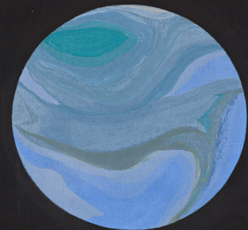


A WHOLE NEW WORLD:
RETIREMENT BENEFITS

By **Bruce D. Steiner**

New Laws Implemented and Clarified

Keeping up with the changes

In 2020, practitioners handling retirement issues had their hands full. They needed to understand and apply the provisions of the Setting Every Community Up for Retirement Enhancement (SECURE) Act (passed in 2019) when advising clients about taking distributions from their retirement plans. The Internal Revenue Service issued some private letter rulings to help clarify certain issues raised by this new law. Practitioners also had to help their clients take advantage of several relief provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act that benefited individual retirement account owners and beneficiaries. Here's an overview of the significant developments.

The SECURE Act

The SECURE Act was enacted at the end of 2019 and was discussed in last year's review. Now that it's been in effect for a year, we've had a chance to consider how it affects planning and what aspects of it need clarification.

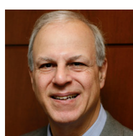
Before the SECURE Act, beneficiaries of retirement benefits could stretch distributions over their life expectancies. If a trust met certain requirements, the trustees could take distributions over the life expectancy of the oldest beneficiary.

Under the SECURE Act, beneficiaries must generally take distributions by the end of the 10th calendar year following the IRA owner's death. Exceptions include spouses, the IRA owner's minor children (but not other minors such as grandchildren), individuals not more than 10 years younger than the IRA owner and disabled and chronically ill individuals.

Because most beneficiaries will have to take distributions within a shorter period of time, the distributions will often be bunched into a higher income tax bracket. As a result of this bunching, Roth conversions will more often be appropriate.

There's sometimes a tension between leaving retirement benefits to the spouse outright or in trust. By leaving these benefits outright, the spouse may roll them over, name new beneficiaries and do Roth conversions when appropriate. On the other hand, by leaving the IRA to the spouse in trust, the IRA owner may obtain more control over when the spouse will receive distributions and where the balance at the spouse's death will go. Now that the benefit of the rollover isn't as great as it had been, some IRA owners who previously left their IRA to their spouse outright may decide to leave the IRA in trust for their spouse. If the trust is a conduit trust (that is, one in which distributions from the IRA to the trust must be paid out to the spouse on a current basis), the trust may recalculate the spouse's life expectancy each year. That will slow the required distributions.

There's also a tension between leaving IRA benefits to minor children outright (or to a custodian under the Uniform Transfers to Minors Act or a conduit trust for the minor) and leaving them to an accumulation (discretionary) trust. A minor child may use the life expectancy stretch during minority, which includes the period until the child has completed a specified course of education, but not beyond age 26. The remaining benefits must be distributed by the end of the 10th calendar year following majority (as defined above). We don't know what the IRS will consider as completing a specified course of education. A discretionary trust for a minor child doesn't qualify for the stretch during minority. Therefore, an IRA owner



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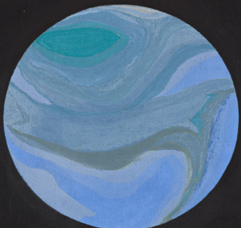


with a minor child must choose between creating a discretionary trust with distributions to the trust subject to the 10-year rule or allowing the minor to gain control of all of the benefits by age 36 (or sooner).

In other cases, conduit trusts will be even less desirable than under prior law. A conduit trust requires that distributions from the IRA be paid out to the beneficiary on a current basis. The advantage of a conduit trust is that it ignores subsequent beneficiaries in determining whether the trust qualifies for the life expectancy stretch. However, the disadvantage is that it throws all of the distributions into the beneficiary's estate and exposes them to the beneficiary's creditors, spouses and Medicaid. Some IRA owners were comfortable with beneficiaries receiving distributions gradually over a long time but may not be comfortable with beneficiaries receiving complete distribution outright within 10 years. These IRA owners may wish to consider changing these trusts to discretionary trusts, so that the trustees may retain the IRA benefits in trust after receiving them from the IRA.

The CARES Act suspended required minimum distributions from defined contribution plans and IRAs for employees, IRA owners and beneficiaries.

A charitable remainder unitrust (CRUT) will sometimes be a good way to replicate the stretch. A CRUT provides for annual payments at a rate of at least 5% of the value of the trust for the life of the beneficiary, recalculated annually. On the beneficiary's death, the balance of the trust goes to charity. The actuarial value of the charity's remainder interest must be at least 10% of the initial value of the trust. However, the benefit of the stretch will often offset or outweigh the cost of the charity's remainder interest.

A CRUT works best when the beneficiary is relatively young (but is at least 27), is likely to need distributions, is unlikely to have a taxable estate and is at low risk of creditors, divorce or Medicaid.

The SECURE Act also changed the required beginning date (RBD) from April 1 following the year the IRA owner reached age 70½ to April 1 following the year the IRA owner reached age 72. This allows additional deferral and gives IRA owners one or two additional years to do Roth conversions without being in a higher bracket as a result of required distributions.

In addition, the SECURE Act eliminated the maximum age for contributions to a traditional IRA. This allows more people to do backdoor Roth conversions.

The CARES Act

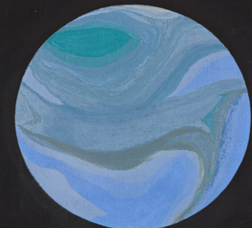
The CARES Act included several relief provisions for employees and IRA owners and beneficiaries.

An employee or IRA owner affected by COVID-19 may withdraw up to $100,000 in 2020 without the penalty for distributions before age 59½. The distribution may be included in income over three years, and it may be repaid within three years. Eligible individuals are those: who were diagnosed with COVID-19; whose spouse or dependent was diagnosed with COVID-19; or who experienced adverse financial consequences as a result of: being quarantined; being furloughed or laid off; having work hours reduced due to the virus; being unable to work because of lack of child care due to the virus; closing or reducing hours of a business the individual owned or operated due to the virus; or other factors to be determined by the IRS.

This distribution relief will provide a benefit to employees and IRA owners who need the money as a result of the virus. However, given the income tax benefits of retirement plans and IRAs, employees and IRA owners who don't need the money would generally be better off not taking these distributions. If they're temporarily in a lower bracket, they might want to consider doing Roth conversions to use their lower bracket space.

The CARES Act suspended required minimum distributions (RMDs) from defined contribution plans and IRAs for employees, IRA owners and beneficiaries. RMDs were also suspended for employees and IRA owners who reached their RBD on April 1, 2020 and didn't take their 2019 RMDs in 2019. The IRS granted relief for individuals who had previously taken what would have been RMDs but for the CARES Act.

Employees and IRA owners who don't need the suspended RMDs might want to consider doing Roth



conversions to take advantage of any lower bracket space freed up as a result of the suspension of their RMDs.

The Health and Economic Recovery Omnibus Emergency Solutions Act passed by the House, but not by the Senate, as of this writing, would have gone even further than the CARES Act in this regard. It would retroactively waive RMDs from defined contribution plans and IRAs for 2019 and give employees and IRA owners a window to repay them.

Unclaimed Funds

In Revenue Ruling 2018-17, the IRS ruled that the payment of an IRA to a state's unclaimed property fund is a taxable distribution and is subject to withholding at the rate of 10%. In Rev. Rul. 2020-24, the IRS extended the reporting and withholding to qualified plan benefits paid to a state's unclaimed property fund.

That would be a bad result. In the case of a traditional IRA, if the IRA owner didn't have any basis in the IRA, the entire value of the IRA would be taxable income. The IRA owner would lose the benefits of the IRA going forward. In addition, if the IRA owner was under age 59½, there would be a 10% penalty on the early distribution.

However, Revenue Procedure 2020-46 provides relief to affected employees and IRA owners. Internal Revenue Code Sections 402(c)(3)(B) and 408(d)(3)(I) allow the IRS to waive the 60-day deadline for a rollover "where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement." Prior to the issuance of Rev. Proc. 2016-47, it was necessary to obtain a PLR to get a waiver of the 60-day deadline. However, Rev. Proc. 2016-47 allowed taxpayers to self-certify their eligibility for an exception to the 60-day deadline in certain enumerated situations. Rev. Proc. 2020-46 updated Rev. Proc. 2016-47 by adding that "distribution was made to a state unclaimed property fund" as an acceptable reason for missing the 60-day deadline.

PLRs

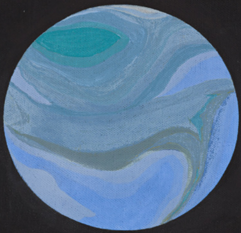
The IRS issued several PLRs rescuing IRA owners and beneficiaries from unnecessarily complicated planning.

In PLR 201944003 (released Nov. 1, 2019), the decedent and the surviving spouse created a joint revocable trust. The decedent owned an IRA and named the trust as the beneficiary. On the decedent's death, the trust was divided into separate trusts, one of which was revocable by the surviving spouse. The IRA was community property. The trust allowed the community property to be divided non-pro rata. The IRS permitted the IRA to be allocated to the trust that was revocable by the surviving spouse and allowed the surviving spouse to roll it over into the spouse's IRA.

This result was consistent with several prior rulings. However, the IRA owner could have avoided the need for a ruling by naming the spouse as the beneficiary of the IRA.

> While the IRS has discretion to waive the 60-day deadline when the failure to waive such requirement would be against good conscience, the IRS won't waive it when the IRA owner intended to use the distribution for another purpose.

In PLR 202031007 (released July 21, 2020), the IRA owner died after her RBD and before the SECURE Act. She left her IRA to her estate. Her estate was payable to a trust of which the personal representative was the trustee. The trust was payable to her children. The IRS allowed the personal representative to transfer the IRA to inherited IRAs for the children. The IRS didn't require the personal representative to first transfer the inherited IRA to an inherited IRA for the trust, a step that wouldn't have served any purpose. The IRA owner could have avoided the need for a ruling by naming the children as the beneficiaries of the IRA. Also, because the IRA owner died before the SECURE Act, by naming the children as the beneficiaries of the IRA, the children could have stretched the IRA over their life expectancies rather than over their mother's remaining life expectancy as if she hadn't died.

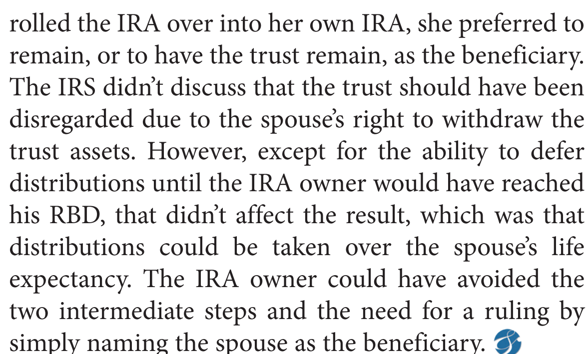


In PLR 202033008 (May 18, 2020), an IRA owner took a distribution from his IRA to buy a home, intending to repay the money on the sale of his old home. However, the IRA owner didn't sell his old home until more than 60 days from when he took the distribution. Because the purpose of the distribution was to buy a new home, the IRS refused to waive the 60-day deadline for a rollover. While the IRS has discretion to waive the 60-day deadline when the failure to waive such requirement would be against equity or good conscience, including casualty, disaster or other events beyond the reasonable control of the individual subject to such requirement, and has been liberal in doing so, the IRS won't waive the 60-day deadline when the IRA owner intended to use the distribution for another purpose.

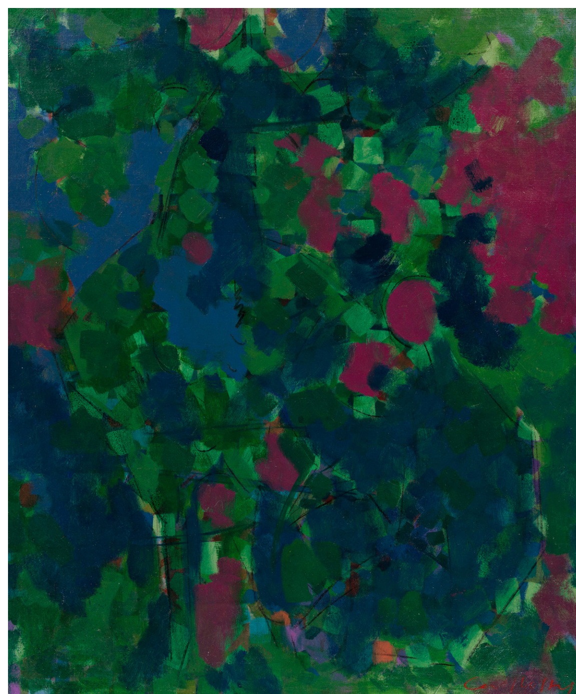
In PLR 202039002 (released Sept. 25, 2020), the IRA owner died after his RBD and before the SECURE Act. He left his IRA to his estate. The personal representative set up an inherited IRA for the estate. The IRS allowed the personal representative to distribute the inherited IRA to inherited IRAs for his partner, son and grandson, who were the beneficiaries of the estate. The IRA owner could have avoided the need for a ruling by naming the beneficiaries of the estate as the beneficiaries of the IRA. Also, because the IRA owner died before the SECURE Act, by naming his partner, son and grandson as the beneficiaries of the IRA, they could have stretched the IRA over their life expectancies rather than over the IRA owner's remaining life expectancy as if he hadn't died.

In PLR 202040003 (released Oct. 2, 2020), the IRA was payable to a trust that the surviving spouse could revoke. The IRS allowed the spouse to roll the IRA over into her own IRA. The IRA owner could have avoided the need for a ruling by naming the spouse as the beneficiary of the IRA.

In PLR 202044001 (released Oct. 30, 2020), the IRA owner died before age 70½ and before the SECURE Act. He left his IRA to a trust. The trust provided that the IRA would go to another trust. The second trust was for the benefit of the surviving spouse, with remainder to two individuals or their issue. The spouse had the right to withdraw the assets of the second trust. The IRS said that the issue of the presumptive remainder beneficiaries were mere successor beneficiaries and that distributions could be taken over the spouse's life expectancy. While the spouse could have



rolled the IRA over into her own IRA, she preferred to remain, or to have the trust remain, as the beneficiary. The IRS didn't discuss that the trust should have been disregarded due to the spouse's right to withdraw the trust assets. However, except for the ability to defer distributions until the IRA owner would have reached his RBD, that didn't affect the result, which was that distributions could be taken over the spouse's life expectancy. The IRA owner could have avoided the two intermediate steps and the need for a ruling by simply naming the spouse as the beneficiary.



SPOT LIGHT

Hope Springs Eternal

Untitled by Carl Holty sold for $5,980 at Swann Auction Galleries Modern & Post-War Art sale on Dec. 3, 2020 in New York City. Holty was an abstract painter known for his use of color, shape and form. The German-American artist Hans Hofmann's training and ideology, whom Holty greatly admired, helped shape and transform Holty's own work and was the influence for his paintings becoming more abstract over time. Though abstract, Holty's works always related to the natural world. He notably used tape to create his clean-edge painted forms.