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'SECURE' Trust Planning

The Secure Act of 2019 and its 2022 proposed regulations (collectively, SECURE) have dramatically altered estate planning for retirement benefits.

SECURE's implications are numerous, and this article does not attempt to address them comprehensively. Instead, this article is limited to analysis of two common estate planning scenarios: (1) designating a trust for spouse as beneficiary of retirement benefits; and (2) designating a trust for the benefit of an adult child. Special rules apply to beneficiaries who are minors, disabled or chronically ill, or less than 10 years younger than the participant. For simplicity, these rules are not covered in this article, and likewise neither Roth IRA planning nor charitable remainder trust planning is addressed.

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As under the old rules, the most preferential income tax treatment for individual beneficiaries is available to a surviving spouse. A surviving spouse can "rollover" the retirement account and be treated as its owner. This postpones any required minimum distributions (RMDs) until the spouse attains age 72 (in most cases) and subjects the RMDs to calculation under the favorable "uniform life table" applicable to account owners. Also, as has long been the case, it may be optimal to use retirement accounts to satisfy a client's charitable giving, because retirement accounts passing to charity will not be subject to estate tax and retirement account distributions to charity will not be subject to income tax.

However, there are dispositive reasons in many cases to designate a trust as beneficiary of retirement accounts—often, wealth preservation for remainder beneficiaries, and creditor protection.

Trust for Spouse

A married client frequently will want to use retirement accounts to fund a trust that qualifies for the estate tax marital deduction (a QTIP trust), provides a stream of income to the spouse for life, and leaves the balance remaining at the spouse's death to children. Most often, a QTIP trust for retirement accounts is structured to require distribution of all accounting

income to the surviving spouse, with trustee discretion to distribute or accumulate any plan distributions beyond that amount.

The tax treatment of such an "accumulation" QTIP trust is one of SECURE's most significant changes. Prior to SECURE, an accumulation QTIP trust had to take annual RMDs over the course of—and calculated based on—the spouse's life expectancy. Now, that same trust typically must withdraw the entire retirement account by the end of the tenth year following the year of the client's death (a "10-year payout") and, if the client dies after age 72, must take annual RMDs based on the spouse's life expectancy (determined under the less favorable "single life table" applicable to beneficiaries). If the spouse dies before the end of the 10 years, the remainder beneficiary continues on the same schedule.

To avoid this result, a QTIP trust must instead be structured as a "conduit" trust, meaning that it requires *all* plan distributions to be distributed to the spouse in the year received by the trust. There is some complexity in the rules for calculating distributions to a conduit trust for a surviving spouse:

(i) If the client dies before age 72, RMDs will be calculated using the spouse's life expectancy (recalculated in each year of the spouse's life using the single life table, and reduced by one year in each year following the spouse's death), but the requirement to begin taking distributions is deferred until the year in which the client would have reached age 72. Alternatively, if permitted by the plan, the spouse may elect a 10-year payout.

(ii) If the client dies at or after age 72, RMDs must be taken each year and are calculated using the longer of (a) the spouse's life expectancy (recalculated as above); and (b) the client's life expectancy at death.

(iii) In any event, the entire retirement account must be fully paid out by the earliest to occur of: (x) the end of the spouse's life expectancy (recalculated as above); (y) the end of the 10th year following the year of the spouse's death; and (z) if the client's death occurs at or after age 72, the end of the client's life expectancy at death.

Accordingly, each client must decide whether to structure a QTIP trust to prioritize income tax deferral, which is typically best provided by a conduit trust, or wealth preservation and creditor protection, which are better provided by an accumulation trust. Wealth preservation may be particularly important if the spouse is younger than the client or if the client's children are from a prior marriage. In addition, a conduit trust may distribute significant sums to the spouse that the spouse does not need. Any unneeded money would build up in the spouse's hands, where it would be exposed to the spouse's creditors and eventually pass pursuant to the spouse's estate plan rather than the client's estate plan.

The estate plan for a married client in New York with assets in excess of the federal and New York estate tax exemptions often includes a credit shelter trust for the amount of the New York exemption and a QTIP trust for the balance of the estate assets. Ideally, the credit shelter trust would be fully funded with other assets, and retirement accounts would go into the QTIP trust (assuming the client has decided not to designate the retirement accounts outright to the spouse or charity).

Funding a credit shelter trust with retirement accounts erodes the trust's estate tax efficiency, because RMDs will either be distributed to the spouse, and thereby become includible in the spouse's estate, or retained in the trust, where their value will be eaten away by the income tax. If it is necessary to fund the credit shelter trust with retirement accounts, then a conduit trust may be the preferred structure where

it is expected that all RMDs will be needed to support the spouse. In that case, the estate tax benefit of the credit shelter trust will be limited to estate tax insulation of trust assets in the event of the spouse's premature death.

Most trusts can qualify as either a conduit trust or an accumulation trust, but it is possible to fail the technical requirements to attain either status, in which case a trust will be treated as a "non-designated beneficiary" of the plan. If the client dies before age 72, a non-designated beneficiary must withdraw the retirement account by the end of the fifth year following the year of the client's death (a "5-year payout"), with no RMDs required in any year except the fifth year. If the client dies at or after age 72, a non-designated beneficiary must take RMDs each year based on the life expectancy of the client at the time of the client's death ("ghost life expectancy") and must fully withdraw the account by the end of the last year of the ghost life expectancy.

Failing to attain conduit or accumulation trust status is not the only way for a trust to be treated as a non-designated beneficiary. Failing to have adequately identified beneficiaries of the plan or trust will have the same result. For example, designating "my revocable trust" does not suffice. Additionally, it is unclear under SECURE whether an accumulation sprinkle trust for spouse and descendants, with a charity as taker of last resort, or an accumulation trust for spouse that continues for descendants beyond the life of the spouse, can avoid non-designated beneficiary treatment, although the proposed regulations provide some flexibility for a properly authorized independent trustee to modify or decant the trust to remove any problematic beneficiaries.

Trust for Child

If retirement accounts will be used to fund a trust for the benefit of the client's child for life, with remainder to grandchildren, a determination must be made if the trust will be crafted as an accumulation trust or a conduit trust. Either type of trust would be subject to the 10-year payout described above. Accordingly, an accumulation trust will generally be preferable because it will provide the trustee flexibility to retain retirement account assets in trust based on real-time determinations of what is in the best interests of the child (possibly forgoing income tax efficiency), while a conduit trust has no such flexibility.

As noted above, for a trust to qualify for a 10-year payout, the beneficiaries must be adequately identified. For an accumulation trust, this means that any presumptive remainder beneficiaries must be identifiable individuals at the client's death, which will not always be the case—for example, where the child does not have any living descendants at the client's death and the contingent remainder beneficiary is a charity. In that case, the trust must either be structured as a conduit trust or treated as a non-designated beneficiary, with the 5-year or ghost life expectancy payout described above.

Conclusion

There is no one-size-fits-all approach in estate planning for retirement accounts in light of SECURE; the appropriate plan for each client must be determined on a case-by-case basis. When issued, the final regulations may provide more guidance, and clients who wish to may modify their estate planning structures accordingly.

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