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Estate Planning Insights

July 31, 2024

Some Recent Developments

Final Regulations on the RMD Rules. On July 18, 2024, the Internal Revenue Service issued *final* Treasury Regulations (as well as some proposed regulations) relating to the "RMD Rules." The RMD Rules are basically the income tax rules applicable to distributions from "retirement plans." For purposes of this newsletter, the term *retirement plans* will include IRAs (of all types) and "qualified plans" (also sometimes referred to as "employee benefit plans," which include 401(k) plans, 403(b) plans, profit-sharing plans, stock bonus plans, thrift plans, certain deferred compensation plans, pension plans, etc.). The RMD Rules apply to both (i) the "Participant" (the employee or retiree who participates in a qualified plan *and* the named owner of an IRA) and (ii) the Participant's beneficiaries after the Participant's death. (For simplicity, we will use male pronouns in this newsletter to refer to the Participant, although, obviously, a Participant can be male or female. We will also use the term *Participant* to refer to the participant in any type of retirement plan although, in certain cases, we will distinguish between a participant in a qualified plan and the named owner of an IRA.)

Background. On December 19, 2019, Congress passed the SECURE Act, which became effective (for the most part) on January 1, 2020. We have written multiple newsletters regarding the SECURE Act subsequent to that time, all of which are in the "Reference Center" on the law firm's website.* The SECURE Act made significant changes to the RMD Rules. Perhaps the most notable change was elimination of the "stretch IRA" for many beneficiaries of the Participant after the Participant's death and replacement of that distribution rule with the new "10 Year Rule." The *stretch IRA* allowed the beneficiary of a deceased Participant's retirement plan to "stretch" the beneficiary's required minimum distributions (RMDs) over the beneficiary's life expectancy. In many cases, the stretch IRA allowed for significant tax-deferred growth inside the inherited IRA and reduced annual RMDs, sometimes for a period of 40 or more years.

A living Participant must begin taking RMDs from his retirement plan by his "Required Beginning Date" (RBD). In the case of Participants in a qualified plan who are not 5% or more owners of the employer sponsoring the plan, the RBD is April 1 of the year following *the later of* (i) the year the Participant attains the "Applicable Age" and (ii) the year the Participant retires (assuming the particular plan includes that option). For all IRA owners and Participants who are 5% or more owners of the employer sponsoring the qualified plan, RBD is April of the year following the year the Participant reaches the Applicable Age. The Applicable Age (which is the "age component" of RBD) has been changed several times. The Applicable Age for Participants born before July 1, 1949, is 70½. For Participants born on or after July 1, 1949 through December 31, 1950, the Applicable Age is 72. For Participants born on or after January 1, 1951 through December 31, 1958, the Applicable Age is 73. For Participants born on or after January 1, 1960, the Applicable Age is 75. **NOTE:** No final rule has been issued yet for Participants born during 1959 (there was an error in the statute that must be fixed by a "technical correction").

Some beneficiaries of a Participant's retirement plan are "Designated Beneficiaries" (DBs) and some are not (Non DBs). For the most part, a Non DB is a beneficiary that is not considered to be a "human being," such as a charity, an estate or a trust that does not qualify for DB treatment. In the case where the Participant's sole beneficiary is a Non DB, there are only two distribution rules: (i) the "5 Year Rule," which applies if the Participant dies prior to reaching his RDB, and (ii) the Participant's "ghost life expectancy" (i.e., the Participant's remaining single life expectancy per the Single Life Table, not recalculated), which applies if the Participant dies on or after reaching his RBD.

Certain beneficiaries of the Participant's retirement plan are still entitled to take RMDs using a *life expectancy distribution method*. These "special" beneficiaries are referred to as "Eligible Designated Beneficiaries" (EDBs). The five types of EDBs are (i) the Participant's spouse, (ii) a disabled individual, (iii) a chronically ill individual, (iv) a *child of the Participant* who has not reached "the age of majority" by the date of the Participant's death (the *age of majority* is defined in the regulations as age 21), and (v) an individual not more than 10 years younger than the Participant. All other individuals (human beings) named as beneficiaries of the Participant's retirement plan are going to be "Plain Old Designated Beneficiaries" (PODBs), a term coined by the nationally known RMD expert, Natalie Choate. PODBs are now subject to the 10 Year Rule. The most prominent example of a PODB would be an adult child of the Participant who is not disabled or chronically ill. **NOTE:** A PODB who is an EDB's "successor beneficiary" (i.e., the beneficiary designated to receive the EDB's inherited retirement plan on the EDB's death) is also subject to the 10 Year Rule when the EDB dies.

Although each type of EDB is entitled to some sort of life expectancy distribution, the rule is not the same for all types of EDBs. For example, in the case of the Participant's child who has not reached age 21 by the Participant's date of death, when that child reaches age 21, that child converts to a PODB and the full amount held in that child's inherited IRA must be distributed by the end of the year that contains the 10th anniversary of the year when that child reached age 21, which would be by the end of the year when that child reaches age 31.

When the 10 Year Rules applies, the PODB must withdraw 100% of the amount held in the retirement plan he/she inherited from the Participant (referred to as an "inherited IRA") by December 31 of the year that contains the 10th anniversary of the Participant's date of death. For PODBs, that is a drastic acceleration of withdrawals from the inherited IRA compared to the *stretch IRA* that applied before the SECURE Act. In addition, that is a rapid acceleration of, and increase in the amount of, income taxes payable on each withdrawal from the inherited IRA during the period of the 10 Year Rule. Except in the case where a retirement plan contains after-tax contributions, amounts withdrawn from inherited IRAs will be treated as "ordinary income" for federal income tax purposes, taxable to the beneficiary for the year of receipt.

The Proposed Regulations. Based on what appeared to be Congressional intent with respect to the 10 Year Rule that was added by the SECURE Act, the vast majority of lawyers, accountants, financial advisors and commentators believed that, if the 10 Year Rule applied, the PODB would not have to withdraw *any* amounts from his/her inherited IRA until the end of the 10th year following the Participant's death. That interpretation of the 10 Year Rule in the SECURE Act was consistent with how the longstanding 5 Year Rule had been applied to Non DBs. However, the Proposed Regulations, which were published in February 2024 (more than 2 years after the effective date of the SECURE Act) indicated that there are basically 2 different 10 Year Rules, depending on when the Participant dies. If the Participant dies prior to reaching

his RBD with a PODB as his beneficiary, then that particular 10 Year Rule *is* applied just like the 5 Year Rule—no withdrawals from the inherited IRA are required until December 31 of the year containing the 10th anniversary of the Participant's death. However, if the Participant dies on or after reaching his RBD with a PODB as his beneficiary, per the "second" 10 Year Rule, that PODB must take RMDs in years 1 through 9 of the period of the 10 Year Rule, based on the PODB's life expectancy per the Single Life Table, not recalculated. So, per the "second" 10 Year Rule that applies if the Participant dies after reaching his RBD, the PODB must take RMDs in years 1 through 9 after the year of the Participant's death AND must also withdraw 100% of the amount held in his/her inherited IRA by December 31 of the year containing the 10th anniversary of the Participant's date of death.

NOTE: With respect to RMDs after the Participant's death, the SECURE Act does not just apply to qualified plans and pre-tax IRAs. It also applies to Roth IRAs and, now, per SECURE 2.0, to "Roth designated accounts," too. The Participant of a Roth IRA (or a Roth designated account, such as a Roth 401(k) plan) is always deemed to have died prior to reaching his RBD. Thus, for example, if the beneficiary of the Participant's Roth IRA is a PODB, the "first" 10 Year Rule applies. Per that rule, the PODB is not required to withdraw any amounts from the inherited Roth IRA in years 1 through 9 following the year of the Participant's death. That PODB simply must withdraw 100% of the amounts held in the inherited Roth IRA by December 31 of the year that contains the 10th anniversary of the Participant's death. In addition, those withdrawals are after-tax withdrawals and not pre-tax withdrawals. These facts are why a Participant can still name accumulation trusts as beneficiaries of his Roth IRA but, except in the case of certain types of EDBs, the Participant should no longer name accumulation trusts as beneficiaries of his pre-tax IRA or qualified plan.

When either a Participant or a beneficiary of a deceased Participant fails to take the full amount of an RMD, a penalty applies. Before SECURE 2.0 (which was passed in December 2022) became effective, the penalty for such a failure was a whopping 50% of the shortfall! Fortunately, SECURE 2.0 dropped the under-distribution penalty to 25% and, in some cases, to 10%, starting in 2023. Nevertheless, neither Participants nor beneficiaries of Participants desire to pay a penalty for failure to withdraw the full amount of an RMD, which is an excise tax that applies in addition to the income taxes payable on each RMD that is actually taken.

Because the interpretation of the "second" 10 Year Rule was a *surprise* to most PODBs and their advisors, the IRS issued 3 separate Notices, i.e., Notice 2022-53, Notice 2023-54, and Notice 2024-35, basically indicating that the IRS would refrain from imposing a penalty on beneficiaries of deceased Participants who died (i) on or after their RBD and (ii) on or after the effective date of the SECURE Act (1/1/2020) who failed to take their RMDs pursuant to the "second" 10 Year Rule in the years 2021, 2022, 2023, and/or 2024 (as applicable). Per Notice 2024-35, the IRS said that the "second" 10 Year Rule would not be applied until January 1, 2025.

Certain other provision in the Proposed Regulations that were "changed" by the Final Regulations will be discussed below.

Some Specific Provisions in the Final Regulations.

Confirmation of IRS's Interpretation of "Second" 10 Year Rule. Perhaps the most important provision in the Final Regulations is the one that confirms that PODBs must take RMDs in years 1 through 9 of the period of the 10 Year Rule if the Participant dies on or after reaching his

RBD. (As noted above, the 10 Year Rule also applies in the case of a PODB who is a "successor beneficiary" of an EDB.) Thus, beginning in 2025, every PODB in this situation will need to begin taking RMDs from his/her inherited IRA. **NOTE 1:** The Final Regulations do not change the method for calculating the PODB's applicable RMD beginning in year 2025 even if the PODB did not take an RMD per the "second" 10 Year Rule in prior applicable years. A PODB in this situation must calculate his/her RMD as if the PODB had begun taking RMDs in the year immediately following the year of the Participant's death. A PODB's RMD per this "second" 10 Year Rule is based on the PODB's single life expectancy per the Single Life Table, not recalculated. This means that, to determine the RMD for the first distribution year, the prior year-end balance of the inherited IRA is divided by the "Life Expectancy Factor" (previously referred to as the "divisor") from the Single Life Table for the PODB's age (i.e., the age the PODB attained or would have attained in that year) in the year immediately following the year of the Participant's death. In each subsequent year, the prior year's Life Expectancy Factor is reduced by the whole number one (1) to calculate that year's RMD. A PODB cannot go back to the Single Life Table to obtain a new Life Expectancy Factor each year because that would be "recalculating" life expectancy, which PODBs are not permitted to do. **NOTE 2:** PODBs subject to the "second" 10 Year Rule do not have to "make up" RMDs that they failed to take in years prior to 2025.

Certain Other Changes. There are at least ten changes (by our count) made in the Final Regulations that are an improvement over certain provisions that were included in the Proposed Regulations. We will not mention all of those changes. However, a few of them are noted below.

Multiple Children Rule. When the Participant names all of his children ("multiple children") as beneficiaries of his retirement plan and at least one of those children has not reached "the age of majority" (i.e., age 21) as of the Participant's date of death, the Proposed Regulations provided that the "switch" from EDB treatment to PODB treatment would occur when the *oldest* child of the Participant who had not reached age 21 as of the Participant's date of death reached that age. Because full distribution of the inherited IRA to the Participant's children would then have been required when that particular child reached age 31 and because one or more the Participant's other children might still have been minors or otherwise "too young" to receive an outright distribution of their shares of the Participant's retirement plan, the IRS changed this rule in the Final Regulations. Per the Final Regulations, the distribution rules after the Participant's death when the Participant names multiple children as beneficiaries of his retirement plan and at least one child is under age 21 when the Participant dies are based on when the *youngest* child of the Participant who had not reached age 21 as of the Participant's death reaches age 21, so that full distribution is not required until that particular child reaches age 31.

Payment of Participant's Final RMD from Qualified Plan to "any" beneficiary. In the case of qualified plans (but *not* IRAs—different rules apply to IRAs), if the Participant did not take the full amount of his RMD for the year of his death, that RMD—or the shortfall—(the applicable amount herein referred to as the "Final RMD") can now be paid to *any* beneficiary of the Participant's qualified plan, instead of having to be paid proportionately to all beneficiaries of the Participant's qualified plan. This new rule in the Final Regulations can be particularly helpful when the Participant dies late in the year and inherited IRAs have not yet been established for all beneficiaries of the Participant's qualified plan. In addition, if the Participant's beneficiary designation for his qualified plan includes a specific gift of a dollar amount to charity, the

Participant's Final RMD can be distributed entirely to that charity (up to the amount of the Final RMD), which is a very beneficial option from an income tax standpoint.

Continuing with the payment of the Participant's Final RMD, in the case of *both* qualified plans and IRAs, if the Participant's Final RMD is not paid by December 31 of the year of the Participant's death (which, again, can be difficult to accomplish if the Participant dies late in the year), the deadline to make that distribution after the Participant's death without incurring a penalty for failure to make that distribution by the deadline has been extended by the Final Regulations from the due date in the year following the year of the Participant's death for filing the applicable beneficiary's tax return (including extensions) to December 31 of the year following the year of the Participant's death.

Separate Account Treatment for See-Through Trusts that Divide "Immediately" Upon the Participant's Death. Prior to the SECURE Act, if the Participant named his revocable trust (also known as a "living trust") as the beneficiary of his retirement plan, even if the revocable trust instrument specifically provided for division of the Participant's retirement plan upon the Participant's death and distribution to separate trusts ("sub-trusts") created in the trust instrument for separate beneficiaries, "separate account treatment" per the "separate account rules" was *not* available. When *separate account treatment* is not available, then every beneficiary of every sub-trust must be taken into account for purposes of the RMD Rules, including for (i) determining whether all of the trust beneficiaries of all of the sub-trusts are "human beings" (versus entities)—this has to do with which particular distribution rule applies—and (ii) determining which beneficiary out of all the beneficiaries of all of the sub-trusts is the oldest individual because the life expectancy of the oldest trust beneficiary would have to be used by all beneficiaries of all of the sub-trusts to calculate RMDs after the Participant's death in the case of the "second" 10 Year Rule. In contrast, when separate account treatment is available, each separate sub-trust can be analyzed separately and the RMD Rules are then applied separately to each of those sub-trusts.

The SECURE Act made a notable exception to the separate account rules in the case in which the Participant named his revocable trust as the beneficiary of his retirement plan and at least one of the sub-trusts created per the trust instrument upon the Participant's death was an "Applicable Multi-Beneficiary Trust" (AMBT). An AMBT is a type of trust created specifically for the benefit of a disabled or chronically ill beneficiary for life that qualifies for EDB treatment. Now, per the Final Regulations, separate account treatment is available if the Participant names his revocable trust as the beneficiary of his retirement plan and the trust instrument provides that the Participant's retirement plan be "immediately divided" between the separate sub-trusts on the Participant's death.

Although this new separate account rule is helpful, there are at least two issues with it. First, what does "immediately divided" mean? When the Participant dies, there will usually be various tax and administration matters that must be handled before distributions are made to the sub-trusts. Fortunately, the Final Regulations do include a definition of "immediately divided": "…a trust will not fail to be immediately divided…merely because there are administrative delays between the date of the employee's [i.e., Participant's] death and the date on which the [revocable] trust is divided and terminated, provided that any amounts received by the trust during this period are allocated as if the trust had been divided on the date of the employee's death." Thus, administrative delays in dividing the revocable trust into the separate sub-trusts

are not fatal as long as any distributions from the Participant's plan during the post-death administration period are allocated proportionately to the sub-trusts.

The second issue is more problematic. Sometimes a revocable trust instrument provides for distributions to one or more individual beneficiaries "outright"—i.e., not in a sub-trust. The way the Final Regulations are worded, however, this special exception to the separate account rules applies only if the revocable trust named as beneficiary of the Participant's retirement plan divides into separate sub-trusts. If the Participant intends that certain beneficiaries receive their shares of his retirement plan outright (not in trust), it would be better for the Participant to name those individuals as outright beneficiaries directly in the beneficiary designation form submitted for his retirement plan, instead of naming his revocable trust as the beneficiary of that retirement plan.

We will continue to discuss the RMD Rules in future newsletters because so many of our clients have retirement plans.

Corporate Transparency Act: Reporting Beneficial Ownership of Legal Entities by December 31, 2024. This is our fourth reminder that, if you created a Limited Liability Company (LLC), limited partnership (LP), or corporation prior to this year, you have until December 31, 2024, to file your Beneficial Ownership Information (BOI) Report with FinCEN (Financial Crimes Enforcement Network). You must do this on line. As we have discussed before, the penalties for failing to file a completely accurate report in a timely manner can be significant.

Other Recent Developments. A couple very significant U. S. Supreme Court cases have recently been decided. We will report on those cases in a future newsletter.

New Attorney! In May, Karen S. Gerstner & Associates, P.C. welcomed a new associate attorney, Libby Mosher. Libby previously worked at Vinson & Elkins LLP as a corporate attorney for over three years and enjoyed her time working on fast-paced mergers and acquisitions. In addition to being a dedicated attorney, Libby is also Karen's youngest daughter. Karen plans to train Libby as part of her long-term succession plan so that the law firm will be able to provide continued service to our clients even after Karen retires. But don't worry—Karen has no plans to retire any time soon!

Libby received her bachelor's degree in history from the University of Mississippi in 2016 and received her J.D. from Tulane University School of Law *cum laude* in 2020. Libby and her husband, Rayne, were married in February 2023 and have a cockapoo named "Pringles" whom they adore. Libby is a committed Francophile and loves traveling and collecting antique art and home furnishings. She also enjoys painting with watercolors, going on long walks, taking French lessons and reading history books in her spare time. She is excited to meet you during your next appointment with the law firm.

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*FYI: We are in the process of creating a "more modern" website. Stay tuned!

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 (713-520-5205), fax (713-520-5235) or email sent to:

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