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Estate Planning Insights
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Some Provisions in SECURE 2.0, Including a Trap for Surviving Spouses

Newsletter Delay. Some "extra activities" have gotten in the way of sending a newsletter in 2023 (such as two ACTEC projects and the wedding of Karen's youngest daughter). Out of curiosity, we checked to see how many newsletters the law firm has sent since its inception in January 2004 (note that this is the law firm's 20th year). Over the past 19 years, a total of 70 newsletters have been sent to clients and other persons on the newsletter circulation list. That's an average of 3.7 newsletters per year. In 10 of the 19 years, we sent 4 newsletters. In 6 of those years, we sent 3 newsletters. One year we only sent 2 newsletters and in the remaining 2 years during that time frame we sent 5 newsletters.

The SECURE Act. During the past two years, our newsletters have focused on the SECURE Act, the proposed regulations to the SECURE Act, and certain Notices relating to the SECURE Act. The SECURE Act made significant changes to the "required minimum distribution rules" (the "RMD Rules") relating to distributions from qualified employee benefit plans (sometimes simply called "qualified plans" or "plans") and IRAs. The RMD Rules apply to both the employee or retiree who participates in a qualified plan and the named owner of any type of IRA (both referred to as the "participant") and to the beneficiaries of the participant on the participant's death. The SECURE Act became effective January 1, 2020. The proposed regulations interpreting the SECURE Act (which are not yet final) were published on February 24, 2022. In our SECURE Act newsletters sent during 2020 - 2022, we explained the new rules and various defined terms, such as "designated beneficiary" and "eligible designated beneficiary." We will not repeat all of that in this newsletter. All of the firm's newsletters are available on the firm's website, **www.gerstnerlaw.com**.

SECURE 2.0. In December 2022, Congress passed SECURE 2.0. Some provisions in SECURE 2.0 became effective on January 1, 2023, but other provisions in SECURE 2.0 do not become effective until future years.

The following are *some* of the noteworthy provisions in SECURE 2.0:

1. SECURE 2.0 changed the age component (the "Applicable Age") of the required beginning date ("RBD"). The RBD is when required minimum distributions ("RMDs") to the participant must commence. In the case of a participant who attains age 72 after December 31, 2022, and attains age 73 before January 1, 2033, the Applicable Age is 73, and in the case of a participant who attains age 74 after December 31, 2032, the Applicable Age is 75. In most cases, RBD is April 1 of the year following the year in which the participant reaches the Applicable Age. An exception may apply to participants in certain qualified plans who are not 5% or more owners of the company sponsoring the plan. If the particular plan so provides, the RBD for those participants is *the later of* April 1 of the year following the year the participant reaches the Applicable Age or the year the participant retires.
2. SECURE 2.0 allows unused funds held in a 529 plan, up to an aggregate lifetime limit of $35,000, to be transferred in a direct (trustee to trustee) transfer to a Roth IRA for the benefit of the 529 plan beneficiary if certain conditions are met. 529 plans have become very popular as a way for parents and grandparents to contribute funds for their children's and/or grandchildren's educational expenses. But sometimes funds in 529 plans are "left over" after the child or grandchild completes his/her education. That is a case where this new option may be useful. The 529 plan has to have been in effect for at least 15 years before the rollover to the Roth IRA is made and the amount that can be rolled over is limited to the aggregate contributions (plus earnings) made at least 5 years before the date of the rollover. The 529 plan to Roth IRA rollover can be made without regard to the otherwise applicable income limits, although the annual Roth contribution limits do apply ($6,500 for 2023). This provision is effective for distributions made after December 31, 2023.
3. SECURE 2.0 allows an IRA participant to make a special type of qualified charitable distribution ("QCD") directly from the participant's IRA to a "split interest entity," i.e., either to a charitable remainder trust ("CRT") or to a charitable gift annuity ("CGA"). The CRT or CGA must be for the benefit of the participant or the participant's

spouse. This is a one-time election and the total amount that can be distributed from the participant's IRA for this purpose is $50,000, all of which must be distributed directly to the split interest entity within one taxable year. No individual other than either the participant or the participant's spouse can hold the income interest in the CRT or CGA and that income interest cannot be a deferred interest. If this type of QCD is made, it will count toward the participant's QCD limit for that year. As a reminder, the QCD limit is $100,000 per year. While charities have been working toward something like this for many years, it is unlikely that this provision, as currently written, will be used to fund a CRT (because of the low contribution limit), although it might be used to fund a CGA. The $50,000 limit will be adjusted for inflation. This provision is effective starting in 2023.

4. Prior to SECURE 2.0, an Applicable Multi-Beneficiary Trust ("AMBT") created for a disabled or chronically ill beneficiary (often a "specially designed" Supplemental Needs Trust) could not have a charity as a remainder beneficiary of the trust and qualify as an "Eligible Designated Beneficiary" ("EDB"). As explained in our prior SECURE Act newsletters, EDBs--special types of designated beneficiaries ("DBs")--are the only beneficiaries who may still take RMDs using some sort of life expectancy distribution method (not the same for all EDBs). Regular DBs are now subject to the 10 year rule. Normally, trusts (other than conduit trusts) that have have a charity as a "countable" beneficiary (a beneficiary that must be taken into account per the RMD rules) would not even qualify for DB treatment. In the case of disabled and chronically ill beneficiaries, grantors of the trusts created for those individuals often desire to name as the remainder beneficiary of the trust a charity having purposes related to the beneficiary's particular type of disability or illness. However, before SECURE 2.0, doing that would have disqualified the trust from obtaining EBD treatment (and even from obtaining DB treatment if the trust was drafted as an accumulation trust, rather than a conduit trust). Fortunately, SECURE 2.0 provides that a charity *can* be named as the remainder beneficiary of a Supplemental Needs Trust designed as an AMBT and not disqualify the trust for EDB treatment.
5. Owners of Roth IRAs are not required to take RMDs during their lifetimes (which is why they are always deemed to have died prior to their RBD). However, prior to SECURE 2.0, participants in designated Roth accounts, such as Roth 401(k) plans and Roth 403(b) plans, were required to take RMDs during their lives. SECURE 2.0 repeals the prior RMD rule for designated Roth accounts, effective for taxable years after December 31, 2023.
6. SECURE 2.0 changed the penalty for failure to take the full amount of an RMD or of any other required distribution from a qualified plan or IRA from 50% of the under-distributed amount to 25% of the under-distributed amount, with an even lower penalty amount (10%) if the taxpayer is able to correct the under-distribution during the "correction window." It is not known whether a particular taxpayer can still try to obtain a complete waiver of the penalty, as was allowed prior to SECURE 2.0, if the taxpayer is able to demonstrate "reasonable cause" for the failure and prompt efforts to correct that failure.

Surviving Spouse as Beneficiary. SECURE 2.0 added a provision applicable when the participant's surviving spouse is the participant's "sole" beneficiary. It is not clear why this provision was added. This particular provision has caused a lot of consternation among estate planning lawyers and other advisors. Currently, an ACTEC SECURE 2.0 Task Force (on which Karen serves) is working on comments to submit to Treasury regarding this provision. Before we discuss the *new* provision added by SECURE 2.0, we will briefly explain prior law that was available when the participant's spouse was deemed to be the participant's "sole" beneficiary.

Before SECURE 2.0. Prior to SECURE 2.0, if the participant's spouse was deemed to be the participant's "sole" beneficiary, the participant's spouse may have had up to three options after the participant died (explained below). Note that, prior to SECURE 2.0, it was clear that the participant's spouse would be treated as the participant's *sole* beneficiary if (i) the spouse was named as the 100% outright beneficiary of the participant's entire plan or IRA, or (ii) the spouse was named as the outright beneficiary of a "separate share" of the participant's plan or IRA (i.e., the beneficiary designation was structured so that "separate account" treatment was available and obtained due to the plan or IRA being timely divided on a pro rata basis between the spouse and the other beneficiaries of the plan or IRA), or (iii) a conduit trust for the sole benefit of the spouse for life was named as either the 100% beneficiary of the participant's plan or IRA or as the beneficiary of a "separate share" of the participant's plan or IRA (again, the beneficiary designation was structured so that "separate account" treatment was available and obtained due to the plan or IRA being timely divided on a pro rata basis between the conduit trust for the spouse and the other beneficiaries of the plan or IRA). To make the following discussion easier to understand, *assume the participant's spouse is the sole beneficiary of the participant's entire plan or IRA*.

If the participant's spouse was the *outright* beneficiary of the participant's plan or IRA, the spouse had three options:

1. The spouse could roll over the participant's plan or IRA to an IRA in the spouse's name and become the participant of that IRA rollover.
2. The spouse could treat the participant's IRA as the spouse's own IRA and, in so doing, become the participant of that IRA. If the spouse failed to take distributions from the participant's IRA by the date that would have been

the participant's RBD (see option 3), it was assumed that the spouse had elected to treat the participant's IRA as his/her own where the spouse had not yet reached his/her own RBD.

3. The spouse could remain in the position of being the participant's *beneficiary* (i.e., not become the participant) and take RMDs from the participant's plan or IRA as the participant's beneficiary based on special rules (discussed below).

If the spouse selected option 1 or 2, the spouse became the *participant* of the IRA, resulting in the spouse then being subject to the RMD Rules that apply to a living participant. Thus, in that case, RMDs to the spouse would need to commence by the spouse's RBD. Once RMDs commenced to the spouse in these cases, they were determined using the Uniform Lifetime Table. The Uniform Lifetime Table is a "more favorable" table compared to the Single Life Table (discussed below). That is because the Uniform Lifetime Table contains distribution periods that are based on the age of the participant *plus 10 years*. Of course, it is imperative when a spouse elects (or is deemed to elect) options 1 or 2 for the spouse to complete and submit to the IRA custodian a beneficiary designation for the spouse's IRA because the prior beneficiary designation that was submitted by the original participant prior to the original participant's death will no longer apply to the IRA owned by the surviving spouse as participant. If the spouse dies without having at least a "designated beneficiary," a less favorable distribution rule usually will apply.

However, in certain cases, selecting option 1 or 2 was either problematic or not available. For example, if the participant's surviving spouse was under age 59 1/2 when the participant died and the spouse elected to become the participant by either making the rollover of the participant's plan or IRA to an IRA in the spouse's name or treating the deceased participant's IRA as the spouse's own, that "too young" spouse could not take distributions from the spouse's IRA without a penalty. (A surviving spouse under age 59 1/2 who became the participant of the IRA might enter into an arrangement providing for substantially equal periodic payments to be able to take distributions without a penalty, but that was normally done only for spouses age 55 or older.) Thus, if the participant's spouse was "too young" when the participant died to elect option 1 or 2, the spouse usually would not select either option 1 or 2 right away, but would wait until the spouse reached an old enough age to become the participant so that the spouse could then take distributions from the spouse's IRA without a penalty.

Note that options 1 and 2 were not available when the participant named a conduit trust for the spouse, rather than the spouse, individually, as the beneficiary of the participant's plan or IRA. That type of planning was often done in the "second marriage" situation (i.e., in cases in which the participant's spouse was not the parent of the participant's children). In those cases, the participant wanted to provide distributions to the spouse for the rest of the spouse's life, but also wanted to control the distribution of the remaining amount of the participant's plan or IRA on the spouse's death. Option 3 would be the only choice in the case of a conduit trust for the spouse.

Another situation where option 3 was usually considered more desirable than options 1 and 2 was when the participant's spouse was "much older" than the participant was at the time of the participant's death and, especially, if the spouse was already past the spouse's own RBD. As noted above, if the spouse chose option 1 or 2, the spouse's RBD would determine when RMDs had to commence and RMDs, once commenced, would be based on the spouse's life expectancy due to the spouse becoming the participant. Thus, the delay in commencement of RMDs allowed by option 3 was attractive when the surviving spouse was much older than the participant and the participant died before his/her RBD.

Per the law before SECURE 2.0, if the spouse chose option 3 (remained in the position of being the participant's beneficiary, rather than becoming the participant), the results were as follows:

1. If the participant died before his/her RBD, the spouse was not required to take RMDs until December 31 of the year when the participant would have reached his/her RBD (i.e., commencement of RMDs was delayed, regardless of the spouse's own age). This was especially beneficial in cases where the participant's spouse was older than the participant was at the time of the participant's death (and even more beneficial if the participant's spouse was already past his/her own RBD).
2. If the participant died after RBD, RMDs to the spouse commenced the year after the participant's death.
3. Once RMDs commenced from the participant's plan to the spouse as beneficiary, they were based on the spouse's single life expectancy, per the Single Life Table, *recalculated* each year. Recalculating life expectancy produces lower RMDs each year compared to not recalculating life expectancy. Thus, recalculation reduced the amount of income taxes payable on the RMD each year. In addition, recalculation allowed a greater amount to remain inside the participant's plan or IRA, continuing to grow tax deferred. Only participants and their spouses are permitted to recalculate life expectancy.
4. If the spouse died before RMDs commenced per option 3, the spouse's successor beneficiary had to commence taking RMDs by December 31 of the year following the year of the spouse's death. RMDs to the successor

beneficiary were taken over the successor beneficiary's non-recalculated single life expectancy per the Single Life Table (even if the successor beneficiary was the new spouse of the participant's surviving spouse). If the spouse died before RMDs commenced and the spouse did not have a "designated beneficiary," the 5 year rule (instead of the 10 year rule available to designated beneficiaries) applied to the actual successor beneficiary of the spouse.

Section 327 of SECURE 2.0. First, SECURE 2.0 did not eliminate options 1 and 2 for spouses named as outright beneficiaries of the participant's plan or IRA. Those options are still available to the spouse named as outright beneficiary of the participant's plan or IRA. However, for reasons that are not clear, Congress made some significant changes to the situation described in option 3. *It is not clear whether the new option 3 per SECURE 2.0 eliminates the "old" option 3 that applied prior to SECURE 2.0.*

As a result of Section 327 of SECURE 2.0, if the participant's spouse is deemed to be the participant's sole beneficiary, to obtain the results of the "new" option 3, an *irrevocable election* must be timely made by the spouse. We will refer to this election as the "327 election." As noted, prior to SECURE 2.0, option 3 was "automatically" the result if the participant's spouse did not select option 1 or 2 (i.e., no election was required to be made by the spouse).

Section 327(a) provides that, if the 327 election is made, (i) RMDs to the spouse (or to the conduit trust for the spouse, as applicable) do not have to commence until the date the participant would have reached his/her RBD (same as before) and (ii) if the participant's spouse dies before RMDs commence, the spouse is treated as if the spouse "is" the participant (same rule as before, although the verb "were" in the prior rule was changed to "is" in the new rule for some inexplicable reason). It is imperative in this situation that the participant's spouse, as beneficiary, submit a beneficiary designation for the participant's plan or IRA as soon as possible so the spouse does not die without having named a successor beneficiary of the participant's plan or IRA.

Section 327(b) provides that, if the 327 election is made, once RMDs commence, they are determined using the Uniform Lifetime Table (not the Single Life Table, as before). But there is some controversy regarding this provision.

Section 327(b), which is titled, *Extension of Election of At Least As Rapidly Rule*, directs the Secretary of the Treasury to revise certain provisions in the 2002 final regulations (i.e., the RMD Rules prior to SECURE 2.0) relating to distributions from qualified plans and IRAs, although the section referenced in 327(b) only applies if the participant dies *after* RBD. That reference is confusing in view of the fact that one of the two major benefits of making the 327 election is to delay commencement of RMDs if the participant dies *before* his/her RBD. In addition, the "at least as rapidly rule" only applies to distributions when the participant dies *after* RBD. For those reasons, some commentators believe that use of the Uniform Lifetime Table to calculate RMDs in this situation is only available if the participant dies *after* RBD. We do not believe that is the case, but that issue needs to be clarified in regulations.

Note that it can be problematic in a second marriage situation if, as the statute says, it is the spouse (and not the Trustee of the conduit trust) who makes the election. We do not know whether, if the spouse does *not* make the 327 election, the "old rule" applies. Per Option 3 prior to SECURE 2.0, once RMDs commenced, they were based on the spouse's life expectancy per the Single Life Table, recalculated each year. Recall that the Single Life Table provides for distributions based on the spouse's age each year. Compare that to the Uniform Lifetime Table, which provides for distributions based on the (deemed) participant's age *plus 10 years*. In a second marriage situation, if the spouse makes the 327 election, the RMDs will be smaller than if the spouse does not make the election (assuming the "old rule" would apply as a default). This may cause at least some spouses in a second marriage situation not to want to make the 327 election if not making the election will allow RMDs to be calculated using the Single Life Table instead of the Uniform Lifetime Table. Whether not making the 327 election means that the rule prior to SECURE 2.0 applies is one of the issues being submitted to Treasury for clarification.

Another issue involving the provisions in Section 327(b) is, if the spouse makes the 327 election, whose life expectancy is to be used to calculate RMDs once they commence: the deceased participant's life expectancy or the spouse's life expectancy? Remember that the spouse is treated *as if the spouse were the participant* in these cases. So does that mean the spouse gets to use the deceased participant's life expectancy if it is longer than the spouse's life expectancy (often the case when option 3 is chosen). The most likely answer would be that, once RMDs commence, it is the spouse's life expectancy per the Uniform Lifetime Table that is used to calculate RMDs. But that is another issue that needs to be clarified.

There are also issues regarding the "irrevocable election" that must be made. When and how is that election made? If the participant's spouse does make the 327 election (perhaps due to being "too young" at the time of the participant's

death to make the rollover and be able to take distributions without a penalty), can the spouse nevertheless still roll over the participant's plan or IRA to an IRA in the spouse's name at a later date (i.e., before RMDs commence to the spouse as the participant's beneficiary)? The answer to that question is very important based on what "too young" spouses normally did prior to SECURE 2.0.

The provisions in Section 327 of SECURE 2.0 become effective January 1, 2024.

There are other technical issues involving Section 327 that need to be clarified, but, suffice it to say, surviving spouses in this situation need to be aware of these provisions. Hopefully, these rules will be clarified before January 1, 2024.

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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