Trusts and the Proposed RMD Regulations

By

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The purpose of this Outline is to state the RMD rules applicable to trusts under the Treasury's proposed RMD regulations issued in February 2022, then show how these rules impact various typical forms of trusts the terms of various common types of trusts—along with some commentary and planning suggestions for most of the trusts. For each statement, a citation is given to the applicable proposed regulation ("PR").

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Terminology, symbols & abbreviations used in this Outline

§ Indicates a section of the Internal Revenue Code of 1986, as amended through March 2022, unless followed by "Reg." (For Treasury regulation) or "Prop. Reg." (for proposed Treasury regulation).

¶ Refers to a section of the author's book *Life and Death Planning for Retirement Benefits* (8th ed. 2019)**.**

Accumulation Trust. "The term accumulation trust means any see-through trust that is not a conduit trust." Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(B).

AD; Applicable Denominator. The number that is divided into the prior year-end account balance to produce the RMD for the current year. See Prop. Reg. § 1.401(a)(9)-5(d) and proposed amendments to Reg. § 1.401(a)(9)-9. Replaces the formerly used terms "applicable distribution period" and "divisor."

Annual distributions track. Not an official term. Used in this Outline to refer to annual "RMDs" required after the death of the employee (in contrast to the final year in which

Conduit trust. "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..." Prop. Reg. § 1.401(a)(9)-4(f)(1)(ii)(A).

DB; Designated Beneficiary. "...any individual designated as a beneficiary by the employee." § 401(a)(9)(E)(I). Also "an individual who is a beneficiary designated under the plan." Prop. Reg. § 1.401(a)(9)-4(a)(1).

D/CI individual: A beneficiary who is an EDB by virtue of being a disabled or chronically ill individual within the meaning of § 401(a)(9)(E)(ii)(III). See Prop. Reg. § 1.401(a)(9)-4(e)(1), (4) for definition of "disabled," Prop. Reg. § 1.401(a)(9)-4(e)(1), (5) for "chronically ill."

EDB. Eligible designated beneficiary as defined in § 401(a)(9)(E)(ii): The five categories of EDBs are, the participant's surviving spouse or minor child, a disabled or chronically ill (D/CI) individual, or an individual who is not more than 10 years younger (NoMoTTYY) than the Participant and does not fit into any of the other EDB categories.

EDB Treatment. Under the proposed regulations, certain trusts are entitled to use the life expectancy payout, as an EDB name directly as beneficiary would be, even though the trust has multiple countable designated beneficiaries not all of whom are necessarily EDBs. In this Outline, "EDB treatment" indicates that the trust is entitled to the life expectancy payout.

First Tier, Second Tier, Third Tier. See "Tier system" below.

NoMoTTYY. An EDB by virtue of being a not more than 10-years-younger individual, i.e., whose date of birth was more than 10 years later than the participant's date of birth (and who does not qualify as an EDB in any other category). Prop. Reg. § 1.401(a)(9)-4(e)(1), (6).

Outer Limit Year. Prop. Reg. § 1.401(a)(9)-5(e) provides what this Outline calls an "Outer Limit Year" for any payout of death benefits. In the Outer Limit Year [not an official term], the RMD is 100% of the account, regardless of what "annual distributions track" the retirement plan was subject to in the preceding years. The Outer Limit Year is the "earliest of" various calendar years.

Participant. Not an official term. For convenience this word is used here to represent the "employee" (with reference to qualified retirement plans and other "workplace" retirement plans") and the "IRA owner" with respect to IRAs.

PODB. Plain old designated beneficiary. A beneficiary who is a "designated beneficiary" but not an "ELIGIBLE designated beneficiary" (i.e., not the spouse or minor child of participant, not D/CI, and not a NoMoTTYY individual).

RBD. Required beginning date. The date by which the participant must commence taking lifetime RMDs from the retirement account. For IRAs, the RBD is April 1 of the year after the year in which the Participant attained age 72 [or age 70½ in the case of participants born before July 1, 1949]. For a qualified plan, the RBD may be later than the preceding if the participant is still working (not retired); see ¶ 1.4 of *Life and Death Planning for Retirement Benefits* (8th ed. 2019). For Roth IRAs, there is no RBD because there are no lifetime RMDs so death is always "before the RBD."

SS. Surviving spouse.

Tier System. The Proposed Regulations' method of testing a trust for purposes of determining whether the "countable" beneficiaries of such trust qualify as designated beneficiaries. The Proposed Regulations do NOT use the term "tier" for this system. Prop. Reg. § 1.401(a)(9)-4(f)(3). The "Tier System" is explained in the other Outline.

Introduction

This Outline delves into the most complicated minimum distribution calculations (and planning concepts) known to man. And it is based on simple common trust structures.

The moral of the story seems to be emerging: **Striving for see-through trust status and some semblance of a long-term payout for the retirement assets is going to be a hopeless quest in many cases.** Even when you "win" you may lose, due to an unexpected order of deaths or the compromises made to achieve the life expectancy payout. We will find that the pretax retirement account is the worst possible asset to use to fund a trust in most cases.

There is no easy path to a long term life expectancy payout except possibly this—to leave the IRA to an AMBT for a young disabled or chronically ill (D/CI) beneficiary who has a long (actual, in addition to "IRS table") life expectancy. It's easy to achieve "AMBT" status and gain a life expectancy payout based on the life expectancy of the D/CI beneficiary. However this will be a pyrrhic victory if the retirement plan is a substantial amount and the trust is restricted, as a "supplemental needs trust," from making large distributions to the disabled beneficiary: Large IRA distributions will hit the trust each year and encounter the high trust income tax rates, without the ability (in many cases) to lower that tax by making distributions to the disabled beneficiary (due to possible asset/income restrictions if the beneficiary is in various government benefit programs) or by making distributions to other family members (due to the restrictions of the AMBT).

> "Every way you look at this, you lose..."
> —Simon & Garfunkle ("Mrs. Robinson")

So even when a long life expectancy is available through the AMBT, the pretax IRA is the worst asset you can find to use to fund a supplemental needs trust.

Planners need to persuade clients to regard the AFTER TAX value of their retirement accounts as the actual amount that they are able to leave to their chosen beneficiaries. If they don't like the resulting picture, clients should be looking at Roth conversions during life, charitable gifts, life insurance and annuity products, and....? other ideas....? to accomplish their estate planning goals.

Planners need to confront their own conflict of interest. We are paid to write trusts. Are we fairly evaluating the costs and benefits of leaving the IRA to a trust vs. leaving the IRA directly to the intended individual beneficiaries?

I. The RMD Rules Applicable to Trusts

Under SECURE, the general payout rule for designated beneficiaries is the 10-year rule. The "life expectancy of the beneficiary" payout described in § 401(a)(9)(B)(iii) only applies to Eligible Designated Beneficiaries (EDBs). § 401(a)(9)(H)(ii).

Note: Generally under the 10-year rule no distributions are required until the year that contains the 10th anniversary of the participant's death—so the "annual distributions track" is zero dollars per year and the "Outer Limit Year" (100% distribution required) is the 10th year. However, if the participant dies after his RBD, the designated beneficiary must take annual RMDs based on the life expectancy payout method (based on such beneficiary's own life expectancy) during years

one through nine after the participant's death *even if* he or she is subject to the 10-year rule. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). So in effect, in cases of death after the RBD, EVERY beneficiary is subject to the "life expectancy payout"—however, for PODBs that payout will end (switch to the 10-year rule) after 10 years, whereas for EDBs it will continue for the EDB's life [or attainment of age 31 in the case of a Minor-child EDB].

So, if the client is leaving retirement benefits to a trust you need to know what RMDs that trust must take, when

A. A trust is entitled to the life expectancy payout (i.e. it is not subject to the 10-year rule) if and only if one of the following is true:

- All countable trust beneficiaries are EDBs. Prop. Reg. § 1.401(a)(9)-4(e)(2)(i); Or
- The trust is a Type II AMBT. Prop. Reg. § 1.401(a)(9)-4(e)(2)(i), (g)(3)(ii). Or:
- At least one countable trust beneficiary is a Minor-child EDB. Prop. Reg. § 1.401(a)(9)-4(e)(2)(ii).

B. If a trust is entitled to the life expectancy payout (see "A"), the term of the *life expectancy payout* ("annual distributions track") will be based on:

- If the trust is an AMBT, the life expectancy of the oldest D/CI beneficiary. Prop. Reg. § 1.401(a)(9)-5(e)(2)(i), § 1.401(a)(9)-5(f)(1)(ii).
- If the participant's surviving spouse is the sole countable beneficiary of the trust [i.e., the trust is a Conduit Trust for the sole life benefit of the spouse], the spouse's life expectancy, which is recalculated annually (unlike the fixed-term life expectancy applicable to other beneficiaries). Prop. Reg. § 1.401(a)(9)-5(d)(3)(iv). If participant died before the end of the year in which he reached or would have reached age 72 [age 70½ if participant born before 7/1/49], the trust does not have to commence taking distributions until that year (and, for purposes of determining RMDs after spouse's death, spouse is treated as "the employee" if she dies before that required commencement date). Prop. Reg. § 1.401(a)(9)-3(d), (e); Preamble, p. 30.
- Otherwise, the life expectancy of the trust's oldest countable DB. Prop. Reg. § 1.401(a)(9)-5(f)(1)(i). Note: This rule for determining annual distributions applies even if the trust has one or more Minor-child EDBs as beneficiaries and the oldest DB of the trust is not a Minor-child EDB.

C. If a trust is entitled to the life expectancy payout (see "A"), the Outer Limit Year applicable to that trust will be:

- If the trust is a **Type II AMBT**, the year that contains the 10th anniversary of the death of the "last trust beneficiary" who is a D/CI beneficiary. Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii). Also, the "shorter of" rule will not apply (requiring 100% distribution in the final year of the designated beneficiary's life expectancy if the participant died after his RBD and the DB was older than the participant). Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii). I'm not quite able to envision what the preceding sentence means in practical terms.

- If at least one beneficiary of the trust is a **Minor-child EDB**, the year that contains the 10th anniversary of the date the oldest such Minor-child EDB reached majority (or died, if earlier). Neither the 10-year rule nor the shorter-of rule would apply to this trust for purposes of determining the Outer Limit Year. Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii).

- Otherwise, the Outer Limit Year is the year that contains the 10th anniversary of the death of the trust's oldest countable designated beneficiary.

D. If a trust is NOT entitled to the life expectancy payout (see "A") there are two reasons why that could be:

- If the trust's countable beneficiaries include nonindividuals (charities or the participant's estate), the trust does not qualify as a designated beneficiary. The trust must withdraw 100% of the retirement plan: by the end of the year that contains the 5th anniversary of the participant's death ("5-year rule") if the participant died before his RBD with respect to that particular plan, otherwise over the ghost life expectancy (see other Outline).

- If the trust beneficiaries qualify as Designated Beneficiaries, but do not qualify for the life expectancy payout (see "A"), the trust is subject to the 10-year rule. See other outline for how that works.

We will next look at trusts established for various categories of Eligible Designated Beneficiaries and see how those fare under the Proposed Regulations RMD rules.

II. Trusts for the primary or sole life benefit of the participant's surviving spouse

For convenience Participant is "he," spouse is "she."

A. Conduit Trust for surviving spouse (SS)

- All plan distributions received by the trustee during spouse's life must be upon receipt paid to or for the benefit of spouse.

- Trust qualifies as a designated beneficiary, spouse qualifies as sole DB, spouse is an EDB. therefore EDB treatment allowed, REGARDLESS of who the remainder beneficiary(ies) is/are—charity, older individual, doesn't matter, because as conduit beneficiary spouse is deemed sole beneficiary of the retirement plan.

- After spouse's death, the terms of the trust do NOT have to continue "conduit" provisions. The conduit requirement ends at death of SS. For example, the trust could convert to "Accumulation" mode at that time. Prop. Reg. § 1.401(a)(9)-4(f)(3)(iii).

- Because spouse is sole life "conduit" beneficiary, trust is considered the same as the spouse and gets all the special spousal "deals" that spouse is entitled to as an EDB/surviving spouse, namely:

- If participant died *before* RBD, trust can take distributions over spouse's life expectancy (recalculated annually). Payout commences year decedent would have reached age 72 [age 70½ if decedent was born before 7/1/1949]; if surviving spouse dies before the end of that year SS is treated as "the employee" for purposes of determining payout to the successor beneficiary(ies). **Comment:** Not clear that the trust's remainder beneficiary(ies) would be considered "designated beneficiary(ies)" *of the surviving spouse* for this purpose because she didn't write the trust. See PLR 2006-44022 in which the IRS ruled that the surviving spouse had no designated beneficiary when benefits passed at her death to her son pursuant *to a settlement agreement she had entered into*. Therefore to get "DBs of spouse" treatment for a conduit trust for spouse it would probably be advisable to give spouse a power of appointment over the benefits and have spouse exercise it—presumably that would make the successor beneficiary(ies) "her" DBs.

- Also applicable to participant death before RBD: Instead of life expectancy payout, the trust can elect the 10-year rule if permitted by the plan. **Comment:** Why would trust ever do this? Perhaps if spouse's life expectancy was less than 10 years, or for a Roth IRA? If the trust gives the spouse right to demand any distributions beyond the RMD (such as 5% of principal per year...or income if it exceeds the RMD, as in a marital trust...) and the trustee elected the 10-year rule, the spouse would have the right to "roll over" to her own IRA any amounts that she was so entitled to, and did, demand distribution of (in excess of the RMD). But if spouse

rolls over any such amounts after her own RBD, she may be required to take catchup distributions. Prop. Reg. § 1.402(c)-2(j)(3)(iii).

- <u>If participant died *after* RBD</u>, annual payouts to the trust are based on the longer of the spouse's life expectancy or the ghost life expectancy ("greater or" or "longer of" rule; Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii)). **Comment:** If the surviving spouse is older than deceased spouse, then in early years after the participant's death the AD will be determined using the ghost life expectancy under the "greater of" rule. However, because the surviving spouse's life expectancy is recalculated annually, eventually her life expectancy will become the "greater of" as his shrinks to one and then disappears. The final year of the payout (100% payout required) is the final year of the surviving spouse's life expectancy (Prop. Reg. § 1.401(a)9)(-5)(e)(5)), but since spouse's life expectancy is recalculated annually that would not occur (her life expectancy would not go to "1") until spouse reaches age 120, so with a spousal conduit trust the "shorter of" rule presumably has no impact.

- Upon spouse's death (unless 10-year rule was elected or the "treated as employee" rule applies), annual payouts continue to successor beneficiary over spouse's remaining life expectancy (not recalculated annually any more) but ends no later than 10th year after spouse's death. Prop. Reg. § 1.401(a)9)(-5)(e)(3).

B. Accumulation Trust: Income to spouse, remainder to an EDB who is a NoMoTTYY; if the NoMoTTY beneficiary predeceases spouse, trust passes to charity at spouse's death.

- This example is in the proposed regulations. Prop. Reg. § 1.401(a)(9)-4(f)(6)(ii) (Example 2).

- **Comment:** Examples of the type of trust covered here would be "income to spouse for life, remainder to X"; or, "during spouse's life, trustee shall distribute to spouse or apply for her benefit such amounts of the principal and/or income of the trust as the trustee deems advisable for spouse's care, support, and welfare"; or, "trustee shall pay to spouse, each year during her life, the greater of the income of the IRA for such year or the RMD from such IRA for such year" [but trustee can take distributions from the IRA in excess of that amount and hold them in the trust for future distribution]. The point is: no one other than spouse can receive any distributions during spouse's life, but spouse is NOT entitled to receive all amounts the trustee withdraws from the IRA—the trustee can accumulate some IRA distributions for future use.

- First tier is spouse, second tier is NoMoTTY EDB; both are "countable." Charity is disregarded as third tier.

- Since all countable beneficiaries are EDBs, life expectancy payout applies. Note that there are no D/CI or Minor-child EDBs in this trust.

- If death was before the RBD: Life expectancy payout is based on the life expectancy of the oldest countable DB. That would be the spouse's life expectancy if she is older than the NoMoTTYY or the NoMoTTY's life expectancy if he/she is older than the spouse. (In the example in the Proposed Regulations the NoMoTTYY is younger than the surviving spouse.) Special spousal "deals" (recalculation of life expectancy, delayed commencement date of RMDs) do NOT apply even if spouse is oldest DB because she is not the sole DB. The trust can elect the 10-year rule instead of the life expectancy payout.

- If death was after the RBD the "annual track" payout is based on the longer of the ghost life expectancy or the oldest EDB's life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii), (f)(1). The Outer Limit Year will be the final year of such life expectancy payout—unless the oldest EDB was older than the participant, in which case, under the "shorter of" rule, it will be the final year of the oldest EDB's life expectancy (Prop. Reg. § 1.401(a)(9)-5(e)(5)) (or, if earlier, in either case, the year that contains the 10th anniversary of the death of the oldest EDB; Prop. Reg. § 1.401(a)(9)-5(e)(3), (f)(1)). Got that?

C. Accumulation Trust: Income to spouse, remainder to an individual who is not an EDB (a PODB in other words). Facts are same as in "B" except that now not all trust beneficiaries are EDBs.

- GENERAL RULE: If not all beneficiaries are EDBs, then the trust itself is not an EDB and is treated as merely a PODB; see distribution rules for PODBs (basically the 10-year rule will apply).

- EXCEPTION: If one or more trust beneficiaries is a Minor-Child EDB then the general rule does not apply; see instead Part III of this Outline, "Trust for Minor Child(ren) of the Participant."

III. Trust for Minor Child(ren) of the Participant

This section looks at trusts set up for the sole or primary benefit of one or more minor child(ren) of the participant. The statements in this section may not work (probably do not work) for a trust that also has one or more D/CI beneficiaries. See separate section for D/CI beneficiaries.

Comment: One category of EDB is, a minor child of the participant ("minor child-EDB"). This minor-child EDB is entitled to the life expectancy payout, but EDB status ends when the minor reaches majority; all the benefits must be distributed out of the retirement plan within 10 years after that time. The Proposed Regulations decree a universal definition of reaching majority: it is the age-21 birthday regardless of the "age of majority" under whatever state law is applicable and regardless of dependent status or educational status.

Prior to issuance of the proposed regulations, the only KNOWN SURE way for a parent to capture the benefit of this semi-life-expectancy payout (which in fact ends no later than age

31–hardly a “life” payout) was to leave benefits to the minor directly (or through a custodian UUTTMA) or to a “conduit trust” for the minor (a separate conduit trust for each minor child).

THE PROPOSED REGULATIONS SUBSTANTIALLY EXPAND THE OPTIONS FOR LEAVING BENEFITS IN TRUST FOR MINOR CHILD-EDBS: Benefits can be left to an accumulation trust and still get the (so-called) life expectancy payout. Benefits can be left to a trust for multiple beneficiaries (such as a “pot trust”) and still get the (so-called) life expectancy payout even though not all of the beneficiaries are Minor-Child EDBs (as long as at least one of them is). Funds do not have to be distributed outright to the minor at age 31 or any particular age.

If the trust qualifies as a “designated beneficiary,” and at least one trust beneficiary is a Minor-Child EDB, the “life expectancy payout” will apply (see below for WHOSE life expectancy) until the Outer Limit Year (see below).

- If ANY countable beneficiary of the trust is a Minor-Child EDB, the trust qualifies for the “life expectancy payout.” Prop. Reg. § 1.401(a)(9)-4(e)(2)(ii): “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.” Emphasis added.

- Being “treated as having an eligible designated beneficiary” brings a life expectancy payout (based on the trust’s oldest DB—not the minor’s life expectancy unless he/she is the oldest DB)... and presumably the ability to elect the 10-year rule instead of the life expectancy payout if the employee died before the RBD:

  - **Death before the RBD:** “If the employee has an eligible designated beneficiary distributions must satisfy the life expectancy rule described in paragraph (c)(4) of” [apparently] Prop. Reg. § 1.401(a)(9)-3. This life expectancy rule applies in cases of death before the RBD: distributions must commence the year after the year of the employee’s death (or in some cases later if the sole beneficiary is the surviving spouse). So even though the trust may have only ONE EDB (a minor child of the participant), it gets the EDB life expectancy payout. (But remember you’re not finished yet—you still have to figure out WHOSE life expectancy, and what the Outer Limit Year will be.)

  - **Death after the RBD:** If the employee died on or after his RBD, then the position of the Proposed Regulations is that the designated beneficiary(ies) (whether EDBs or mere PODBs) must take annual distributions over the “greater of” the employee’s life expectancy or the designated beneficiary’s life expectancy. Prop. Reg. § 1.401(a)(9)-5(d)(1)(ii). Therefore a trust with multiple individual beneficiaries (whether or not they are EDBs) is treated the same as a trust with multiple individual beneficiaries all of whom are EDBs: Annual distributions must be taken based on the

longer of ("greater of") the designated beneficiary's life expectancy or the participant's life expectancy.

- Ok, but whose life expectancy? The life expectancy payout is based on the life expectancy of the oldest countable DB of the trust, NOT the oldest Minor-Child EDB (unless he/she is also the oldest countable DB). Prop. Reg. § 1.401(a)(9)-5(f)(1)(i).

Example: Laurence dies at age 45 leaving his IRA to a "spray" trust for the benefit of his surviving spouse Marianne and his three children. Spouse is 42, children are Peter 22, Paul 18, and Mary 15. Not all the trust beneficiaries are EDBs—Laurence's oldest child Peter is not a minor anymore. Paul and Mary, the two youngest children are EDBs (as is Marianne of course). Since there is at least one Minor-Child EDB, the trust is entitled to the life expectancy payout, even though not all trust beneficiaries are EDBs. But the life expectancy payout is based on *Marianne's* life expectancy because she is the oldest Designated Beneficiary.

- **The Outer Limit Year**. The "system" of the Proposed Regulations can be "sort of" explained as follows: To figure out required distributions for the beneficiary of an inherited IRA, you first figure out the beneficiary's "Annual Distributions Track" RMDs (such as a life expectancy payout), and, separately (sort of), an "Outer Limit Year" (spelled out in Prop. Reg. § 1.401(a)(9)-(e)) in which the entire account becomes the RMD—100% distribution required. The system becomes more complicated when there a multiple beneficiaries of the IRA (as is always true when benefits are paid to an Accumulation Trust). And an Accumulation Trust with at least one Minor-Child EDB is the trust for which determining the Outer Limit Year may be most difficult because it may be so divorced from the "annual distributions track." Here's how we figure it out:

    - The opening-bid general **Outer Limit Rule** is that the entire interest of the employee must be distributed by the end of "the earliest of the calendar years described in paragraph (e)(2), (3), (4), or (5)..." That would be 10 years after the participant's death ((e)(2)—applicable to a PODB), or 10 years after the death of the EDB ((e)(3)—applicable if the beneficiary was an EDB), or 10 years after the minor child reaches majority ((e)(4)—applicable if the beneficiary was a Minor-Child EDB), or the final year of the EDB's life expectancy (i.e., the year in which the Applicable Divisor based on the EDB's life expectancy would be less than or equal to one) ((e)(5)—applicable if the employee died after his RBD and the EDB was older than the employee). Ok—but what if there are *multiple* designated beneficiaries? Then we move on to the next general rule:

    - The general Outer Limit Year rule for MULTIPLE designated beneficiaries is: the Outer Limit Year is determined "with respect to the oldest" of the employee's designated beneficiaries. Prop. Reg. § 1.401(a)(9)-5(f)(2)(i)). In the case of Laurence's trust, that would be wife Marianne. The Outer Limit Year under this general multi-beneficiary rule would be for Laurence's trust, 10 years after

Marianne's death (because she is an EDB, therefore her Outer Limit Year is 10 years after her death). However that general rule *does not apply to Laurence's trust* because of:

- Special rule for Minor-Child EDBs: If any of the employee's multiple designated beneficiaries is an EDB by virtue of being the participant's minor child, then this special rule applies, apparently overriding the above "general Outer Limit Year rule" for multiple designated beneficiaries (Prop. Reg. § 1.401(a)(9)-5(f)(2)(i)): The 10-year limit based on death of an EDB is applied using the *oldest Minor-Child EDB*. The 10-year limit based on a Minor-Child EDB's reaching majority is also based on the *oldest Minor-Child EDB*. Prop. Reg. § 1.401(a)(9)-5(f)(2)(ii)(A). By the way, if the oldest trust beneficiary had not been an EDB (Marianne, the surviving spouse) but just a PODB (maybe Laurence's oldest child—who was over age 21 at Laurence's death so not a minor) the 10-year rule normally applicable to the trust (based on oldest DB being a PODB) would also be "overruled" by the "Special rule" for a trust that has at least one minor-child EDB.

- Putting it all together it seems we have it all figured out for Laurence's trust. The IRA must be distributed in annual instalments over Marianne's life expectancy until the year that contains son Paul's 31st birthday (or the 10th anniversary of Paul's death if Paul dies before reaching age 21), in which year 100% of the balance of the IRA must be distributed to the trust (not to the individuals, just to the trust), because Marianne is the "oldest DB" and Paul is the oldest "Minor-child EDB."

- Does this make sense? It's a little rickety sense-wise. Paul turned age 18 in the year of Laurence's death (2022) which means the entire IRA will have to be distributed to the trust by the end of 2035 (the year he will reach age 31). If the IRA is worth $2 million, that means annual distributions of well over $100,000 a year assuming a reasonable growth rate and an attempt to distribute evenly over the period. (The alternative is to take the smallest possible RMDs in early years based on Marianne's 40-plus-years life expectancy and a big huge distribution in the final year of the payout?)

- All this assumes Laurence's trust qualifies as a see-through trust in the first place. To do that, as an accumulation trust, it means there must be only individual beneficiaries in Tiers 1 and 2. Since this is a spray trust for the children and spouse, all four of them are first tier beneficiaries (eligible to receive distributions after Laurence's death....they don't have to wait until someone else dies to get distributions from this trust). See next section:

IV. Do we still care about who is the "oldest trust beneficiary"? No...errr, yes

Continuing the "Laurence's Trust example from the preceding section:

Suppose the trust says after Marianne's death it is distributed outright to the then living issue of Laurence, upon their reaching age 31. In other words, upon Marianne's death if all three children

are living and age 31 or older the trust is distributed to the children immediately. So there are no "second tier" beneficiaries who are not also first tier beneficiaries. But if at Marianne's death one or more of the children are under age 31 (or deceased leaving issue under that age), the trust for that child (or issue) continues until they reach that age. If ALL the children and issue die before reaching age 31 the trust terminates and goes outright to Marianne if living otherwise to Uncle Oscar the Potato Farmer who is now age 83. Is Oscar "disregardable"?

- He would be disregardable as a 3rd tier beneficiary if he could only inherit if a second tier beneficiary died. But there don't seem to be any 2d tier beneficiaries since all the issue and Marianne are permissible "spray" beneficiaries at all times so they are all "first tier" beneficiaries.

- He would be disregardable if he could only inherit by surviving someone who would die before age 31. That would apply if he could only inherit by surviving the children because they get their shares outright at 31. But he also has to survive Marianne and she is over 31, so that's an extra survival requirement, so the "age 31" rule doesn't seem to exclude him either.

- If Oscar is countable then HE is the oldest DB and the life expectancy payouts would have to be made over his approximately 9-year life expectancy. Instead of essentially a 14-year payout period (based on the oldest minor child's attaining age 31) the trust would be stuck with a 9-year payout period.

Moral: Hesitate before naming an older generation "wipeout" beneficiary. Name a wipe-out beneficiary who is younger than your person who is otherwise the oldest trust beneficiary or at least who has a life expectancy longer than the waiting period until the oldest minor child's 31st birthday.

V. Trust for D/CI Beneficiary

By special rules applicable to an "AMBT," the Proposed Regulations (following the Code) override some of the usual rules in order to allow a trust for the benefit of a disabled or chronically ill EDB to use the life expectancy payout. An AMBT is defined thus: "An applicable multi-beneficiary trust is a see-through trust with more than one beneficiary and with respect to which– (i) All of the trust beneficiaries are designated beneficiaries; and (ii) At least one of the trust beneficiaries is an eligible designated beneficiary" by virtue of being a D/CI individual. Prop. Reg. § 1.401(a)(9)-4(g)(1).

The Proposed Regulations then subdivide AMBTs into Type I and Type II AMBTs.

The two "overrides" that may apply to an AMBT are:

Separate account for subtrusts

An AMBT is a "Type I" AMBT if "the terms of the trust provide that it is to be divided immediately upon the death of the employee into separate trusts for each beneficiary." Prop. Reg. § 1.401(a)(9)-4(g)(2).

The rule in (existing) Reg. § 1.401(a)(9)-4, A-5(c) that "separate accounts" cannot be established for an IRA inherited by a single trust (even if that trust is divided into separate subtrusts immediately on participant's death) will continue to apply under the proposed regulations, except that it would NOT apply "with respect to the separate interests of the beneficiaries reflected in the separate trusts of each beneficiary of a Type 1" AMBT..." provided various requirements are met. Prop. Reg. § 1.401(a)(9)-8(a)(1)(iii)(B).

Note that, if this rule applies, the beneficiaries of *each* subtrust so created (not just the subtrust for the benefit of any D/CI beneficiary(ies)) would be entitled to "separate accounts treatment." Apparently this means the following:

Smith Family Trust: John Smith leaves his IRA to the Smith Family Trust, which is to divide immediately upon his death into three equal subtrusts, one for his surviving spouse, one for his adult non-disabled child, and one for the benefit of his disabled child. Because one of the beneficiaries is a D/CI beneficiary, the three subtrusts are recognized as separate accounts for purposes of applying the minimum distribution rules. Thus the RMD rules applicable to each subtrust will apparently be determined separately just for that subtrust, not for the combined pre-division trust that was named as beneficiary.

Jones Family Trust: Bill Jones leaves his IRA to the Jones Family Trust, which is to divide immediately upon his death into three equal subtrusts, one for his surviving spouse, one for his adult non-disabled child, and one for his older sister. Because none of the beneficiaries is a D/CI beneficiary, the three subtrusts are not recognized as separate accounts for purposes of applying the minimum distribution rules. Thus the RMD rules applicable to each subtrust will apparently be determined based on the combined pre-division trust that was named as beneficiary.

Type II AMBT

A "Type II" AMBT is an AMBT under which no beneficiary who is not a disabled or chronically ill individual (D/CI beneficiary) "has any right to the employee's interest in the plan until the death of all of" such D/CI beneficiaries of the trust.

So, the trust may have many beneficiaries receiving various amounts from the trust, but the retirement accounts payable to the trust may be paid to (or for the benefit) NO ONE other than the trust's D/CI beneficiary(ies). When the trustee takes a dollar out of the IRA, the trustee has three choices of what to do with that dollar:

- Use it to pay trust expenses, such as the trustee's fee.

- Pay it "to or for the benefit of" the disabled beneficiary. That means giving the money to the beneficiary or paying the beneficiary's expenses directly from the trust. Or:

- Hold it in the trust for use in a future year for one of the two preceding uses.

This discussion will look at a TYPE II AMBT established for the benefit of one D/CI individual. Case studies involving multiple D/CI beneficiaries are beyond the scope.

Suppose there is a trust for multiple beneficiaries, one of whom is a D/CI individual, containing the inherited IRA and other assets. To qualify for EDB treatment, the trust specifies that distributions from the IRA (including proceeds and reinvestments thereof) must not be distributed to any beneficiary other than the D/CI beneficiary so long as the D/CI beneficiary is living. This will require the trustee to somehow maintain a meticulous accounting for the IRA and distributions therefrom, separate from all other assets and never commingled. Yet the trust will be taxed as a single combined entity.

Corey Example: Corey leaves his $500,000 IRA and $1 million of other assets to a spray trust for the benefit of his three adult children, Dinny, Vinny, and Winnie. Winnie is disabled. The trust specifies that distributions from the IRA can not be paid to any beneficiary other than Winnie. The trustee in its absolute discretion can pay money from the trust to Winnie or for her benefit. It is contemplated that this will be used to provide for her supplemental needs and not replace government benefit programs she is enrolled in. Otherwise, all income of the trust (not including any part of the IRA distributions) shall be distributed annually to Dinny and Vinny. The trustee must somehow keep the IRA and its distributions away from all other trust assets. Presumably if accumulating the IRA distributions in the trust generates income tax at the trust level the trustee can pay that tax out of the IRA proceeds.

The trust would have the life expectancy payout for the IRA, based on Winnie's life expectancy (as she is the oldest D/CI beneficiary, even though she is the youngest child). Prop. Reg. § 1.401(a)(9)-5(e)(2)(i), § 1.401(a)(9)-5(f)(1)(ii). The Outer Limit Year would be the final year of Winnie's life expectancy or if earlier the 10th year after her death. Prop. Reg. § 1.401(a)(9)-5(f)(2)(iii).

All that appears beneficial if Winnie has a long life expectancy. However, it ties the trustee to retaining in the trust (and paying tax at trust rates) all IRA distributions not paid out to Winnie under whatever standard the trust and/or requirements of applicable benefits programs dictate. The trust could be trapped into paying high trust tax rates on quite a bit of the IRA.

Questions include: Would Corey be better advised to have a single trust for all the children with payouts to Winnie strictly discretionary with the trustee (if the goal is to have the trust function as a supplemental needs trust), and make the IRA payable to that trust, and forget about trying to achieve AMBT status—just distribute the IRA within 10 years after Corey's death? This approach would eliminate the need for RMD concerns, separate accounting, and (worst of all) holding back IRA distributions, in the trust, to qualify as an AMBT.

VI. Trust for NoMoTTYYs.

Leaving an IRA to a trust for the benefit of a NoMoTTYY is no easier than leaving a trust for any other beneficiary. The fixed-term life expectancy payout may end well short of the actual lifespan of the NoMoTTY, which is not good if the NoMoTTYY will actually be depending on this income stream. The early death of a NoMoTTYY could accelerate the payout unexpectedly for other trust beneficiaries who were counting on him/her to live to at least within 10 years of his/her IRS life expectancy.

Case study: Natalie is age 76, unmarried and childless. She wants to leave her $3 million IRA to a trust for the benefit of her three siblings Molly (age 74), Billy (72), and Kelly (70). Her goal is to provide them with professional management of the funds, a predictable (not necessarily large) income for life, and fund that can be tapped disproportionately for extra expenses when needed.

Preserving the fund for other possible beneficiaries after the siblings are all deceased is not one of Natalie's goals for this trust. However, if there are funds left over they will go to charity, or (if that would cause the trust not to pass the "all beneficiaries must be individuals" test) to Natalie's nieces and nephews.

None of the siblings is disabled. All are, obviously, NoMoTTYYs.

Here are possible structures and the pluses and minuses of each based on the assumption Natalie dies right now.

- **A single "conduit" trust fund which would pay out to all of the siblings as needed.** As a conduit trust, the remainder ("tier 2") beneficiaries would be disregarded so charity could be named as the remainder beneficiary. Since all countable beneficiaries would be EDBs, the life expectancy payout would apply based on the life expectancy of Molly, the oldest sibling. The 10-year Outer Limit Year would apply based on Molly's death—100% distribution of the IRA and the trust would be required within the earlier of about 15 years (Molly's approximate life expectancy) or 10 years after Molly's death (if she dies in the next five years, i.e., when her life expectancy is still over 10 years). This last feature makes this structure unacceptable. Since anyone can die at any time, you have to look at what happens if Molly dies suddenly, shortly after Natalie, say at age 77? The whole trust would be paid out by the year Molly would have turned 87, when Billy and Kelly are still living and with many years to go on their probable life expectancy (their parents lived into their 90s). This result would destroy the plan for the IRA to provide a lifelong source of income and financial security managed by a professional trustee for the younger siblings.

- **3 separate "conduit trusts," one for each sibling.** This gets closer to the goal. Although each sibling would have an equal predefined share (which is not QUITE the ideal—the ideal was to have some flexibility to pay more to one than another based on relative needs), each sibling would have a life expectancy payout based on his or her own life expectancy, and not be surprised by a speeded up payout based on the unexpected death of the oldest sibling. If a sibling died, his or her remaining share would be placed into a trust for the benefit of the

other siblings. This "one third remainder trust" would NOT be a conduit trust and would not be subject to ANY of the restrictions applicable to see through trusts...it could accumulate IRA distributions and have a charitable remainder beneficiary. This remainder trust would have to withdraw the deceased sibling's share of the IRA in annual instalments over the remainder of the deceased sibling's life expectancy (with an Outer Limit Year of 10 years after such sibling's death—even if the remaining life expectancy payout would have been longer than 10 years). **Drawbacks:** A conduit trust forces the trustee to pay out to or for the benefit of the sibling the RMD each year; the trustee is not able to accumulate distributions for possible needs in later years. And, as the IRA payout ends at the end of the sibling's life expectancy, the trust for that sibling is then "gone" and the sibling has to fend for him/her self. For example, at age 72, Billy's life expectancy is about 17 years. If he lives into his 90s (as their parents did), Billy will no longer have any income from his conduit trust. Once again, this structure does not fit well with Natalie's goals.

- **3 separate "accumulation trusts," one for each sibling.** Here is how this trust would be drafted. The trust for, e.g., Sally, would say "the trustee will use income and principal for the benefit of Sally as long as she lives [setting forth the goal of a lifelong income plus extra funds as needed etc.]. Upon her death, if both of the other siblings are then living, the trust shall continue for their benefit on the same terms, or, if only one of them is then living, the trust shall terminate and the fund shall be distributed outright to such surviving sibling, or, if none of them is then living to Charity X." Assuming all 3 siblings survive Natalie, here's how this trust is tested. Countable beneficiaries are Sally (first tier) and Molly and Billy (second tier). Charity is a 3rd tier (it can inherit only by surviving the second tier beneficiaries) so it is disregarded. Since all countable beneficiaries are EDBs, the trust is entitled to the life expectancy payout. The life expectancy payout and Outer Limit Year are both determined based on the oldest sibling's (i.e. Molly's) life expectancy. Thus, the trust has a foreseeable payout of about 15 years (Molly's life expectancy) after Natalie's death if Natalie dies in the near future. That anticipated payout would be accelerated by up to five years if Molly dies less than 10 years after Natalie (because then the Outer Limit Year would be 10 years after Molly's death). But regardless of when exactly Molly dies, the trustee would have the ability to accumulate IRA distributions and (after paying tax on them) save them for future years' needs. **Drawbacks**: If two of Natalie's siblings predecease her, she would need to take a different approach since in that case the two countable beneficiaries would be last surviving sibling + charity, and the trust would not qualify as a DB. In that case the payout would be over NATALIE's then remaining life expectancy, with no option to elect the 10-year rule (since Natalie is past her required beginning date).

Conclusion about Natalie's IRA trust plan: No matter how you slice and dice it:

- This IRA is going to have to be distributed within no more than about 15 years after Natalie's death and that payout period gets shorter each year that Natalie and the siblings live. And:

- Natalie has to make some compromises to get even that much "life expectancy payout" (such as possibly diverting the remainder to nephews to avoid having a countable charity/nonindividual beneficiary). And:

- The trust will have to pay trust income tax rates on any significant IRA distributions accumulated for the purpose of providing for the siblings' later years and unexpected large expenses....and the trust will be in a higher income tax bracket than Natalie is right now.

So: Natalie has a problem if this is the only asset she has to fund her goal of providing for the siblings. If that is the case, she should consider annuity solutions and/or consider doing Roth conversions during life so the trust can be funded with an asset that does not creates such income tax complications.

If this asset is just one of many, then the conduit trust for each beneficiary for his/her 1/3 share can make sense: The siblings would be advised to regard the life expectancy payouts as temporary income, to be saved for the future or used for nonrecurring expenses. Or to level out each beneficiary's cash flow, distributions from the "main" trust (holding Natalie's substantial other assets) would be reduced in the "early" years then accelerated as the "life expectancy payouts" ran out. The main trust provisions would say exactly what Natalie wants them to say with no compromises (in either drafting or trust administration) to accommodate the RMD rules.

And/or (again, if Natalie has other assets besides the IRA), Natalie could leave the IRA to a charitable remainder trust which would pay the siblings a predictable lifelong income AND eliminate all income tax on the IRA death benefit AND provide for her charitable intent AND even provide an estate tax charitable deduction. The CRT distributions would provide the steady lifelong income which is one of the goals and other (nonIRA assets) could be used to provide the slush fund for extra/unforeseen expenses to supplement the income from the CRT.

In summary, qualifying for EDB status/"life expectancy payout" does not by itself accomplish the client's goals. As a supplement to substantial other assets providing for the beneficiary(ies), it can work. As is often the case, the life expectancy payout does not provide a long enough "payout period" to actually increase the value of the inherited plan, while its attendant complications and drawbacks may force compromises with the client's goals if those goals cannot be achieved with other assets.