The Impact Of New IRS Proposed Regulations On The SECURE Act: RMDs, Eligible Designated Beneficiaries, Trusts, And More!

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EXECUTIVE SUMMARY

When the SECURE Act was signed into law in December 2019, it ushered in some of the most significant changes to the rules for retirement accounts in well over a decade. At the same time, however, the statutory language included a number of provisions that were either ill-defined or left open to substantial IRS interpretation. To fill this gap, the IRS issued Proposed Regulations on February 23, 2022, to reflect the changes to the Internal Revenue Code made by the SECURE Act. The Proposed Regulations are likely to be amended at least somewhat before they are finalized, but they do provide the best window into the IRS's current thinking on a variety of issues.

For many individuals, the most significant change made by the SECURE Act was the introduction of the 10-Year Rule, under which most non-spouse beneficiaries are required to distribute the entirety of their inherited retirement accounts by the end of the tenth year after the decedent's death. But while the general consensus among practitioners was that such Non-Eligible Designated Beneficiaries would be allowed to distribute the entire account as a lump sum at the end of the 10th year instead of taking annual distributions to empty the account, the new Proposed Regulations seek to implement a system that would require Non-Eligible Designated Beneficiaries inheriting from retirement account owners who died on or after their Required Beginning Date to comply with the 10-year distribution requirement in addition to taking annual RMDs during that period.

The Proposed Regulations also clarify who can be considered an Eligible Designated Beneficiary (and who are able to use the previous 'stretch' RMD rules rather than the 10-Year Rule), including the decedent's minor children, considered minors until they reach their 21st birthday regardless of the age of majority defined by state laws. Which means that minors would use the 'stretch' RMD rules until their 21st birthday, and then be subject to the 10-year rule and potential continued RMDs (if the decedent had reached their Required Beginning Date).

Furthermore, the Proposed Regulations provide significant new guidance on trust beneficiaries of retirement accounts, proposing that much of the existing trust-as-a-retirement-account-beneficiary structure be left in place, including the requirements for a trust to qualify as a "See-Through Trust" and the concepts of Conduit and Discretionary Trusts. In addition to continuing to allow remainder beneficiaries of a Conduit Trust to be disregarded when determining the post-death payout schedule of a See-Through Trust named as the beneficiary of a retirement account, the Proposed Regulations also outline other new types of Discretionary Trust beneficiaries that can be disregarded, including secondary beneficiaries who can only inherit trust assets contingent on the death of another secondary beneficiary, and beneficiaries who can only receive distributions of retirement assets from a trust that are first required to be fully distributed to a minor trust beneficiary before the end of the year in which they reach age 31 (provided that they survive to that age).

In a departure from IRS historical norms, the Proposed Regulations would prevent a general power of appointment from causing a trust to fail to meet the See-Through Trust requirement that beneficiaries of a trust be identifiable (given that certain requirements are met). Additionally, in the event that a trust is modified via a method provided for under state law, any trust beneficiaries removed via such a process by September 30th of the year following the year of death will not be considered when determining the trust's post-death payout schedule.

Ultimately, the key point is that the IRS's recent Proposed Regulations provide important insight and clarity on several aspects of the SECURE Act, of particular relevance to certain Non-Eligible Designated Beneficiaries and those with trusts. And while the Proposed Regulations can still be amended before they are finalized, taxpayers (and their advisors) can start preparing themselves now for how their individual situations might be affected!

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On December 20, 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law, ushering in some of the most significant changes to the rules for retirement accounts in well over a decade. As is often the case with statutory language, the SECURE Act included a number of provisions that were either ill-defined or left open to substantial IRS interpretation. Thus, for more than two years, practitioners have been anxiously awaiting the issuance of Treasury Regulations to help fill in the gap and answer open questions.

To that end, on February 23, 2022, the IRS issued Proposed Regulations to reflect the changes to the Internal Revenue Code made by the SECURE Act. Although the Regulations cannot yet be relied upon, are not yet finalized, and

are likely to be amended at least somewhat before that happens, they provide the best window into the IRS's current thinking on a variety of issues to date.

Some Non-Eligible Designated Beneficiaries Would Be Subject To *BOTH* Annual RMDs And The 10-Year Rule

For many individuals, the most significant change made by the SECURE Act was the introduction of the 10-Year Rule. Under the rule, most non-spouse beneficiaries are required to distribute the entirety of their inherited retirement account by the end of the tenth year after the decedent's death.

After the enactment of the SECURE Act, the general consensus among practitioners was that the 10-Year Rule would be implemented in such a manner that would simply require the inherited account to be fully distributed by the end of the 10th year after death. During those 10 years, however, it was thought that beneficiaries would have ultimate flexibility, and the ability to take out as much, or as little, as desired in each of the first nine years after the owner's death (as long as anything still left in the 10th year after death was distributed by the end of that year).

Then, in early 2021, the IRS issued its annual update to Publication 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*, which included an example that seemed to indicate that Non-Eligible Designated Beneficiaries would be required to abide by 'regular' 'stretch' RMDs in *addition* to the 10-Year Rule. Practitioners immediately raised questions about the Publication, and within weeks, an IRS spokesperson indicated that the initial version contained a mistake, and that a corrected version of the Publication would soon be made available.

To that end, on May 25, 2021, the IRS posted a revised version of Publication 590-B, in which it seemed to confirm that the original interpretation of the 10-Year Rule was correct, and that Non-Eligible Designated Beneficiaries would *not* be required to take any distributions until the 10th year after the retirement account owner's death.

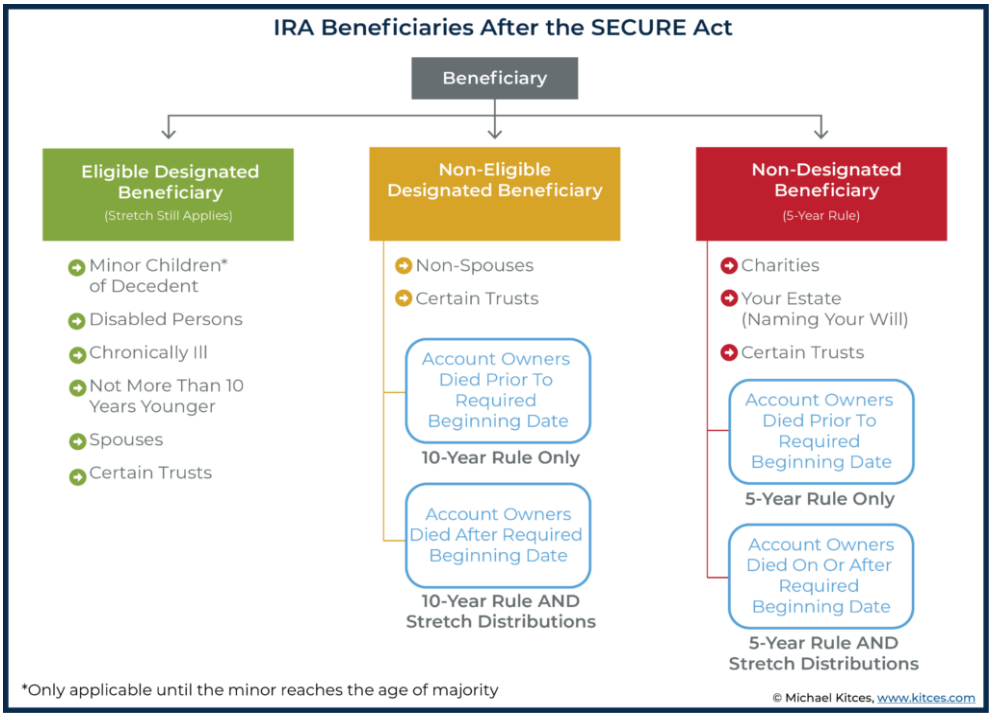
More specifically, the revised Publication of 590-B stated:

***10-year rule**. The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner's death. For example, if the owner died in 2020, the beneficiary would have to fully distribute the plan by December 31, 2030. **The beneficiary is allowed, but not required, to take distributions prior to that date**.*

In what can only be considered an incredibly surprising turn of events, the new Proposed Regulations seek to implement a remarkably complex system, whereby Non-Eligible Designated Beneficiaries would be split into two distinct groups, each with their own set of post-death distribution rules.

One group would be comprised of Non-Eligible Designated Beneficiaries who inherited from retirement account owners who died *prior* to their Required Beginning Date. This group of beneficiaries would be subject to 'only' the 10-Year Rule.

Non-Eligible Designated Beneficiaries who inherited from retirement account owners who died *on or after* their Required Beginning Date would comprise the second group. And this group of beneficiaries would be subject to *both* the 10-Year Rule *and* 'regular' 'stretch' distributions.



In other words, beneficiaries who inherit retirement accounts whose owners die *on or after* the Required Beginning Date would continue to have to comply not only with the 'stretch' distribution rules in place before the SECURE Act was passed, but, on top of those annual minimum requirements in each of the first nine years after death, they would *also* be required to empty the account by the end of the 10th year after death.

Example 1: *Bart is the healthy adult child of Homer and Marge, and will turn 39 years old in 2022. In June 2022, tragedy strikes, and Homer, age 68, and Marge, age 75, are killed in a car accident, leaving Bart as the beneficiary of each of their IRA accounts.*

Since Bart does not meet any of the requirements to be an Eligible Designated Beneficiary (discussed in greater depth in the following section), Bart will be a Non-Eligible Designated Beneficiary, and subject to the 10-Year Rule. Notably, though, under the Proposed Regulations, Bart would be subject to two different sets of post-death distribution rules.

Since Homer died prior to his Required Beginning Date, with respect to the IRA Bart inherits from Homer, he must simply empty the inherited account by the end of 2032 (the 10th year after Homer's death). Distributions before that time would be allowed, but not required.

By contrast, Marge had already passed her Required Beginning Date (of April 1 of the following the year that she turned 72). Accordingly, with respect to the IRA Bart inherits from Marge, he will be subject to ***both*** *the 10-Year Rule* ***and*** *annual 'stretch' RMDs. Thus, beginning in 2023 (the year after death), Bart would need to begin taking 'stretch' distributions, calculated in the same manner as if the SECURE Act had not been enacted, and on top of that, he must be sure to empty the entire inherited IRA from Marge by December 31, 2032.*

In the preamble to the Proposed Regulations, the IRS provided its rationale for this approach, indicating the following:

…section 401(a)(9)(H)(i)(II) provides that section 401(a)(9)(B)(ii) applies whether or not distributions have commenced. Accordingly, if an employee dies after the required beginning date, distributions to the employee's beneficiary for calendar

years after the calendar year in which the employee died must satisfy section 401(a)(9)(B)(i) as well as section 401(a)(9)(B)(ii).

Such an interpretation of the statute seems reasonable, but also unnecessary. In the past, the IRS has certainly interpreted *more* narrowly written statutes in a much broader manner. To that end, given the complexity such a bifurcated approach to implementing the 10-Year Rule would create, it's likely that the IRS will receive a substantial number of comment letters recommending a simpler implementation.

It remains to be seen whether any such commentary will sway the IRS's opinion on the matter, and as such, advisors should begin to consider the implications of such requirements on clients' plans.

CLARIFICATIONS AROUND THE DEFINITION OF ELIGIBLE DESIGNATED BENEFICIARIES

While the general rule under the SECURE Act is that Designated Beneficiaries will be subject to the new 10-Year Rule, the law did leave the original 'stretch' rules in place for Eligible Designated Beneficiaries. The SECURE Act went on to provide that Eligible Designated Beneficiaries would consist of the following five subgroups:

1. Surviving spouses
2. Individuals who are disabled
3. Persons who are chronically ill
4. Persons not more than 10 years younger than the deceased individual
5. Minor children of the decedent

Notably, although the SECURE Act did provide some definitions to clarify the requirements for qualifying for one or more of the above categories of Eligible Designated Beneficiaries, there remained a substantial number of questions. The Proposed Regulations provide additional information meant to help close that gap.

Minor Children Of Decedents

Perhaps the group of Eligible Designated Beneficiaries for which practitioners

were most anxious for additional clarification was minor children of the deceased retirement owner. Critically, while the definition of who is, and who is not, a minor is generally a matter of state law, the text of the SECURE Act pointed to IRC Section 401(a)(9)(F) for further clarification.

That Section of the Internal Revenue Code, however, redirects taxpayers to Treasury Regulation 1.401(a)(9)-6, A-15, which previously only applied to defined benefit plans and allowed children actively pursuing a specific course of education to be considered minors until as late as their 26th birthday.

The Proposed Regulations would modify the existing Regulations to provide that, in general, children of a decedent would be treated as reaching the age of majority on their 21st birthday. This would apply to children in all states, regardless of when such an individual would normally reach the age of majority under state law for other purposes. Accordingly, under the Proposed Regulations, minor children would be subject to the 'stretch' RMD rules beginning in the year after the death of their parent, and continuing through the year of their 21st birthday, at which time, the 10-Year Rule would begin to apply.

Owing to the ages when individuals generally tend to have children, it's likely that most minor children (i.e., younger than age 21) would inherit from parents dying prior to their Required Beginning Date. Thus, in most situations, minors would *not* be subject to annual RMDs during the period of time in which the 10-Year Rule applies.

Of course, there will be the occasional situation where a minor child inherited from a retirement account owner who had already reached their Required Beginning Date. In such a situation, under the Proposed Regulation, that child would continue to be subject to annual RMD requirements both prior to, and during, the application of the 10-Year Rule.

Example 2: *Bud is a 5-year-old healthy child of Peggy, age 45, and Al, age 75. In May 2022, Peggy and Al are both killed in a boating accident, leaving Bud as the beneficiary of each of their IRA accounts.*

As a minor child of both decedents, Bud would be considered an Eligible Designated Beneficiary under the SECURE Act. And, as provided by the Proposed Regulations, that status would continue to apply until Bud turned 21, at which point, he would

no longer be considered a minor and therefore, from that point forward, would be considered a Non-Eligible Designated Beneficiary subject to the 10-Year Rule.

From age 6 (the year after his parents' death) through age 21 (the year in which Bud would reach the age of majority under the Proposed Regulations), the post-death distributions rules to which Bud was subject would be the same for both the IRA inherited from Peggy ***and*** *from Al. More specifically, Bud would have to take RMDs from each account annually (the same as before the SECURE Act).*

Once Bud reached the age of majority, however, he would be subject to two different sets of rules. Since Peggy died ***prior to*** *her Required Beginning Date, as explained earlier, Bud would* ***not*** *be subject to any RMDs from the account he inherited from Peggy during the period of time in which the 10-Year Rule applied. The annual distribution requirement, which existed from his age 6 through age 21 would stop, and he would 'simply' have to empty whatever was still left in the account by the end of the year in which he turned 31.*

The 10-Year Rule would apply to the account inherited from Al in the same manner as it applies to the account inherited from Peggy. Accordingly, that account would also have to be fully distributed by the end of the year in which Bud turned 31. However, since Al died ***after*** *reaching his Required Beginning Date, Bud would still be subject to annual RMDs from the account inherited from Al each and every year.*

It's worth noting that the Proposed Regulations provide a limited number of exceptions to the "minor children reach the age of majority at 21" rule. One exception, for instance, would allow plans adopted prior to the publication of the Final Regulations to continue to incorporate their own plan-specific definition of "majority" that is different from that in the Final Regulations.

In addition, governmental plans, which require 'only' a "reasonable, good faith standard in complying with the rules of section 401(a)(9)" would be allowed to continue to use the age of majority definition incorporated into the existing Regulations, regardless of when those plans were adopted.

Individuals Who Are Disabled

As noted earlier, the SECURE Act included individuals who are disabled in the group of beneficiaries who qualify as Eligible Designated Beneficiaries. It

further provided that "disability" would be defined by IRC Section 72(m)(7), which states that an individual is disabled if they any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. The Proposed Regulations offer several important clarifications regarding the status of such persons.

First, the Proposed Regulations provide a safe harbor for determining whether an individual is disabled *enough* to qualify as an Eligible Designated Beneficiary. More specifically, the regulations provide that if an individual has been deemed disabled by the Social Security Administration as of the date of death, for purposes of determining their status as an Eligible Designated Beneficiary, they will automatically be considered disabled as defined by IRC Section 72(m)(7).

Second, the Proposed Regulations also help to shed light on how the IRS will treat young beneficiaries who may be disabled. Notably, the 'regular' definition of disabled involved a determination of whether the beneficiary is able to engage in substantially gainful activity. But most individuals under 18 don't engage in substantially gainful activity, regardless of whether or not they are disabled!

Accordingly, the Proposed Regulations clarify that someone who is under 18 (on the date of the decedent's death) has a disability if that individual:

*…has a medically determinable physical or mental impairment that results in **marked and severe functional limitations** and that can be expected to result in death or to be of **long-continued and indefinite duration**. [emphasis added]*

Finally, the Proposed Regulations would require that, in order for an individual to be an Eligible Designated Beneficiary by virtue of having a disability, they would need to provide "documentation" to the plan administrator (or IRA custodian) by October 31st of the year following the year of death.

The Proposed Regulations do not specify the nature of this documentation though (e.g., is it just a doctor's note stating that the person is unable to engage in substantially gainful activity for an indefinite period of time?), nor do

they outline what, if any, requirements an administrator or custodian would need to meet in verifying such information.

Persons Suffering From Chronic Illness

Persons suffering from a chronic illness are also considered Eligible Designated Beneficiaries under the SECURE Act. In general, IRC Section 7702B(c)(2) defines an individual as chronically ill if, without substantial assistance, they are unable to complete two or more of the activities of daily living (e.g., grooming, dressing, toileting, ambulating, eating, or transferring) for a period of at least 90 days.

The SECURE Act *slightly* modifies that definition, removing the 90-day threshold, and replacing it with a requirement that the illness be "reasonably expected to be lengthy in nature," and thus longer than the 'regular' 90-day requirement.

The Proposed Regulations reinforce this modified definition, and further provide that, in order to be considered chronically ill for purposes of determining beneficiary status, a chronically ill individual must provide written documentation to the plan administrator (or IRA custodian) by October 31st of the year after the decedent's death.

Notably, though, unlike the documentation requirement for disabled persons, the Proposed Regulations specify the nature of such documentation. Specifically, they require that the documentation "include a certification from a licensed health care practitioner" verifying the inability of the individual to complete the two (or more) activities of daily living for at least a "lengthy" period of time.

Persons Not More Than 10 Years Younger Than The Deceased Individual

One of the questions that was raised shortly after the enactment of the SECURE Act was how the IRS would interpret the "10 years younger" portion of the statute. More specifically, there was a question as to whether the IRS would use the actual age of the decedent and the beneficiary, or whether they would use a simpler more-than-ten-calendar-years definition.

For instance, if a deceased IRA owner was born on March 1, 1970, and the IRA account beneficiary was born on December 1, 1980, would the beneficiary be considered "not more than 10 years younger", since, by calendar years, they are 10 years apart? Or would they be considered *more* than 10 years younger, since, by actual birth dates, they are 10 years *and 9 months* apart?

The Proposed Regulations clarify this point by providing that the *actual* age of the decedent and the beneficiary must be used in determining whether an individual is an Eligible Designated Beneficiary.

***Example 3**: AJ is an IRA owner whose date of birth is July 1, 1970. The beneficiaries of his IRA are his two cousins, Bobby and Tommy, whose dates of birth are March 1, 1980, and August 1, 1980, respectively. Unfortunately, in October 2022, AJ dies.*

In determining whether Bobby and/or Tommy are Eligible Designated Beneficiaries, we must compare their actual dates of birth to that of AJ. Accordingly, Bobby, who is 'only' 9 years and 8 months younger than AJ will be considered an Eligible Designated Beneficiary and will be able to 'stretch' distributions over his remaining (single) life expectancy.

By contrast, Tommy is 10 years and 1 month younger than 111. Accordingly, he would be considered a ***Non-****Eligible Designated Beneficiary, and would be required to distribute the balance of his portion of the inherited IRA by the end of 2032 (the 10th year after AJ's death).*

The IRS's decision to interpret the not-more-than-ten-years-younger rule based on actual dates of birth is particularly interesting when juxtaposed against the rules for determining whether a retirement account owner can use the Joint life and Last Survivor Expectancy table (the "Joint Table") to calculate the amount of their RMD. Notably, that table can only be used by those who have dates of birth in *calendar* years that are at least 11 (more than 10) years apart.

Proposed Regulations Would Clarify Application Of Change Of RMD Starting Age To Surviving Spouse Beneficiaries

In addition to changes to the post-death distribution rules for many beneficiaries, the SECURE Act also changed the year in which RMDs must begin for retirement account owners. Prior to the SECURE Act, RMDs were generally applicable beginning in the year when an individual reached age 70 ½. The SECURE Act, however, pushed back the general RMD starting age to 72, effective for those individuals attaining age 70 ½ on or after January 1, 2020. This created a question as to how several rules applicable to (sole) surviving spouse beneficiaries should be applied.

Notably, prior to the SECURE Act, a surviving spouse who remained the beneficiary of their deceased spouse's retirement account (i.e., established and maintained an inherited IRA) was not required to begin taking RMDs from the inherited retirement account until the year that the deceased spouse would have turned 70 ½. Similarly, in the event that the surviving spouse died before that time (the year in which the deceased spouse would have turned 70 ½), the surviving spouse's beneficiaries were treated as though they had inherited directly from the original account owner.

The primary question was how the SECURE Act's changes should impact surviving spouse beneficiaries who inherited prior to the effective date of the SECURE Act's changes, but from decedents who would have turned 70 ½ on or after January 1, 2020. In other words, should the SECURE Act's language be interpreted to mean that a retirement account owner had to *actually* turn 70 ½ on or after January 1, 2020 (meaning they would have needed to live until at least that date), or 'merely' that the individual would have turned 70 ½ on or after January 1, 2020, *had they lived?*

Thankfully, for ease of administration, the IRS appears on track to take the latter viewpoint. Because if a decedent was born on or after July 1, 1949 (and thus, would have turned 70 ½ on or after January 1, 2020, had they lived), surviving spouses remaining as a beneficiary of such individuals accounts will not be required to take RMDs until the year the decedent would have turned 72.

Similarly, in the event that the surviving spouse beneficiary dies before the year in which the original decedent would have turned 72, the surviving spouse's beneficiaries will be treated as inheriting directly from the original retirement account owner.

Eligible Designated Beneficiaries Can Opt Out Of 'Stretch' And Into 10-Year Rule, But Custodians Can Limit Options

Under the 'old' rules, Designated Beneficiaries of decedents who died prior to reaching their Required Beginning Date were able to opt out of the 'stretch' and into the 5-year rule that applies to Non-Designated Beneficiaries inheriting from the same individuals. Accordingly, a natural question on the minds of many planners after the SECURE Act was enacted was whether *Eligible* Designated Beneficiaries who inherit from the same individuals (someone dying prior to reaching their Required Beginning Date) would be able to opt out of 'stretch' distribution in favor of the 10-Year Rule that the SECURE Act applies to Non-Eligible Designated Beneficiaries.

New Proposed Treasury Regulation 1.401(a)(9)-3(c)(5)(C)(iii) makes it clear that the IRS intends Eligible Designated Beneficiaries to make just such an election. Specifically, the Proposed Regulations state:

A defined contribution plan may include a provision, applicable to an employee who dies before the employee's required beginning date and who has an eligible designated beneficiary, that permits the employee (or eligible designated beneficiary) to elect whether the 10-year rule in paragraph (c)(3) of this section or the life expectancy rule in paragraph (c)(4) of this section applies.

It's worth noting that while the Proposed Regulations *permit* a plan or IRA custodian to allow such an election, they don't require that such an option be granted. In fact, the Proposed Regulations go so far as to explicitly state that a plan need not make both options available at all. Rather, the plan/IRA can simply require Eligible Designated Beneficiaries to use the 10-Year Rule or the 'stretch'!

Nerd Note:

The actual text of the Proposed Regulation that discusses the ability of a plan to limit the ability of an Eligible Designated Beneficiary to 'stretch' distribution includes some peculiar wording. Specifically, the Proposed Regulations state that a plan won't be in violation of 401(a)(9) simply because it requires "**some or all** of the employees" [emphasis added] to use only the 10-Year Rule. It goes on to say that "a plan need not have the same method of distribution for the benefits of all employees." This would seem to give companies the ability to preference certain employees over others with respect to the post-death distribution options afforded to their beneficiaries.

Proposed Regulations Would Provide Significant New Guidance To Trust Beneficiaries Of Retirement Accounts

The rules for retirement accounts are complicated. The rules for trusts are complicated. Put them together and you get… well… something really complicated!

Unfortunately, the recently released Proposed Regulations don't do a whole lot to reduce the complexity introduced to a plan by naming a trust as the beneficiary of a retirement account. They do, however, seek to provide material clarifications on a variety of matters that have perplexed planners for years.

Critically, the Proposed Regulations contemplate leaving in place much of the existing trust-as-a-retirement-account-beneficiary structure, including the requirements for a trust to qualify as a "See-Through Trust" (thereby enabling the applicable beneficiaries of the trust to be treated as the beneficiary of a decedent's retirement account instead of the trust, itself). The Proposed

Regulations also retain the concepts of Conduit and Discretionary (a.k.a. Accumulation) Trusts.

CERTAIN TRUST BENEFICIARIES CAN BE DISREGARDED WHEN DETERMINING THE POST-DEATH PAYOUT PERIOD

Under the existing regulations, remainder beneficiaries of a Conduit Trust are disregarded when determining the post-death payout schedule applicable to a See-Through trust that has been named as the beneficiary of a retirement account, and the Proposed Regulations would continue to allow such treatment. But the Proposed Regulations also introduce several new types of trust beneficiaries that can be disregarded.

One new group of trust beneficiaries that could be disregarded is secondary beneficiaries of Discretionary (accumulation) Trusts who are only able to inherit trust assets because of the death of another secondary beneficiary.

In order for this exception to apply, the first secondary beneficiary *must* survive (and be treated as surviving) the retirement account owner.

Example 4: *John Doe has created the John Doe Retirement Account Trust to provide for the management of his retirement accounts after his death. The trust is a Discretionary Trust, and names his spouse, Jane Doe, as the first-in-line beneficiary of the trust.*

In the event that Jane Doe dies prior to the distribution (from the trust) of all retirement assets left to the trust, John's brother, Jim Doe, is next-in-line to receive such distributions. And should Jim die prior to the distribution (from the trust) of all retirement assets left to the trust, John's favorite charity is entitled to any remaining amounts.

Here, provided that Jane (a primary beneficiary of the trust) and Jim (a secondary beneficiary of the same trust) both survive John, the charity would be a secondary beneficiary of the trust that would only be able to receive assets after the death of Jim, another secondary beneficiary (who had survived the decedent). Accordingly, the charity would be disregarded when determining the post-death distribution schedule.

Another new group of trust beneficiaries that could be disregarded under the Proposed Regulations is trust beneficiaries of Discretionary Trusts who can only receive distributions of retirement assets left to the trusts that first require the *full distribution* of assets to a minor trust beneficiary by no later than the end of the year in which they reach age 31.

That, needless to say, is an absolute mouthful, and is best explained via an example. So, let's look at one…

Example 5: *Ned is a single IRA owner who has a 15-year-old daughter, Sansa. Accordingly, Ned establishes a Discretionary Trust for his daughter.*

The trust provides that, while the trustee shall have discretion over how much of the IRA should be paid to Ned's daughter annually until she is 30, whatever is left in the trust in the year that Sansa turns 31 ***must*** *be distributed to her before the end of the year.*

In the unlikely event that Ned's daughter does ***not*** *receive all of the retirement assets left to the trust – which, by the trust's terms, necessarily means that she has died before the end of the year in which she turned 31 – the trust assets are to go to Ned's mother, who is 85.*

Since the only way Ned's mother is entitled to any of the retirement assets left to the trust is if Sansa dies, ***and*** *since the trust* ***must*** *payout all of the retirement assets to Sansa no later than the end of the calendar year in which Sansa turns 31, Ned's mother can be disregarded for purposed of determining the post-death distribution schedule applicable to the trust.*

PROPOSED REGULATIONS WOULD ALLOW TIMELY EXERCISING OF POWERS OF APPOINTMENT WITHOUT VIOLATING THE 'IDENTIFIABLE BENEFICIARIES' SEE-THROUGH TRUST REQUIREMENT

Another significant trust-related element of the Proposed Regulations would prevent the inclusion of a general power of appointment from causing the trust to fail to meet the See-Through Trust requirement that beneficiaries of a trust be identifiable.

More specifically, to the extent that an individual is granted a power of appointment over trust assets, provided that such power is exercised by September 30th of the year following the year of death in favor of one or more beneficiaries who are all identifiable (or restricts their unexercised power to a limited group of identifiable beneficiaries), the identifiable beneficiaries (or limited group of potential future beneficiaries) will be considered a beneficiary of the trust.

If, on the other hand, such a power of appointment has neither been exercised, nor restricted, by September 30th of the year following the year of death, the Proposed Regulations would treat the *power holder* as a trust beneficiary.

Finally, to the extent that a power of appointment was exercised after September 30th of the year after death, any such appointed beneficiaries would, from that point forward, be treated as a beneficiary of the trust, *along with* the power holder.

Example 6: *Ty died on January 15, 2022, and left his IRA to his trust. Under the terms of the trust, his daughter, Cersei, has a general power of appointment, and can decide to whom the IRA shall pass (via the trust). Cersei is considering appointing her son, Joffrey, who is 25 years old and disabled, as the beneficiary of the trust (assume the trust has standby special needs trust language to avoid assets from being available to Medicaid, etc.).*

If Cersei exercises her power of appointment in favor of Joffrey by September 30, 2023 (the year after Ty's death), then ***only*** *Joffrey will be considered a beneficiary of the trust. Furthermore, since Joffrey is disabled, the trust would be able to stretch distributions over Joffrey's ~60-year life expectancy.*

If, on the other hand, Cersei did ***not*** *exercise her power by September 30, 2032, then* ***she*** *would be considered a beneficiary of the trust, and thus, would force the trust to be subject to the 10-Year Rule (even if she later exercised her power in favor of Joffrey).*

If finalized by the IRS, this element of the Proposed Regulations would mark a *dramatic* shift from the IRS's historical viewpoint by relaxing its stance with respect to post-death powers of appointment. Notably, in the past, to the extent an applicable trust beneficiary held a general power of appointment *on*

the date of death, the IRS viewed the trust as *failing* to meet the See-Through Trust requirement that trust beneficiaries be identifiable. Accordingly, such trusts were considered Non-Designated Beneficiaries, and subject to the less favorable post-death distribution rules that apply to such beneficiaries.

PROPOSED REGULATIONS WOULD ALLOW TIMELY MODIFICATIONS OF TRUSTS UNDER STATE LAW WITHOUT VIOLATING THE 'IDENTIFIABLE BENEFICIARIES' SEE-THROUGH TRUST REQUIREMENT

In another departure from IRS historical norms, the Proposed Regulations contemplate allowing trust beneficiaries to be added *and* removed pursuant to timely state-authorized trust modifications.

More specifically, in the event that a trust is modified via a method provided for under state law (e.g., court reformation, decanting to a new trust) any trust beneficiaries removed via such a process by September 30th of the year following the year of death will not be considered when determining the trust's post-death payout schedule. On the flip side, beneficiaries added via such a process will be considered beneficiaries of the trust when determining the applicable post-death distribution rules.

In the past, the IRS has repeatedly ruled that the trust language *as of the date of death* was instructive of the applicable trust beneficiaries. If finalized, this provision would allow trusts with drafting errors, unwanted beneficiaries, etc., a limited window of time in which they could be 'corrected' after death using methods authorized under state law.

The much-anticipated Proposed Regulations provide valuable insight into how the IRS is thinking about updating its rules to accommodate the changes made by the SECURE Act. Indeed, much of the Proposed Regulations are likely to remain the same when all is said and done.

There are, however, some very obvious elements (e.g., the application of the 10-Year Rule) of the Proposed Regulations that neither align with conventional wisdom, nor are particularly taxpayer-friendly. Accordingly, it's likely that the IRS will receive a substantial number of comments about such matters,

potentially leading it to revise its position when the Final Regulations are ultimately published.

But while nothing can be certain at this point, it appears that the IRS is prepared to make some major concessions in a number of areas that *would* be to the benefit of many taxpayers. Its proposed treatment of surviving spouse beneficiaries would greatly simplify administration, and its proposed revisions to the trust-as-retirement-account-beneficiary rules would be a material improvement over the existing regulations in a variety of ways.

Given the timing of the Proposed Regulations and comment period, and the fact that the Proposed Regulations, themselves, contemplate applicability for 2022, it's likely that we'll have a final version of the regulations before the end of the year.

Until then, advisors should keep an eye out for when the rules are finalized, prepare certain Non-Eligible Designated Beneficiaries for the potential of unanticipated distributions that could be required by year-end, and note trusts that may need to be reviewed in light of changes to the regulations.