Estate Planning Insights

A Quarterly Publication of

Karen S. Gerstner & Associates, P.C.

Attorneys at Law
5615 Kirby Drive, Suite 306
Houston, Texas 77005-2448
(713) 520-5205

Vol. 17, No. 1 **January 15, 2020**

THE SECURE ACT: Insecurity for Estate Planing Lawyers And their Clients

THE BOTTOM LINE. For those clients who do not read our newsletters (or who do not read them all the way to the end), we are going to put "the Bottom Line" first! Then we will discuss the SECURE Act in more detail.

Initial Information: The SECURE Act, which became effective January 1, 2020, made significant changes to the income tax rules (called the "minimum distribution rules") that apply to "Retirement Plans" and, especially, the rules that apply to *beneficiaries* of Retirement Plans. For purposes of this newsletter, references to Retirement Plans will mostly include (i) qualified employee benefit plans that are "defined contribution plans," such as 401(k) plans and profit sharing plans–but not "defined benefit plans" (such as "true" pension plans)–and (ii) most types of IRAs, including traditional (pre-tax) contributory IRAs, SEP IRAs, and IRA rollovers (we'll discuss Roth IRAs later). As you know, when you die, your Retirement Plans will be distributed pursuant to the *beneficiary designation forms* that you submitted to the applicable "administrator" or "custodian" of those plans.

1. Married Couples. If you are married and **you have named a Trust for your spouse** (and NOT your spouse, individually) as the *primary* beneficiary of any of your Retirement Plans, you need to come in for an "estate planning check up" right away! Although there still may be valid, non-tax reasons for naming a trust for your spouse, rather than your spouse, as the primary beneficiary of your Retirement Plans, the income tax rules applicable to trusts that are named as beneficiaries of Retirement Plans have changed drastically. On the other hand, if you are married and **you have named your spouse** (as an individual) as the 100% primary beneficiary of your Retirement Plan, *that is not a problem under the SECURE Act.*

2. Single and Married Clients Who Have Named a Trust as the **Primary** Beneficiary of their Retirement Plans. Whether you are married or single, if you have named a Trust (or multiple Trusts) as the *primary* beneficiary of any of your Retirement Plans, you are also in the "urgent group" who needs to come in for an estate planning check up right away.

3. Single and Married Clients Who Have Named a Trust as a **Contingent** Beneficiary of their Retirement Plans. You may have named one or more individuals as the primary "outright" beneficiaries of your Retirement Plans. In general, that is OK under the SECURE Act (although the tax rules applicable to those beneficiaries have changed). Sometimes people name a Trust or multiple Trusts as the *contingent* (secondary) beneficiaries of their Retirement Plans (in case all of their primary beneficiaries predecease them). If you are in this situation (outright primary beneficiaries with one or more Trusts as contingent beneficiaries), that is not an urgent situation, although you do need to consider whether you still want to name a Trust or Trusts as contingent beneficiaries of your Retirement Plans. Continue reading this newsletter to learn more!

A Refresher Regarding the Pre-SECURE Act Rules. With respect to the *minimum distribution rules* relating to Retirement Plans, we have been operating under "applicable regulations" since 2002. Before the new rules per the SECURE Act can be understood, it is important to know something about the *old rules*.

In general, before the SECURE Act became effective, there were six different income tax rules applicable to *beneficiaries* of Retirement Plans after the death of the "Participant": the employee or retiree participating in an employee benefit plan or the named owner of an IRA. Under the old rules, beneficiaries who inherited

Retirement Plans had to take "Required Minimum Distributions" (RMDs) based on the rule that applied to them. The applicable rule depended on two things: (i) whether the Participant died before or after his Required Beginning Date (RBD) and (ii) whether the Participant had a "Designated Beneficiary" (DB)–or not. Under the old rules, RBD was generally April 1 of the year following the year in which the Participant reached age 70½ (although some qualified plans changed the RBD to April 1 of the year following the year of retirement in the case of certain Participants).

Not all beneficiaries of Retirement Plans qualified as *Designated Beneficiaries* (DBs). Only individuals–and not "entities" (such as estates and charities)–could qualify as Designated Beneficiaries (keep this definition of DB in mind as you read this newsletter–it is important). However, certain provisions in the old rules allowed *specially drafted trusts,* called "qualified see-through trusts," to receive Designated Beneficiary treatment. Two types of qualified see-through trusts were recognized under the old rules: conduit trusts and accumulation trusts. Conduit trusts were not very consistent with non-tax estate planning goals because the distributions from the Retirement Plan to the trust merely flowed through the trust to the beneficiary. Accumulation trusts were usually more favored by estate planning attorneys because those trusts allowed distributions from the Retirement Plan to remain in the trust, where they would be protected from "creditors' claims," such as a spouse of the trust beneficiary suing for a divorce or a plaintiff in a lawsuit suing the trust beneficiary for personal injuries resulting from a car accident.

Death *Before* RBD. Under the old rules, if the Participant died *before* his RBD, the income tax rules for his beneficiaries (depending on who they were) were as shown below. NOTE: We will continue to refer to what the beneficiary inherits as the "inherited Retirement Plan" even though it is actually an inherited IRA.

1. NO DB: The 5 year rule applied. A beneficiary who did *not* qualify as a DB (i.e., the Non DB) had to withdraw 100% of the inherited Retirement Plan by December 31 of the year that contained the 5th anniversary of the Participant's death. This rule applied to "entities" (non human beings) and to trusts that were *not* qualified see-through trusts.

2. Spouse of Participant as SOLE DB: The Participant's spouse, as sole beneficiary of the Retirement Plan (or of a severable portion of the Retirement Plan), could either (i) roll over the Participant's Retirement Plan (or her portion) to her own IRA rollover and become the Participant herself or (ii) remain in the position of being the *beneficiary* of the Participant. If she was "too young" to take distributions from her own IRA without penalty, then she needed to pick the second option and wait until later to make the spousal IRA rollover. If the spouse chose the second option, she did not have to take any RMDs until December 31 of the year in which the Participant would have reached age 70½ (although she could take discretionary distributions without penalty prior to that date) and when she did starting taking RMDs, they were based on her life expectancy, recalculated each year. NOTE: A conduit trust for the surviving spouse would fall into this category but an accumulation trust for the surviving spouse would not.

3. Non-Spouse DB: A non-spouse DB could take distributions from the inherited Retirement Plan over his life expectancy (not recalculated), but had to begin taking RMDs by December 31 of the year following the year of the Participant's death. The beneficiary's life expectancy could be a very long period of time. For example, a 47 year old had a 37 year life expectancy, meaning that only 1/37 of the retirement plan had to be withdrawn as the RMD in the first distribution year. The beneficiary could always withdraw more than his RMD, but could not withdraw less without a penalty. Many beneficiaries in this situation purposely withdrew only the RMD each year, allowing the rest of the inherited Retirement Plan to remain inside the plan and to continue to grow, tax-deferred. Using that method was known as the "stretch IRA." NOTE: Accumulation trusts–even accumulation trusts for the primary or sole benefit of the Participant's spouse during her lifetime–fell under this rule.

Death *After* RBD. If the Participant died after his RBD but before taking the full amount of his RMD for the year of his death, his undistributed RMD (or the shortfall) had to be distributed to his beneficiary/ies by December 31 of the year of his death, otherwise a penalty would apply. Beneficiaries in this scenario (Participant's death after RBD) had to start taking RMDs by December 31 of the year following the year of the Participant's death.

1. NO DB: Distribution rule: Participant's "ghost life expectancy." Under this rule, the Participant's beneficiary (Non DB) had to take RMDs based on the remaining, single life expectancy (not recalculated) of

the now deceased Participant. The RMD for the first distribution year was calculated by starting with the divisor (from the Single Life Table) for the Participant's age as of his birthday in the year of his death and then subtracting the number 1. The number 1 was then subtracted from the prior year's divisor in each subsequent year to obtain that year's divisor. Again, this rule applied to "entities" and to trusts that were *not* qualified see-through trusts. Note, however, that other post-RBD beneficiaries could use this rule, if desired.

2. Spouse of Participant as SOLE DB: The spousal rollover option was available. *If the spouse chose not to do the rollover but to remain as the beneficiary of the Participant*, she could take RMDs over her life expectancy, recalculated each year. As previously noted, a conduit trust for the benefit of the surviving spouse would fall into this category, but an accumulation trust for the sole or primary benefit of the surviving spouse would not.

3. Non-Spouse DB: The non-spouse DB could take distributions from the inherited Retirement Plan over his life expectancy (not recalculated). As noted above, accumulation trusts–even accumulation trusts for the primary or sole benefit of the Participant's spouse–fell under this rule.

Successor Beneficiaries. The Participant's *beneficiary* could name a "successor beneficiary" to receive the amounts remaining in the inherited Retirement Plan on the beneficiary's death. Under the old rules, the successor beneficiary of the now deceased DB continued taking RMDs based on the remaining single life expectancy (not recalculated) of that DB.

How Does the SECURE Act Change the Distribution Rules Applicable to Beneficiaries of Retirement Plans? First, the SECURE Act was more or less "added on top of" the old rules, so that *some* (but not all) of the old rules still apply.

Second, the SECURE Act changes the Participant's RBD from April 1 of the year following the year in which the Participant reaches age 70½ to April 1 of the year following the year in which the Participant reaches age 72.

Third, the SECURE Act does *not* change the distribution rules applicable to beneficiaries who are NOT Designated Beneficiaries. In other words, in the case of a Non DB, the 5 year rule still applies if the Participant dies before RBD and the Participant's "ghost life expectancy" still applies if the Participant dies after RBD.

Fourth, the SECURE Act divides Designated Beneficiaries into two sub-categories: (i) "Eligible Designated Beneficiaries" (EDBs) and (ii) "Other Designated Beneficiaries" (ODBs). Later we will discuss EDBs in more detail, but, for now, note that only the following are EDBs:

1. Participant's Surviving Spouse.
2. Participant's Minor Child (but no one else's minor child).
3. Disabled Beneficiaries.
4. Chronically Ill Beneficiaries.
5. Beneficiaries who are not more than 10 years younger than the Participant.

PER THE SECURE ACT, ALL OTHER DESIGNATED BENEFICIARIES ARE ODBS.

New Distribution Rule for ODBs. The new distribution rule for ODBs is very simple: it's the "10 year rule." The 10 year rule is likely to operate just like the 5 year rule. Thus, per the 10 year rule, all ODBs must withdraw 100% of the inherited Retirement Plan by December 31 of the year that contains the 10th anniversary of the Participant's death. This new rule eliminates the "stretch IRA" that most Designated Beneficiaries were able to take advantage of under the old rules. Per government estimates, this new rule is likely to raise revenue by $15.7 billion for years 2020-2029. NOTE: The ODB can withdraw any amounts from the inherited Retirement Plan during the 10 year period–ratably or not–as long as 100% is withdrawn by December 31 of the 10th year. Of course, except for a Roth IRA (discussed later), the amount withdrawn from the Retirement Plan by the beneficiary is going to be taxed to him or her as ordinary income for that year, based on his/her income tax bracket. Advisors will need to consider potential growth in the value of the Retirement Plan if it is left intact until the 10th year versus the likely applicable income tax bracket of the beneficiary each year and, especially, in the 10th year.

Eligible Designated Beneficiaries (EDBs). Eligible Designated Beneficiaries (EDBs) are the only DBs under the new rules who can still obtain a life expectancy distribution. The list of EDBs was shown above, but we will now provide more information.

1. Participant's Surviving Spouse. The Participant's

surviving spouse ("SS") will qualify as an EDB in two cases: (i) the Participant named his SS as the *outright* beneficiary of his Retirement Plan or (ii) the Participant named a *conduit trust* for the *sole benefit* of his SS for life as the beneficiary of his Retirement Plan. In the first case, the SS will have all of the same options she had under the old rules, including the ability to make a spousal IRA rollover. In both cases (assuming the SS does not make a rollover) (i) RMDs do not have to begin until December 31 of the year in which the Participant would have reached age 72 (the new RBD) and (ii) once RMDs begin, they are based on the SS's life expectancy, recalculated each year. Remember that RMDs distributed to the conduit trust from the Retirement Plan must be further distributed OUT of the conduit trust to the SS in that same year. IMPORTANT: Accumulation trusts for either the sole benefit or primary benefit of the SS do not qualify as EDBs under the new rules. As noted earlier, many attorneys created accumulation trusts, rather than conduit trusts, as intended beneficiaries of Retirement Plans because those trusts provided more non-tax benefits than conduit trusts. *That is why all clients who have named a Trust for their spouse as the primary beneficiary of their Retirement Plan must come in for a check up to re-evaluate their plan.*

2. Participant's Minor Child. As previously noted, only the Participant's Minor Child (and not any other minor child) is in this category. Thus, a minor grandchild is NOT in this category, even if the minor grandchild's parent, who was the Participant's child, is deceased. This rule is basically designed for Participants who die young.

This new rule is the most "problematic" of the new EDB rules because it only applies in two situations and it only applies for a portion of the time. If the Minor Child rule applies, during the time when the Minor Child is still a minor (has not reached "majority"), RMDs are payable based on the life expectancy of the Minor Child. The two situations where the Minor Child of the Participant EDB rule applies are: (i) when the Minor Child is named as the *outright* beneficiary of the Participant's Retirement Plan (no estate planning attorney would ever recommend this because it will usually result in a court-supervised guardianship for the Minor Child–unless the particular plan/IRA documents allow distribution to a *custodian* for the Minor Child per the Uniform Transfers to Minors Act [UTMA]) and (ii) when a *conduit trust* for the *sole benefit* of the Minor Child is named as the beneficiary of the Participant's Retirement Plan. As previously noted, distributions from an inherited Retirement Plan to a conduit trust must be further distributed OUT of the trust to the beneficiary in that same year. Fortunately, in the case of a Minor Child, the RMD during the period of minority would be quite small. In addition, most trust instruments allow the Trustee to make distributions from the trust to *or for the benefit of* the beneficiary. Further, most trusts have a "facility of payment" provision that allows the Trustee to distribute amounts to a custodian for the Minor Child, rather than directly to the Minor Child. Thus, the Trustee of a conduit trust for the benefit of the Minor Child would not have to distribute cash directly to the Minor Child. Instead, the Trustee could use that cash to provide for the benefit of the minor child. In other words, the Trustee could pay a "third party" to purchase goods or services *for the benefit of* the Minor Child. Or, the Trustee could make the trust distribution to the Minor Child's UTMA custodian.

Another problem with the Minor Child EDB rule is that *the life expectancy payout only applies while the Minor Child is still a minor.* Once the minor child reaches "majority," the new 10 year rule applies. Remember that, per the 10 year rule, 100% of the inherited Retirement Plan must be distributed out of the plan by December 31 of the 10th year. Thus, even in the case of a conduit trust for a Minor Child EDB, the child is going to receive the full amount in the inherited Retirement Plan at a very young age.

There is also a question regarding what is meant by "majority" as used in the SECURE Act? Does that refer to state law? In Texas, the age of majority is 18. Or does "majority" used in the new rules mean the provision in the current regulations that says that "a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under age 26"? The problem with that "definition" is that there is no definition of "a specified course of education" in the regulations. As in the case of all of the "ambiguities" in the new rules, regulations will need to be issued to clarify what was meant.

Another problem is that "pot trusts" or "group trusts" for the benefit of multiple children are not likely to qualify under the new rules, or, even if they do qualify initially (because ALL of the children are minors at the beginning), the trust will not continue to qualify when the first child reaches majority. *Thus, clients who have Wills or trusts that create a single trust for all of their children (versus a separate trust for each child) also need to come in for an estate planning check up.*

What is the alternative in the case of a Minor Child? Although the life expectancy payout will not apply, clients can name accumulation trusts for minor children (under the OBD rule) instead of conduit trusts (under the EDB rule) as beneficiaries of their Retirement Plans. The downside will be "immediate" application of the 10 year rule (instead of delayed application of the 10 year rule). However, an accumulation trust can provide more "protection" for a young beneficiary than a conduit trust does.

3. Disabled and Chronically Ill Beneficiaries. The SECURE Act contains rules applicable to trusts for beneficiaries who qualify as "disabled" or "chronically ill" that are more favorable than the rules applicable to the other EDBs. Basically, an accumulation trust–rather than a conduit trust–can be used for these particular EDBs as the beneficiary of the Participant's Retirement Plan and a life expectancy distribution period will still be available. We are not going to discuss, in more detail, these two types of EDBs. *Clients who have a disabled child or disabled grandchild (or other disabled beneficiary) who have created in their Will or revocable trust instrument a trust (usually, a "Special Needs Trust") for the benefit of that disabled beneficiary also need to come in for a check up to discuss likely changes that will need to be made to those trusts.* NOTE: It will be more difficult to make changes in the case of an *irrevocable* trust (versus a revocable trust) that has already been established for a disabled child or grandchild.

4. Beneficiaries who are not more than 10 years younger than the Participant ("Close in Age Beneficiaries"). A sibling or non-spouse "significant other" of the Participant might fall into this category. This rule applies in two cases: (i) when the Close in Age Beneficiary is named as the outright beneficiary of the Participant's Retirement Plan or (ii) when a conduit trust for the *sole benefit* of the Close in Age Beneficiary for life is named as the beneficiary of the Participant's Retirement Plan. In either case, RMDs will be distributed after the Participant's death based on the single life expectancy, not recalculated, of the Close in Age Beneficiary.

Summary: The distribution rules applicable to Non DBs are the same as before: (i) 5 year rule (Participant dies before RBD) or (ii) Participant's ghost life expectancy (Participant dies after RBD). The new distribution rule applicable to ODBs is the 10 year rule. The new distribution rule applicable to EDBs is really the old rule, except in the case of a Minor Child EDB: calculate RMDs to the EDB based on the single life expectancy of the EDB (recalculated for the surviving spouse, but not recalculated for other EDBs).

Successor Beneficiaries. It appears that successor beneficiaries to an EDB must use the 10 year rule. At this point, creating a single trust for multiple EDBs is not advisable.

Effective Date Rules. In general, the SECURE Act applies beginning on January 1, 2020, which means it applies in the case of *Participants who die after December 31, 2019.* What about Participants who died before January 1, 2020, having named a DB who has been taking RMDs based on his (the DB's) life expectancy under the old rules? In that case, the DB can continue using the life expectancy method to calculate RMDs for the rest of his life. However, when that DB dies, his successor beneficiary will be subject to the 10 year rule.

Accumulation Trusts. Under the old rules, if an accumulation trust was the beneficiary of the Participant's Retirement Plan, the life expectancy distribution period was available because an accumulation trust is one of the two types of "qualified see-through trusts" that were specifically authorized by the regulations. In the case of an accumulation trust, however, the life expectancy that had to be used to calculate RMDs to the trust after the Participant's death was the life expectancy of the *oldest beneficiary* of the trust. For this purpose, all current beneficiaries of the trust, all first tier remainder beneficiaries of the trust (and even remainder beneficiaries beyond that if the first tier remainder beneficiaries did not take their shares outright when the trust terminated), and all permissible beneficiaries of powers of appointment had to be taken into account (counted).

Bypass Trusts and Marital Trusts Drafted as Accumulation Trusts. Prior to the SECURE Act, married clients frequently created a Bypass Trust for the benefit of their surviving spouse, children and grandchildren. Also, some clients created a Marital Trust for the sole benefit of their surviving spouse for life, with the remaining trust assets being distributed on the spouse's death to children (or to trusts for children). In some cases, the Participant named one of these trusts as the beneficiary of a portion of his Retirement Plan (usually no more than 50% because of community property laws). Under the old laws, as noted above, in the case of an accumulation trust, all "countable beneficiaries" had to be determined because the *oldest* beneficiary's life expectancy was the "measuring life" for purposes of calculating RMDs. In most of these cases, the Participant's surviving spouse was the oldest beneficiary and, therefore, the surviving spouse's life expectancy–not recalculated each year because the trust was designed as an accumulation trust and not as a conduit trust–was used to calculate RMDs distributable to the trust after the Participant's death. Thus, there was still income tax deferral after the Participant's death because the distribution period was the spouse's single life expectancy, not recalculated. Of course, under the old rules, once the spouse died, the first tier remainder beneficiaries of the Trust (usually the children or trusts for the children) had to continue taking RMDs based on the surviving spouse's remaining single life expectancy. Now, under the new rules, these trusts are subject to the 10 year rule *no matter who the oldest beneficiary is*–as long as all "countable" beneficiaries are individuals or qualifying trusts for individuals (no entities, such as charities, can be *countable* beneficiaries of the trust). So, on the one hand, the distribution period may be shorter than what it might have been before (10 years versus non-recalculated life expectancy of the oldest beneficiary of the trust). On the other hand, we no longer need to exclude elderly Aunt Louise, who is 90 years old, as a permissible beneficiary of a Bypass Trust. We can increase the number of current beneficiaries of Bypass Trusts and increase the number of remainder beneficiaries of Marital Trusts (the surviving spouse must always be the sole current beneficiary of a Marital Trust for life) to include beneficiaries who are older than the surviving spouse and the 10 year rule will still apply. By increasing the number of permissible current beneficiaries of a typical Bypass Trust, the Trustee should have the ability to distribute trust income *and principal* (while the RMD received from the inherited Retirement Plan is 100% taxable income, it is only partially "trust accounting income") to beneficiaries who may be in low income tax brackets. Income distributed out of a trust ends up being taxed to the beneficiary who receives it in the beneficiary's applicable tax bracket. Thus, in some ways, the new law increases our flexibility in drafting accumulation trusts.

<u>Descendant's Trusts for Children and Grandchildren Drafted as Accumulation Trusts</u>. What about accumulation trusts created for the primary benefit of children and the secondary benefit of grandchildren (while the children are living), with the grandchildren (or new trusts for their benefit) being the first tier remainder beneficiaries of the children's trusts (to receive what remains when the children die)? Those trusts will be subject to the 10 year rule under the new laws. However, in addition to the Trustee's ability to distribute both income and principal from the trust to both the primary beneficiary and the secondary current beneficiaries for purposes of their health, support, maintenance and education (or for even broader purposes if so drafted and the Trustee of the trust is a corporate Trustee), clients who were expecting a life expectancy distribution period for the inherited Retirement Plan belonging to the trust (such as over the oldest child's life expectancy) will not get that result now. The 10 year rule will apply. So, clients in this situation need to evaluate the pros and cons of leaving their Retirement Plans to Descendant's Trusts versus simply naming their adult competent children as outright beneficiaries of those plans. We have discussed the numerous benefits of Descendant's Trusts many times, including in our newsletter dated October 31, 2018, which is available on the firm's website. *But see* the next section for one particular consideration.

"Houston, We Have a Problem." Actually, all married couples living in Texas (not just Houston) who inherit Retirement Plans have a problem that *almost no other married couples in the United States* have: the Retirement Plan they inherit is at risk of becoming community property, in whole or in part, during their marriage. The 41 common law states, the District of Columbia, and 6 of the 9 community property states do not have the risk of an inherited Retirement Plan losing its *marital property characterization* as the "separate property" (or, non marital property) of the spouse who inherits it. Only in 3 community property states–Texas, Louisiana and Idaho–would this be a possibility due to the "income during marriage rule" applicable in those states (the remainder of this discussion will focus on Texas law and not the law in Louisiana and Idaho).

Most people know that assets received as an inheritance–even assets inherited by a married person living in Texas–are the separate property of the person who inherits the assets. Thus, on the day that a married person living in Texas inherits a Retirement Plan, that inherited Retirement Plan is 100% his or her separate property. However, that may not remain the case because of a particular rule applicable to married couples living in Texas. As noted many times in prior newsletters, Texas has a rule that all income earned during the marriage–even income earned by separate property assets–is community property. Thus, as *income* is earned by the assets inside the inherited Retirement Plan, *community property* is "being added to" that Retirement Plan. That means the spouse of the inheritor is gaining ownership of the Retirement Plan.

Let's look at an example. Dad, a widower, dies in January 2020, leaving his Retirement Plan to Son, his only child. The Retirement Plan is worth $400,000 on the day Dad dies. Son is married and living in Texas. Son plans to remain in Texas "forever." Son is currently 56 years old and has a very good job, earning significant compensation each year. Son plans to retire once he reaches age 65 in 2029. Under the new rules, Son knows that he must withdraw 100% of the inherited Retirement Plan by December 31, 2030. Because Son is in his "peak earning years" right now, he wants to wait until after he retires to withdraw the funds from his inherited Retirement Plan. Son figures he will be in a much lower income tax bracket at that time. Further, Son likes the possibility that the inherited Retirement Plan will continue to grow, tax-deferred, until December 2030.

As noted, the initial value of Son's inherited Retirement Plan is $400,000. Suppose that, during the first year, Son's inherited Retirement Plan earns $14,000 in income (dividends and interest). Son wants to invest that income in a new company he knows a lot about (his college roommate founded the company), which recently went public: Pineapple. Pineapple creates products that are highly desired by both businesses and individuals. Son continues to invest the income earned inside his inherited Retirement Plan in Pineapple stock every year. As hoped, Pineapple stock *appreciates dramatically* in value, year after year. Note that both the investment of income in Pineapple stock each year *and* the appreciation in value of Pineapple stock each year would be community property. By the time Son retires in November 2029, his inherited Retirement Plan is worth $1.4 million, consisting of a "separate property portion" (relating to the initial asset value of $400,000, as appreciated over 9 years), which portion is now worth $700,000, and a "community property portion" (relating to the income earned by the assets held in the inherited Retirement Plan each year that was invested in Pineapple stock, plus appreciation in the value of Pineapple stock over the 9 year period), which portion is now worth $700,000. Thus, Son's inherited Retirement Plan, worth $1.4 million at the end of year 9, is 50% Son's separate property and 50% the community property of Son and his wife.

Unfortunately, in January 2030, Son's wife files for a divorce. In the divorce, Son's wife will claim *her* community property ½ of the community property portion of Son's inherited Retirement Plan (worth $350,000). Son and his wife can agree how to divide their assets upon divorce and Son may give his wife other assets equivalent in value to *her* community property ½ interest in the community property portion of "his" inherited Retirement Plan. (Note that the value of the Retirement Plan is "over-stated" because it is a pre-tax asset. Therefore, $350,000 of value inside the Retirement Plan is NOT equivalent to $350,000 in after-tax assets.) Also note, per Texas law, if Son and his wife cannot agree on a division of their assets, the judge will decide how the assets are to be divided and the judge does NOT have to divide the community property 50-50–more than 50% can go to Son's wife.

Are there any solutions to this problem? Yes, Son and his wife can execute a marital property agreement in which they both agree that the income earned during the marriage inside Son's inherited Retirement Plan (or, earned by all separate property owned by Son) will be Son's separate property. Whether Son's wife is willing to do that may depend on whether Son's wife is likely to inherit assets from her parents, so that the agreement would protect her separate property, too. *Or*, Dad could have created a trust for Son and named that trust, rather than Son, individually, as the beneficiary of his Retirement Plan. The assets owned by that trust would start out as Son's separate property *and remain separate property during Son's marriage to his wife*. That kind of trust prevents the undistributed income earned by the Retirement Plan from being treated as community property because it is "trust income" and not income earned by personally owned assets. If a trust for Son (versus Son himself) had inherited the Retirement Plan in this example, Son's wife would not have acquired any ownership interest in the Retirement Plan. That is why Texas estate planning attorneys often recommend that parents create trusts for children to receive inherited assets, including Retirement Plans, rather than leaving assets outright to children. As noted, this is a problem more or less *unique to Texas*. Of course, the SECURE Act 10 year rule would apply in either case (whether Son or the trust is beneficiary).

Roth IRAs. Roth IRAs inherited by beneficiaries after the Participant's death ARE subject to the SECURE Act "distribution rules" (i.e., the time period for withdrawal(s)). In other words, depending on the particular beneficiary of the Roth IRA, one of three rules applies and determines the distribution period: (i) the 5 year rule or ghost life expectancy rule (No DB); (ii) the life expectancy of the particular EDB (i.e., surviving spouse, minor child of the Participant [during the period prior to majority], disabled or chronically ill beneficiary and Close in Age Beneficiary); or (iii) the

Karen S. Gerstner & Associates, P. C.
A Professional Corporation
Attorneys at Law
5615 Kirby Drive, Suite 306
Houston, Texas 77005-2448

Telephone: (713) 520-5205
Fax: (713) 520-5235

ADDRESS SERVICE REQUESTED

PRINTED ON RECYCLED PAPER

To download back issues and learn more about estate planning, visit our web site at www.gerstnerlaw.com

10 year rule (all DBs who are *not* EDBs and a minor child who reaches majority). Although distributions from a Roth IRA after the participant's death may not be subject to income tax (depending on whether those distributions are "qualified distributions" or not–i.e., the "Roth 5 year rule" must still be met), the Roth IRA must be withdrawn by the beneficiary pursuant to the applicable distribution period.

Regulations Desperately Needed. There appear to be several "quirks" under the new law, such as the fact that a Non DB could end up with a longer distribution period than a DB. There are also many "unknowns" under the new law. We really need regulations to help interpret and clarify the new rules put in place by the SECURE Act. Until we get those regulations, certain types of planning with respect to Retirement Plans may be "premature." At the very least, everyone with a Retirement Plan needs to review both the primary and contingent beneficiary designations on file to determine who will inherit the plan and what the result will be under the new rules. Those who are comfortable naming adult, competent individuals as outright beneficiaries of their Retirement Plan should consider doing that–at least in the short term until the new regulations are published and we can analyze all aspects of the situation.

NOTE. Karen Gerstner has "special expertise" in the "sub-field" of estate planning for Retirement Plans. A review of Karen's resume shows more than 45 professional speeches to other lawyers, CPAs and financial advisors on Retirement Plan matters over the past 20 years. In fact, Karen has been asked to speak on Retirement Plan matters, including the SECURE Act, at the State Bar of Texas' Advanced Estate Planning and Probate Course in June. Karen is also a member of ACTEC's Employee Benefits in Estate Planning Committee.

Contact us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone, fax or traditional mail at the address and phone number shown above, or by email sent to:

Karen S. Gerstner* karen@gerstnerlaw.com

*Board Certified, Estate Planning & Probate Law, Texas Board of Legal Specialization
Fellow, American College of Trust and Estate Counsel (ACTEC)