless of whether the employee (or IRA owner) dies before, on, or after the required beginning date) unless the designated beneficiary is an *eligible* beneficiary as defined in the provision. Thus, in the case of an *ineligible* beneficiary, distribution of the employee (or IRA owner's) entire benefit is required to be distributed by the end of the tenth calendar year following the year of the employee or IRA owner's death.

(Emphasis added.)

Congress clearly intended the 10-year rule to be the exclusive rule for distributions made after the death of the employee or IRA owner (except to eligible designated beneficiaries), which renders the "at least as rapidly" rule inapplicable. The "at least as rapidly" rule was not removed entirely since Congress did not intend to change the rules for beneficiaries of defined benefit plans or for beneficiaries of decedents who die prior to January 1, 2020, but its application is limited solely to those situations.

Adverse Impact of Retroactive Application of the Proposed Regulations

The new rules of section 401(a)(9) applicable to distributions after death apply to decedents who die after December 31, 2019. Therefore, a designated beneficiary of a decedent who died in 2020 would be required to take distributions beginning in 2021, and each subsequent year until 2031, when a distribution of the remainder of the account would be required. An individual who did not take a distribution during 2021, would be in violation of the minimum distribution requirements for 2021, which would trigger an excise tax under section 4974.

The negative consequences for a designated beneficiary of a decedent who died in 2020 may be mitigated by the proposed effective date of the regulations. The regulations are proposed to be effective for distribution calendar years beginning in 2022. However, individuals do not have clear guidance related to their RMD in 2021, the first potential year an RMD requirement applies. If the regulations are not published in final form prior to the end of 2022, uncertainty will extend to beneficiaries of decedents who die in 2021.

Uncertainty as to whether distributions were required may have an economic impact for some beneficiaries as many individuals believed that distributions were not required. Accordingly, IRA beneficiaries may have selected illiquid investments for their IRA, with the intention of investing with a 10-year investment horizon. The position taken in the proposed regulations which mandate annual distributions, would disrupt those investment plans, and create a hardship for these beneficiaries.

In addition, section 401(a)(9) is a retirement plan qualification requirement. If qualified plans were required to make distributions during this period, and did not, the plan would have an operational failure. Adopting the alternative position, that no distribution is required, would preclude operational failures. Distributions to beneficiaries could still be made, but they would be permissive, not required

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