A PROFESSIONAL'S GUIDE TO THE IRA DISTRIBUTION RULES UNDER THE SECURE ACT

(Includes IRS Compliance Issues)

By: Seymour Goldberg, CPA, MBA, (Taxation) JD
www.TrustEstateProbate.com
info.goldbergira@gmail.com
516-222-0422

Credentials

Seymour Goldberg, CPA, MBA, JD

Senior partner in the law firm of Goldberg & Goldberg, P.C., Melville, New York. Professor Emeritus of Law and Taxation at Long Island University. Former director of the Tax Institute of C.W. Post Campus. Recipient of the American Jurisprudence Award in Federal Estate and Gift Taxation from St. John's University School of Law.

CLE instructor for many professional organizations including the New York State Bar Association, American Bar Association, NJICLE, City Bar Center for CLE, local bar associations and law schools.

Authored 4 manuals for the American Bar Association on IRAs and on Trusts.

Formerly associated with the Internal Revenue Service.

Mr. Goldberg handles probate matters, tax disputes with the IRS and the IRS appeals office, IRA penalty waivers and New York State Department of Taxation tax disputes. Represents clients in IRS ruling requests (over 75). Wrote an amicus brief in the 2014 inherited IRA Supreme Court Case, Clark v. Rameker.

His manuals for the American Bar Association can be found in over 100 law school libraries throughout the United States. He is a member of the IRS Long Island Tax Practitioner Liaison Committee.

Mr. Goldberg has conducted continuing education courses with the IRS on the retirement distribution rules. He has recommended corrections to IRS Publication 590 working pro bono with the IRS and then Congressman Steve Israel. This resulted in IRS revisions and the adoption of IRS Publication 590-A and IRS Publication 590-B.

He is the recipient of Outstanding Discussion Leader Awards from both the AICPA and the Foundation for Accounting Education. He has conducted well over 300 CPE programs in the field of taxation including over 100 CPE programs involving IRAs and IRA Compliance issues.

Mr. Goldberg has been quoted in the New York Times, Forbes, Fortune, Money Magazine, U.S. News & World Report, Business Week and the Wall Street Journal. He has also been interviewed on CNN, CNBC and WCBS.

Mr. Goldberg can be reached at 516-222-0422 or by email at info.goldbergira@gmail.com. You may also visit his website at TrustEstateProbate.com.

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<u>Overview</u>

Changes in the Retirement Distribution Rules under the Secure Act

- Under the Secure Act the required beginning date is April 1 of the calendar year following the calendar year in which the IRA owner attains age 72. This is effective for IRA owners who attain age 70½ after December 31, 2019. Limited exceptions to the age 72 rule still apply to working employees who work after age 72 and who are participants in certain retirement plans and are not 5% owners as defined in the Internal Revenue Code.

- The Secure Act did not change the lifetime rules that otherwise apply to IRA owners.

- The Secure Act repeals the maximum age for making traditional IRA contributions for taxable years beginning after December 31, 2019 provided that the taxpayer has sufficient earned income. If the taxpayer (or taxpayer's spouse) is an active participant in retirement plan as defined in the Internal Revenue Code, then the deduction is phased out for taxpayers with income above certain levels. In the event that the individual taxpayer cannot make a deductible contribution to a traditional IRA, then he/she can make a nondeductible contribution to a traditional IRA. Alternatively, Roth IRA contributions can be made subject to certain income level limitations.

- If an IRA owner dies before his/her required beginning date without having a designated beneficiary or eligible designated beneficiary then the five-year rule under the prior law is still applicable. This applies when the IRA owner has an estate, a charity or a nonqualifying trust as the beneficiary of his/her IRA account.

- If Jack, an IRA owner, died in 2021 at age 68 (before his required beginning date) having selected his daughter, Jane, age 30 as his designated beneficiary, then Jane must receive Jack's IRA (entire) account proceeds by no later than December 31, 2031 under the 10-year rule (under the Secure Act).

- If Harry, an IRA owner, died in 2022 at age 75 (after his required beginning date) having select his daughter, Martha, age 40 as his designated beneficiary (assuming Harry received his entire required minimum distribution for 2022 before his date of death in 2022), then Martha must receive Harry's IRA (entire) account proceeds by no later than December 31, 2032 under the 10-year rule (under the Secure Act).

- In the opinion of the author if an IRA owner dies on or after his/her required beginning date without taking his/her entire required minimum distribution for the year of death, then this amount is not subject to the 10-year rule. Instead the beneficiary must receive that amount ASAP after the date of death of the IRA owner. The IRS has special rules regarding this event which has not been changed by the Secure Act.

- If an IRA owner dies on or after his/her required beginning date without having a designated beneficiary or eligible designated beneficiary, then the remaining life expectancy rule under the prior law is still applicable.

- An eligible designated beneficiary is a designated beneficiary who meets certain additional tests as of the date of death of the IRA owner. It applies if the IRA owner dies after December 31, 2019 having any one of the following designated beneficiaries:

  a) A surviving spouse (subject to several technical exceptions under the prior law which have not been changed under the Secure Act);

  b) A child who has not reached the age of majority as defined by the IRS;

  c) A disabled beneficiary (as defined in IRC Sec. 72(m)(7);

  d) A chronically ill beneficiary (as defined in the Secure Act);

  e) An individual not described above who is not more than 10 years younger than the IRA owner.

- An eligible designated beneficiary (subject to several technical exceptions for a surviving spouse) receives a better payout arrangement than a designated beneficiary.

  The eligible designated beneficiary generally (with certain exceptions) receives stretch payments during his/her lifetime and upon his/her death, then the [successor] beneficiary can take advantage of the 10-year rule that commences after the death of the eligible designated beneficiary. Please note that special rules apply with respect to a child who has not attained the age of majority as defined by the IRS.

- Under the 10-year rule, the entire balance in the IRA account must be distributed by the end of the tenth year after the death of an eligible designated beneficiary.

- The stretch payment rules that apply to an eligible designated beneficiary is based in part on the IRS rules that were in effect under the law prior to the Secure Act.

- Please note that if the beneficiary of the IRA owner is a grandchild, that a grandchild is a designated beneficiary and not an eligible designated beneficiary. The 10-year rule applies when a grandchild is the designated beneficiary under the Secure Act. Legal issues and tax issues must be considered before selecting a minor as the designated beneficiary of an IRA account.

- In the event that an IRA owner dies prior to January 1, 2020, then the designated beneficiary of the IRA owner still uses the stretch payment rules in effect under the law prior to the Secure Act. However, under the Secure Act a 10-year rule is then triggered after the death of the designated beneficiary.

- Under the Secure Act if the IRA owner dies prior to January 1, 2020, then on the death of the initial designated beneficiary then the initial designated beneficiary is treated as an eligible designated beneficiary. After the death of the initial designated beneficiary then the 10-year rule is triggered for the benefit of the successor beneficiary. In the opinion of the author a required minimum distribution would still apply with respect to the year of death of the initial designated beneficiary.

- The Secure Act provides in essence that the successor beneficiary of an eligible designated beneficiary must receive the eligible designated beneficiary's remaining beneficiary interest in the decedent's IRA account by the end of the tenth year (10-year rule) following his/her death.

  In the opinion of the author if the eligible designated beneficiary dies without taking his/her entire required minimum distribution for the year of death, then this amount is not subject to the 10-year rule. Instead the successor beneficiary must receive that amount ASAP after the date of death of the eligible designated beneficiary.

- The 50% penalty provisions are triggered if the 10-year rule is not timely satisfied.

- The rules regard involving the changes in the after-death required minimum distribution rules apply to defined contribution plans. For this purpose a defined contribution plan means a qualified plan (other than a defined benefit plan), a section 403(b) arrangement, governmental section 457(b) plans and IRA (traditional and Roth).

- Effective date for the new retirement distribution rules is the date of death of the employee or IRA owner after December 31, 2019 subject to certain exceptions for governmental plans and collective bargaining plans.

- In the case of governmental plans as defined in the statute the new rules apply to employees who die after December 31, 2021.

- In the case of a collectively bargained plan the new rules generally apply to employees who die after December 31, 2021 or an earlier date, if applicable, as defined in the statute.

- Certain annuities are grandfathered if certain tests are satisfied. If the tests are not satisfied, then the annuities are subject to the new distribution rules. In order for the annuity to be grandfathered certain events and tests must be satisfied before the date of enactment of the Secure Act.

The New Retirement Distribution Rules

(Discussion limited to IRA account holders)

The Secure Act of 2019 made major changes regarding retirement distribution rules that you must know.

The following examples focus on a number of key points that professional advisors must be aware of in order to respond to issues and questions raised by many clients and their heirs.

As one can imagine there will be millions of taxpayers that will seek guidance from their advisors regarding how the rules will apply and how they work.

The following is a series of examples on how the rules work in question and answer format.

Example 1

Assume that Jack is age 75 in 2020 and has earned income of $40,000 in 2020.

Question: May Jack make a deductible contribution to his traditional IRA for the 2020 tax year?

Answer: Yes. The Secure Act repeals the maximum age for making traditional IRA contributions for taxable years beginning after December 31, 2019.

Example 2

Assume that John, an IRA owner, of a traditional IRA attains age 71 in the calendar year 2021.

Question: Must John take a required minimum distribution since he attained age 71 in the calendar year 2021?

Answer: No. Under the Secure Act of 2019 the required beginning date for John is April 1 of the calendar year following the calendar year in which John attains age 72.

The new law is effective for distributions that are required to be made after December 31, 2019 for IRA owners who attain age 70½ after December 31, 2019.

The old law applies to an IRA owner who attains age 70½ on or before December 31, 2019.

Author's note

The Secure Act did not change the lifetime rules that otherwise apply to IRA owners.

The following after-death examples will take you through the new maze of rules that you as a practitioner must know. The real headache is the fact that the old after-death distribution rules are out the window for the most part if the IRA owner dies after December 31, 2019.

In addition, many of the new rules are dependent on whether the IRA owner has selected a "designated beneficiary" or an "eligible designated beneficiary" as the beneficiary of his/her IRA account. A designated beneficiary or eligible designated beneficiary means any individual designated as beneficiary by an IRA owner or under a default beneficiary provision under the IRA agreement. A trust beneficiary may qualify as a designated beneficiary or eligible designated beneficiary if certain tests are met.

An estate, a charity or a nonqualifying trust is considered to be a beneficiary and not a designated beneficiary. A 5-year rule applies both under the old rules and new rules if the IRA owner dies before the required beginning date without having a designated beneficiary or eligible designated beneficiary of his/her IRA account. Remember, however that if an IRA owner dies on or after January 1, 2020, that his/her required beginning date is April 1 of the calendar year following the calendar year in which the IRA owner attains age 72 provided that the IRA owner attains 70½ after December 31, 2019. .

An eligible designated beneficiary is a designated beneficiary who satisfies certain additional rules. A trust beneficiary may qualify as an eligible designated beneficiary as well. The rules regarding an eligible designated beneficiary will be discussed later on.

There are certain transitional rules that apply if an IRA owner dies prior to January 1, 2020 having a designated beneficiary of his/her IRA account which will be explained later on.

<u>Example 3</u>

Assume that Mary, an IRA owner, for whatever reason, selected her estate as the beneficiary of her IRA account.

Also assume that Mary died before her required beginning date on June 1, 2020 at age 68.

Question: By what outside date must Mary's estate receive the proceeds of Mary's IRA?

Answer: By no later than December 31, 2025.

<u>Authors note:</u>

The Secure Act provides that if an IRA owner dies prior to his/her required beginning date without having a designated beneficiary, then a 5-year rule applies. Remember that an estate is not a designated beneficiary. The Secure Act follows the same rules that the old rules used when an IRA owner dies before his/her required beginning date in the event that the IRA owner has no designated beneficiary as the beneficiary of his/her IRA account.

The 5-year rule works like this:

You first look at the date of death of Mary which is June 1, 2020. You then go to the fifth anniversary of the date of death which brings you to June 1, 2025. The IRS then allows you to go to the end of the calendar year which contains the fifth anniversary of the date of the IRA owner's death. This brings you to the outside date of December 31, 2025.

Example 4

Assume the facts in Example 3 including the question and answer.

Question: What happens if Mary's deceased IRA account is not paid in full by December 31, 2025?

Answer: The unpaid portion of Mary's deceased IRA account as of December 31, 2025 is subject to an IRS penalty of 50% of the unpaid amount.

Author's note:

If, for example, $40,000 of Mary's deceased IRA account was not paid out by December 31, 2025, then the IRS could impose a penalty of 50% on the shortfall amount of $40,000 which amounts to $20,000.

This penalty may be waived by the IRS if there was a reasonable basis for the error and reasonable steps are being taken to remedy the error.

Example 5

Assume the facts in Example 3 including the question and answer.

Question: What happens if Mary's deceased IRA account is not paid out in full by December 31, 2026.

Answer: The unpaid portion of Mary's deceased IRA account as of December 31, 2026 is subject to an additional IRS penalty of 50% of the unpaid amount.

Author's note:

If, for example, the unpaid amount from Mary's deceased IRA account as of December 31, 2026 is $42,000, then the IRS could impose a penalty of 50% on the shortfall of $42,000 which amounts to $21,000. Once again, the penalty may be waived by the IRS if there was a reasonable basis for the error and reasonable steps are being taken to remedy the error.

Author's note:

The authority for the answer to Example 5 follows:

> Reg. sec. 54.4974-2 at Q-5 states:
>
> If there is any remaining benefit with respect to an employee (or IRA owner) after any calendar year in which the entire remaining benefit is required to be distributed under section 401(a)(9), what is the amount of the required minimum distribution for each calendar year subsequent to such calendar year?
>
> Reg. sec. 54.4974-2 at A-5 states:

> If there is any remaining benefit with respect to an employee (or IRA owner) after the entire remaining benefit is required to be distributed, the required minimum distribution for each calendar year subsequent to such calendar year is the entire remaining benefit.

Example 6

Assume the facts in Example 3 including the question and answer. Further assume the additional facts in Examples 4 and 5 including the questions and answers.

Question: What actions should the executor or personal representative of Mary's estate take in order to avoid his/her potential personal liability regarding the IRS penalties of $20,000 and $21,000 as discussed above.

Answer: The executor or personal representative of Mary's estate should take immediate action and apply for a waiver of the IRS penalties described above. Sufficient assets in the estate should be retained to cover any IRS penalties and tax obligations. The amount retained should cover any additional interest and delinquency penalties for the failure to file the IRS Forms 5329 as well.

It may take several months to find out from the IRS whether or not the waiver of the IRS penalties are granted.

Example 7

Question: Should the legal representative of Mary's estate wait until December 31, 2025 to receive the proceeds of Mary's deceased IRA account?

Answer: No. The outside date to receive the proceeds is December 31, 2025. There is nothing in the law or in the IRS rules that prevents Mary's estate from receiving said distributions in whole or in part prior to December 31, 2025. Waiting until the December 31, 2025 is risky because the deadline may be missed.

Author's note:

From a tax planning point of view, it may pay for the Mary's estate to receive periodic distributions from Mary's IRA account and pay such distributions to the beneficiaries of the Mary's estate.

Further, the legal representative of Mary's estate may prepare paperwork in order to transfer the rights to receive distributions from Mary's deceased IRA account to the beneficiaries of her estate. This may require the financial institution that has the IRA account to go along with this approach. If this can be accomplished, then the estate beneficiaries would have to agree in writing to be responsible for taking out the funds from Mary's deceased IRA account by no later than December 31, 2025. This approach may require the estate beneficiaries to execute certain indemnification agreements to protect the financial institution and the legal representative of Mary's estate from any IRS liabilities in connection with this IRA timing issue.

Example 8

Assume that Mary, an IRA owner, selected her estate as the beneficiary of her IRA account. Also assume that Mary died on October 1, 2024. Her date of birth is December 15, 1950. Mary's attained age in the calendar year 2024, the year of her death is age 74 if she not died. Also assume that Mary received her entire required minimum distribution for the calendar year 2024 prior to her date of death on October 1, 2024.

Question: What required minimum distribution rules apply to Mary's estate after Mary's death?

Answer: In the event that an IRA owner attains age 70½ on or after December 31, 2019 and dies on or after his/her required beginning date having an estate as his/her beneficiary, a charity or a nonqualifying trust as a beneficiary, then an IRS remaining life expectancy rule applies. See Example 8.1.

Author's note:

The Secure Act failed to change the remaining life expectancy rule except that required beginning date in Mary's case is April 1 of the calendar year following the calendar year in which Mary, the IRA owner, attains age 72. This rule would not apply if Mary had a designated beneficiary or eligible designated beneficiary as the beneficiary of her IRA account.

Example 8.1

Assume the facts in Example 8 including the question and answer.

Question: How does the legal representative of Mary's estate determine the amount of the required minimum distributions that is made to Mary's estate from Mary's deceased IRA account?

Answer: The legal representative of Mary's estate uses the following formula:

1) You look at the age that Mary would have attained in the calendar year of her death in 2024 had she not died.

2) You then look at the IRS single life expectancy table for the attained age as described in (1) above.

3) You don't use that number for the year of death but you reduce that number by one for each year commencing after the year of Mary's death.

In Mary's case she would have attained age 74 in the calendar year 2024, the year of her death. The IRS single life expectancy of Mary at age 74 is 15.6.

Therefore, the legal representative of Mary's estate can receive required minimum distributions from Mary's deceased IRA account over a term-certain period of 14.6 years commencing in 2025, the calendar year after the year of death of Mary. This 14.6 year term-certain period is Mary's remaining life expectancy under the IRS remaining life expectancy rule.

Since Mary died in the calendar year 2024, her single life expectancy as previously mentioned is 15.6 years. That number is not used in the calendar year 2024 since she determines her lifetime required minimum distribution using the uniform lifetime table for the calendar year 2024. The uniform lifetime table is used by Mary even if she lives for only one day in the calendar year 2024.

The uniform lifetime table is based on the age that Mary would have attained had she not died in the calendar year 2024. The uniform lifetime table at age 74 is 25.5.

The following formula is used by the legal representative of Mary's estate:

(1) Valuation date account balance of Marty's deceased IRA account as of:	(2) Divisor for year	(3) Required minimum distribution amount determined for year
December 31, 2024	2025 is 14.6	2025-divide (1) by (2)
December 31, 2025	2026 is 13.6	2026-divide (1) by (2)
December 31, 2026	2027 is 12.6	2027-divide (1) by (2)
December 31, 2027	2028 is 11.6	2028-divide (1) by (2)
December 31, 2028	2029 is 10.6	2029-divide (1) by (2)
December 31, 2029	2030 is 9.6	2030-divide (1) by (2)
December 31, 2030	2031 is 8.6	2031-divide (1) by (2)
December 31, 2031	2032 is 7.6	2032-divide (1) by (2)
December 31, 2032	2033 is 6.6	2033-divide (1) by (2)
December 31, 2033	2034 is 5.6	2034-divide (1) by (2)
December 31, 2034	2035 is 4.6	2035-divide (1) by (2)
December 31, 2035	2036 is 3.6	2036-divide (1) by (2)
December 31, 2036	2037 is 2.6	2037-divide (1) by (2)
December 31, 2037	2038 is 1.6	2038-divide (1) by (2)
December 31, 2038	----	Entire remaining balance in Mary's deceased IRA account is paid out in the calendar year 2039 to Mary's estate

<u>Example 8.2</u>

Assume the facts in Example 8.1 including the question and answer.

Question: Is it possible for the legal representative of Mary's estate to avoid holding Mary's estate open for the 14.6 term-certain period?

Answer: Yes. The legal representative can with the written consents and releases from the beneficiaries of Mary's estate to accelerate the distributions from Mary's deceased IRA account and pay such accelerated payments to the beneficiaries. Alternatively, the legal representative of Mary's estate may try to work out an assignment of the rights to the payments from Mary's deceased IRA account to the beneficiaries of Mary's estate. This would require indemnification agreements that are satisfactory to both the IRA institution maintaining Mary's deceased IRA account as well as to the legal representative of Mary's estate.

Example 9

Assume that Harvey, an IRA owner, selected his daughter, Jane, as the beneficiary of his IRA account. Also assume that Harvey dies on October 1, 2020 at age 74. Further assume that Harvey received his entire required minimum distribution amount of $50,000 for the calendar year 2020 prior to his date of death on October 1, 2020.

Further assume that Jane is age 35 in 2020. At the time of the date of death of Harvey on December 1, 2020 Jane is not disabled or chronically ill.

Question: By what outside date must Jane receive the proceeds of Harvey's IRA?

Answer: By no later than December 31, 2030.

Author's note:

Under the Secure Act, the general rule is that a 10-year rule applies if an IRA owner dies having a designated beneficiary as the beneficiary of his/her IRA account. In that event a 10-year rule applies and not a 5-year rule. Further, it does not matter whether the IRA owner dies before, on, or after his/her required beginning date. This rule applies if the IRA owner dies after December 31, 2019.

The Secure Act, except for limited exceptions, eliminates the stretch payment rules that applied under the old rules if an IRA owner died before, on, or after his/her required beginning date.

Example 10

Assume the facts in Example 9 including the question and answer.

Question: How does the 10-year rule work?

Answer: The 10-year rule works like this:

Your first look at the date of death of Harvey on October 1, 2020. You then go to the tenth anniversary of the date of death which brings you to October 1, 2030. The IRS then allows you to go to the end of the calendar year which contains the tenth anniversary of the IRA owner's death. This brings you to the outside date of December 31, 2030.

Example 11

Assume the facts in Example 10 except that Harvey failed to receive his required minimum distribution of $50,000 for the calendar year 2020 prior to his date of death on October 1, 2020.

Question: What immediate action should Jane take regarding the unpaid required minimum distribution that Harvey failed to take for the calendar year 2020?

Answer: Under the IRS regulations Jane must receive the $50,000 shortfall amount by December 31st of the calendar year of Harvey's death which is December 31, 2020.

Accordingly, Jane must fill out the appropriate paperwork with the financial institution together with a death certificate and obtain the $50,000 amount by no later than December 31, 2020. If Jane cannot take care of this in a timely manner by December 31, 2020, then she must request a waiver of the 50% penalty with the IRS on a Form 5329 for the calendar year 2020 so that she as the beneficiary of Harvey's IRA is not liable for the $25,000 penalty ($50,000 x 50% = $25,000). Jane must follow the waiver rules that are provided in the instructions for Form 5329.

<u>Author's note:</u>

The 10-year rule previously described has nothing to do with the required minimum distribution that Harvey did not receive for the year of his death. In fact it is not discussed in the Secure Act. This has to do with an IRS rule that applies when an IRA owner fails to take his/her entire required minimum distribution for the calendar year of his/her death.

<u>Example 12</u>

Assume the facts in Example 11 including the question and answer.

Question: Is there a statute of limitations regarding the 50% penalty of $25,000 if Jane fails to file the Form 5329 with the IRS?

Answer: No. Accordingly the IRS can go after Jane for the $25,000 penalty at any time. The $25,000 penalty is increased by additional penalties and interest if the Form 5329 is not timely filed with the IRS.

<u>Author's note:</u>

This issue can be a major problem for many heirs since many IRA owner's take their required minimum distributions monthly or wait until the end of the calendar year to take their required minimum distribution. This is so because the IRA owner fails to take in whole or in part the required minimum distribution amount for the calendar year of his/her death.

It is a virtual certainty that many beneficiaries of inherited IRA accounts will fall into this penalty trap since they may not have time to take the appropriate action if the IRA owner dies in the last few months of a calendar year.

Based on the author's experience it may take months for the unpaid required distributions as discussed above to be paid out to beneficiaries of an inherited IRA.

<u>Example 13</u>

Assume the facts in Example 9 including the question and answer.

Question: What options are available to Jane after the death of Harvey?

Answer: Jane can defer taking out any proceeds from Harvey's deceased IRA to a date that is no later than December 31, 2030.

Alternatively, Jane can take out periodic payments during the calendar years 2021 through 2030 after considering the time value of money, her needs for the funds and her income tax bracket. Further, Jane can always take out funds beyond the $50,000 amount in 2020 as well.

<u>Example 14</u>

Question: What action should Jane immediately take as an inherited IRA beneficiary after the death of Harvey?

Answer: Jane should immediately fill out a successor-in-interest beneficiary form with the IRA financial institution that holds Harvey's deceased IRA account.

This is necessary so that the successor beneficiary has the rights to Harvey's deceased IRA account in the event that Jane dies prior to her complete withdrawal of Harvey's deceased IRA account.

In the event that Jane fails to take such action, then the IRA custodial agreement default beneficiaries will be triggered.

<u>Example 15</u>

Assume that Jane prepares a successor beneficiary form with the financial institution that maintains the IRA account for her interest in Harvey's deceased IRA account. Also assume that Jane dies on October 15, 2025. At the time of her death she has only received a portion of Harvey's deceased IRA account.

Question: Should Jane's successor beneficiary be able to defer the receipt of Harvey's deceased IRA account until no later than December 31, 2030?

Answer: Probably yes. The old rules at reg. sec. 1.401(a)(9)-3 at Q-2 discuss the application of the 5-year rule and states as follows:

> Q-2. By when must the [IRA owner's] entire interest be distributed in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii)?
>
> A-2. In order to satisfy the 5-year rule in section 401(a)(9)(B)(ii), the [IRA owner's] entire interest must be distributed by the end of the calendar year which contains the fifth anniversary of the [IRA owner's] death.
>
> . . .

Further reg. sec. 1.401(a)(9)-3 at A-1 provides in relevant part as follows:

> A-1 . . . One method (the 5-year rule in section 401(a)(9)(B)(ii) requires that the entire interest of the [IRA owner] be distributed within 5 years of the [IRA owner's] death regardless of who or what entity receives the distribution.

Based on the IRS approach regarding the 5-year rule under the old rules, it would appear that the successor beneficiary of Jane could in essence use the balance of the period (under the 10-year rule) that is applicable to Jane. It should not matter whether an estate, or an individual is the successor beneficiary to Jane, the designated beneficiary at the time of Harvey's death.

It is imperative that the IRS issue temporary guidance on the new law as soon as possible after it is enacted.

Also, Jane should consider who she should select as her successor beneficiary(s) of Harvey's deceased IRA account from both an economic point of view and family relationship point of view. This is especially true if amount involved in Harvey's IRA account is significant. Asset protection issues and income tax issues (federal and state) should be considered by Jane as well.

Author's note:

The 5-year rule under the old rules applied only if the IRA owner died before his/her required beginning date without having a designated beneficiary.

The 10-year rule (under the new rules) applies if the IRA owner dies and has a designated beneficiary. It does not matter if the IRA owner dies before, on, or after his/her required beginning date.

Under the new rules, if an IRA owner dies before his/her required beginning date without having a designated beneficiary, then the 5-year rule applies and not the 10-year rule.

Exceptions to the 10-year rule

There are a number of exceptions to the 10-year rule if the designated beneficiary of an IRA owner satisfies certain rules. In order for an exception to apply, the designated beneficiary of an IRA owner must satisfy any one of the following rules:

1. Be the surviving spouse of the IRA owner;
2. Be a child of the IRA owner who has not reached the age of maturity;

*3. Be disabled (as defined in IRC Sec. 72(m)(7));

4. Be chronically ill (see statutory definition in the Secure Act requiring a certification requirement);
5. An individual not described above who is not more than 10 years younger than the IRA owner.

* The meaning of disabled under IRC Sec. 72(m)(7) follows:

> For purposes of this section, an individual shall be considered to be disabled if he is unable to engage in 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. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require.

If one of the tests is satisfied then the beneficiary is called an “eligible designated beneficiary” instead of a “designated beneficiary.”

The benefit of being an “eligible designated beneficiary is the ability to temporarily avoid the triggering of the 10-year rule for some long-term or short-term period depending on which exception rule is applicable in order to qualify as an “eligible designated beneficiary.”

According to the new law, the time for the determination of whether a “designated beneficiary” is an “eligible designated beneficiary” is made as of the date of death of the IRA owner who dies after December 31, 2019.

The “designated beneficiary” and “eligible designated beneficiary” rules do not apply if the IRA owner dies prior to January 1, 2020 but other transitional rules apply.

The best way to explain the maze of the new rules regarding the exceptions to the 10-year rule involving an “eligible designated beneficiary” is by way of examples which follow:

<u>Example 16</u>

Assume that Marty, an IRA owner, selects Janet, his niece, as the beneficiary of his IRA account. Further assume that Marty dies at age 70 or October 1, 2020 and is survived by Janet, who attains age 25 on December 1, 2020. Also assume that Janet as of the date of death of Marty is disabled. Assume that Janet satisfies the requirements of IRC Sec. 72(m)(7).

Question: Is Janet considered to be an eligible designated beneficiary under the Secure Act?

Answer: Yes. As of the date of death of Marty, she satisfies the disabled rule under the Secure Act and is an eligible designated beneficiary.

<u>Example 17</u>

Assume the facts in Example 16 including the question and answer.

Question: What rules apply under the Secure Act when we have a disabled beneficiary that is an eligible designated beneficiary?

Answer: The Secure Act grants certain beneficial distribution rules to an eligible designated beneficiary such as Janet during her lifetime only. The rule works like this:

1. Starting with the year after the death of Marty, Janet must receive required minimum distributions under the IRS single life expectancy table. That is the same rule that was used under the old rules as well. However, under the old rules the payout period could be continued after Janet’s death. This is not so under the new rules.

2. So in the calendar year 2021 Janet attains age 26. Under the IRS single life expectancy table she has a single life expectancy of 59.1 years. This is the term-certain life expectancy number that is

locked in for the life of Janet. This number is reduced by one for each year thereafter including the year that Janet passes away.

Example 18

Assume the facts in Example 17 including the question and answer. Also assume that Janet passes away on January 15, 2036.

Question: How are the required minimum distributions for Janet determined for the calendar years 2021 through 2036 determined?

Answer: The following formula is used:

(1) Valuation date account balance of Marty's deceased IRA account as of:	(2) Divisor for year	(3) Required minimum distribution amount determined for year
December 31, 2020	2021 is 59.1	2021-divide (1) by (2)
December 31, 2021	2022 is 58.1	2022-divide (1) by (2)
December 31, 2022	2023 is 57.1	2023-divide (1) by (2)
December 31, 2023	2024 is 56.1	2024-divide (1) by (2)
December 31, 2024	2025 is 55.1	2025-divide (1) by (2)
December 31, 2025	2026 is 54.1	2026-divide (1) by (2)
December 31, 2026	2027 is 53.1	2027-divide (1) by (2)
December 31, 2027	2028 is 52.1	2028-divide (1) by (2)
December 31, 2028	2029 is 51.1	2029-divide (1) by (2)
December 31, 2029	2030 is 50.1	2030-divide (1) by (2)
December 31, 2030	2031 is 49.1	2031-divide (1) by (2)
December 31, 2031	2032 is 48.1	2032-divide (1) by (2)
December 31, 2032	2033 is 47.1	2033-divide (1) by (2)
December 31, 2033	2034 is 46.1	2034-divide (1) by (2)
December 31, 2034	2035 is 45.1	2035-divide (1) by (2)
December 31, 2035	2036 is 44.1	2036-divide (1) by (2)

Example 19

Assume the facts in Example 18 including the question and answer. Also assume that Janet would have received a required minimum distribution of $30,000 from Marty's deceased IRA account for the calendar year 2036 had she not died. A required minimum distribution for 2036 is mandated if Janet only lives for one day during the calendar year 2036. Further assume that Janet has selected Joey as the successor beneficiary of her interest in Marty's deceased IRA account.

Question: Who should receive the unpaid required minimum distribution amount of $30,000 for the calendar year 2036?

Answer: Although the IRS never covered that specific issue in any pronouncement, it is the author's position that the successor beneficiary must receive the $30,000 amount. This is based on the old IRS rules that if an IRA owner never received his/her required minimum distribution for the year of death, that his/her beneficiary must receive it. In this case Joey as Janet's successor beneficiary should receive the $30,000 amount attributable to Janet as soon as practicable after the death of Janet.

<u>Example 20</u>

Assume the facts in Example19 including the question and answer. Please remember that Janet is considered to be an eligible designated beneficiary under the new rules.

Question: What new rules are triggered after the death of an eligible designated beneficiary?

Answer: Under the Secure Act, if an eligible designated beneficiary such as Janet passes away, then a subsequent 10-year rule is triggered. Under this new rule, Janet's remaining beneficiary interest in Marty's deceased IRA account (other than the unpaid required minimum distribution amount of $30,000 discussed above) must be distributed by the end of the tenth year following the death of Janet.

<u>Author's note:</u>

It appears to the author that the remaining beneficiary interest referred to in the Secure Act would not include the amount of the unpaid required minimum distribution amount that is required to be paid with respect to the distribution calendar year 2036, the year of death of Janet.

When a law is written, it is subject to subsequent rules and regulations that flush out the details on how the law is to be interpreted. It can take years to cover all the fine points.

Certain fine points may take decades to be addressed or are not addressed until it is brought to the attention of the IRS by means of a letter ruling request or a written or oral communication to the IRS.

Hence, the author works with the question and answer approach and tries to anticipate questions that may come up in the real world.

<u>Example 21</u>

Assume the facts in Examples 19 and 20 including the questions and answers to each example.

Assume that Marty's deceased IRA account in 2036 amounts to in excess of $1,250,000 prior to Joey's receipt of the $30,000 amount of the unpaid required minimum distribution attributable to Janet from Marty's deceased IRA account.

Accordingly, in the author's opinion the remaining beneficiary interest in Marty's deceased IRA account (after Joey's receipt of the $30,000 amount) would be subject to the 10-year rule.

<u>Example 22</u>

Assume that the balance of the remaining interest (the remaining beneficiary interest) in Marty's deceased IRA account after the receipt by Joey of the $30,000 amount in say April 2036 is in excess of $1,200,000.

Question: By what date must Joey, as Janet's successor beneficiary receive the entire interest in Marty's deceased IRA account?

Answer: Joey must receive the remaining beneficiary interest in Marty's deceased IRA account (after his receipt of the $30,000 amount previously discussed) by no later than December 31, 2046.

Author's note:

The computation of the date of December 31, 2046 is determined as follows:

1. Janet's date of death is January 15, 2036.

2. The tenth anniversary of Janet's date of death is January 15, 2046.

3. The end of the calendar year which contains the tenth anniversary of Janet's date of death is December 31, 2046.

4. The answer is therefore December 31, 2046.

The old rules would have permitted Joey to use Janet's remaining life expectancy commencing in the calendar year 2037 of 43.1 years (see Example 18) and reduced by one for each year thereafter. That rule (the IRA stretch rule) is out the window under the Secure Act.

Example 23

Question: When can Joey start withdrawing funds from Marty's deceased IRA account.

Answer: Joey should promptly withdraw the unpaid required minimum distribution amount of $30,000 in 2036 after the death of Janet. Further, Joey can also take out additional arbitrary distributions from Marty's deceased IRA account starting in 2036 and going forward. However, in no event may Joey delay the receipt of the balance of Marty's deceased IRA beyond the outside date of December 31, 2046. A delay beyond that date is subject to an IRS 50% penalty on any shortfall amount.

Example 24

Assume the facts in Example 23 including the question and answer.

Question: What action should Joey promptly take after the death of Janet?

Answer: Joey should immediately select a successor beneficiary for his interest in Marty's deceased IRA account. Please note that in the event of Joey's death that any successor beneficiary to Joey would have to receive any remaining balance in Marty's deceased IRA account by no later than December 31, 2046. It does not matter if the successor beneficiary is an individual(s), a trust or even Joey's estate.

Example 25

Assume that Marty is confused by the maze of all these bifurcated rules that are built into the Secure Act that involves Janet, an eligible designated beneficiary.

Question: What other option is available to Marty?

Answer: Marty can have his attorney draft a qualifying IRA trust that builds all these technical issues into the IRA trust document.

Author's note:

In the event that a supplemental needs trust for the benefit of Janet is desired, then an elder law attorney should be consulted prior to establishing an IRA trust for the benefit of Janet.

Example 26

Assume that Carol, an IRA owner, selects her daughter, Linda, as the beneficiary of her IRA account. Linda is a chronically ill individual.

Question: Is Linda considered to be an eligible designated beneficiary under the Secure Act?

Answer: Probably yes if she satisfied the rules provided for in the Act.

Author's note:

The House Ways and Means Committee Summary states as follows:

> … the definition of a chronically ill individual for purposes of qualified long-term care insurance is incorporated by reference with a modification. Under this definition, a chronically ill individual is any individual who (1) is unable to perform (without substantial assistance from another individual) at least two activities of daily living for an indefinite period (expected to be lengthy in nature) due to a loss of functional capacity, (2) has a level of disability similar … to the level of disability described above requiring assistance with daily living based on loss of functional capacity, or (3) requires substantial supervision to protect the individual from threat to health and safety due to severe cognitive impairment. The activities of daily living for which assistance is needed for purposes of determining loss of functional capacity are eating, toileting, …, bathing, dressing and ….

Example 27

Assume that Carol dies on May 15, 2021 at age 68. Further assume that Linda is still the beneficiary of her IRA as of the date of her death. Further assume that Linda satisfied the definition under the Secure Act as a chronically ill individual.

Question: What IRA distribution rules are applicable to Linda as an eligible designated beneficiary?

Answer: See the prior Examples 16 through 25 inclusive involving Marty and Janet, a disabled beneficiary who qualifies as an eligible designated beneficiary.

The following are a series of examples involving the selection of a surviving spouse as the designated beneficiary of an IRA owner:

Example 28

Assume that Jack, an IRA owner, selects his wife, Jill, as the beneficiary of his IRA account. Further assume that Jack passes away at age 65 on July 1, 2020. Jack's date of birth is October 15, 1955. Jill's date of birth is November 1, 1965.

Question: Under the Secure Act is Jill considered to be an eligible designated beneficiary?

Answer: Generally yes (subject to complex special exception rules described later on.)

Example 29

Question: Is there any reason why Jill should stay as a beneficiary of Jack's deceased IRA account instead of transferring it to her own IRA account?

Answer: Possibly. If Jill may need to use part of the funds in Jack's deceased IRA, then she can withdraw funds from Jack's deceased IRA from time-to-time without incurring an IRS 10% early distribution penalty. This is so because Jill is under the age of 59½. According to the Internal Revenue Code the beneficiary of a deceased IRA owner's account is exempt from the IRS 10% early distribution penalty regardless of the age of the beneficiary. This law applies even if the beneficiary is an estate or a trust as well.

Example 30

Assume that Jill does not transfer Jack's deceased IRA account into her own IRA account since she wants to avoid the IRA 10% early distribution penalty since she is under the age of 59½.

Question: What immediate action should Jill take and why?

Answer: Jill should immediately select a designated beneficiary(s) of her interest in Jack's deceased IRA. This is so because if Jill should die while she is the eligible designated beneficiary of Jack's deceased IRA account prior to a certain date, then Jill is treated as an IRA owner instead of an eligible designated beneficiary.

A summary of this rule is reflected in the House Ways and Means Committee report and states as follows:

> As under present law, if the surviving spouse is the beneficiary, a special rule allows the commencement of distribution to be delayed until end of the year that the employee (or IRA owner) would have attained age [72]. If the spouse dies before distributions were required to begin to the spouse, the surviving spouse is treated as the employee (or IRA owner) in determining the required distributions to beneficiaries of the surviving spouse.

Example 31

Assume the facts in Examples 28 through 30 including the questions and answers. Further assume that Jill passes away on October 1, 2025. Further assume that Jill named her estate as her beneficiary.

Question: At the time of Jill's death, is Jill still treated as Jack's eligible designated beneficiary or treated as an IRA owner under the IRS special rules?

Answer: Jill is treated as an IRA owner. Special rules apply (both under the old rules and the new rules) when a surviving spouse is the sole beneficiary of the IRA owner and dies before a certain date. These rules are not easy to comprehend but are necessary for practitioners to know.

The old rules provide that:

a) If an IRA owner dies having his/her spouse as the sole beneficiary of his/her IRA account, then distributions must commence to the surviving spouse (in her capacity as a beneficiary) on or before the later of –

    1) The end of the calendar year immediately the calendar year in which the IRA owner died; and

    2) The end of the calendar year in which the IRA owner would have attained age 70½.

b) Further if the IRA owner's surviving spouse is the IRA owner's sole beneficiary and such spouse subsequently dies after the IRA owner and before the distributions have begun to the surviving spouse by the later of (1) or (2) above, then the surviving spouse is treated as the IRA owner as of the date of his/her death.

c) The old rules described above apply to any interest in the decedent's IRA account that the surviving spouse has in his/her capacity of a beneficiary.

d) The new rules follow the old rules except that after December 31, 2019 age 72 is substituted for age 70½.

e) The special rules do not apply to the extent that the surviving spouse transfers the deceased spouse's IRA account to the surviving spouse's IRA account.

The following is a detailed analysis under the new rules:

a) Jack's date of birth is October 15, 1955.

b) Jack's date of death is July 1, 2020.

c) Jack would have attained age 72 on October 15, 2027 had he lived.

d) Jill, the surviving spouse, of Jack died on October 1, 2025.

e) Jill up to the date of her death was the eligible designated beneficiary of Jack's deceased IRA account.

f) The end of the calendar year in which Jack would have attained age 72 had Jack lived is December 31, 2027.

g) Since Jill died prior to the cut off date of December 31, 2027, then she is treated as of the date of her death on October 1, 2025 as if she is the IRA owner and not an eligible designated beneficiary.

h) Since Jill named her estate as her successor beneficiary, then her estate must receive the entire proceeds of Jack's deceased IRA account under a 5-year rule, not a 10-year rule. The reason is that an estate is not a designated beneficiary or eligible designated beneficiary.

i) Based on item (h), the estate of Jill must receive the entire proceeds of Jack's deceased IRA account by no later than December 31, 2030.

This is determined as follows:

1) The fifth anniversary of Jill's date of death (since she died or October 1, 2025) is October 1, 2030.

2) Under the new IRS rules, you can delay the receipt of Jack's deceased IRA account until the end of the calendar year that contains the fifth anniversary of Jill's date of death. This brings you to December 31, 2030.

<u>Example 32</u>

Assume the facts in Example 31 including the question and answer. Further assume that Jill selected her brother Max as her successor beneficiary. Assume that Max is age 30 at the time of Jill's death. Also assume that Max is not disabled or chronically ill. Max is therefore a designated beneficiary, not an eligible designated beneficiary.

Question: By what date must Max receive the proceeds of Jack's deceased IRA account?

Answer: By no later than December 31, 2035.

The following is a detailed analysis under the new rules:

a) Jack's date of birth is October 15, 1955.

b) Jack's date of death is July 1, 2020.

c) Jack would have attained age 72 on October 15, 2027 had he lived.

d) Jill, the surviving spouse of Jack died on October 1, 2025.

e) Jill up to her date of death was the eligible designated beneficiary of Jack's deceased IRA account.

f) The end of the calendar year in which Jack would have attained age 72 had Jack lived is December 31, 2027.

g) Since Jill died prior to the cut off date of December 31, 2027, then she is treated as of the date of her death on October 1, 2025 as if she is the IRA owner and not an eligible designated beneficiary.

h) Since Jill in this Example 32 selected Max as her successor beneficiary and who survived her, then Max is considered to be Jill's designated beneficiary at the time of her death on October 1, 2025.

i) Based on item (h), since Max is considered to be Jill's designated beneficiary, then he must receive the entire proceeds of Jack's deceased IRA account under the 10-year rule and not under the 5-year rule.

j) Based on item (i), Max must receive the entire proceeds of Jack's deceased IRA account by no later than December 31, 2035.

This is determined as follows:

1) The tenth anniversary of Jill's date of death (since she died on October 1, 2025) is October 1, 2035.

2) Under the new IRS rules, Max can delay the receipt of Jack's deceased IRA account until the end of the calendar year that contains the tenth anniversary of Jill's date of death. This brings you to December 31, 2035.

<u>Example 33</u>

Question: What action should Max take after the death of Jill?

Answer: Max should immediately select a successor beneficiary with respect to his interest in Jack's deceased IRA account.

<u>Example 34</u>

Question: Why should Max take the action described in Example 33 including the question and answer?

Answer: Max should immediately select a successor beneficiary of his interest in Jack's deceased IRA account. This is necessary in the event that Max passes away prior to the receipt of the remaining proceeds of Jack's deceased IRA account. In the event that Max fails to do so, then the default beneficiary(s) under the IRA agreement will determine who receives the remaining amount in Jack's deceased IRA account, if any, in the event of the death of Max.

<u>Example 35</u>

Assume that Marvin, an IRA owner, died on March 1, 2020. Further assume that Marvin's date of birth is January 15, 1948. He is survived by his wife, Judy, who is age 70 on April 15, 2020 who is the beneficiary of his IRA account.

Question: Do the new required minimum distribution rules under the Secure Act apply to Marvin?

Answer: No. According to the Secure Act, the new rules apply to distributions required to be made after December 31, 2019 with respect to individuals who attain 70½ after December 31, 2019. The old rules apply to IRA owner's who attain age 70½ prior to January 1, 2020.

Since Marvin attained age 70½ on July 15, 2018, he is subject to the old required minimum distribution rules.

<u>Example 36</u>

Assume that Carl, an IRA owner, died on November 1, 2025. Further assume that Carl's date of birth is February 15, 1952. He is survived by his wife, Carla, whose date of birth is March 1, 1954. Assume that she is the beneficiary of Carl's deceased IRA account.

Question: Do the new required minimum distribution rules apply to Carl?

Answer: Yes. Carl attained age 70½ on August 15, 2022. This is so since he attained age 70 on February 15, 2022 and attained age 70½ six months later of August 15, 2022.

Since Carl attained age 70½ after December 31, 2019, then he is subject to the new required minimum distribution rules when he attains age 72 on February 15, 2024.

<u>Example 37</u>

Assume the facts in Example 36 including the question and answer.

Question: Is Carla considered to be an eligible designated beneficiary?

Answer: Yes. Carl died after December 31, 2019 and Carla, his surviving spouse, is the beneficiary of his IRA account.

<u>Example 38</u>

Assume the facts in Example 37 including the question and answer.

Question: When must Carla commence required minimum distributions in her capacity as eligible designated beneficiary of Jack's deceased IRA account?

Answer: Under the special spousal rules discussed in Example 31, if an IRA owner dies having his spouse as the sole beneficiary of his IRA account, then distributions must commence to the surviving spouse (in her capacity as a beneficiary) on or before the later of –

1) The end of the calendar year immediately following the calendar year in which the IRA owner died; and

2) The end of the calendar year in which the IRA owner would have attained age 72.

Based on the fact that Carl was age 73 at the time of his death on November 1, 2025, then rule (1) above applies and not rule (2). Therefore, Carla must commence her required minimum distributions in her capacity as a beneficiary of Carl's deceased IRA during the calendar year 2026.

<u>Example 39</u>

Assume the facts in Example 38 including the question and answer. Also assume that Carl received his entire required minimum distribution for the calendar year 2025 prior to his date of death on November 1, 2025.

Remember that Carl must receive a required minimum distribution for the calendar year 2025 under the IRS lifetime rules. Carl uses the age of 73 in determining his lifetime required minimum distribution for the calendar year 2025. You must use the attained age of the IRA owner that he would have reached during the calendar year of his/her death. It does not matter if the IRA owner lives for only one day in the calendar year of his/her death.

Question: How does Carla in her capacity of an eligible designated beneficiary determine her required minimum distribution for the calendar year 2026.

Answer: The following method:

1) Determine the balance of Carl's deceased IRA account as of December 31, 2025.

2) You look at the IRS single life expectancy table for an individual age 72. This is so because Carla's date of birth is March 1, 1954. Carla is age 72 in the calendar year 2026. Her single life expectancy is 17.1 years.

3) You then divide item (1) by item (2) in order to determine her required minimum distribution amount for the calendar year 2026.

Example 40

Assume that Carla dies on December 15, 2030 after receiving her required minimum distribution for the calendar year 2030.

Question: How does Carla determine her required minimum distributions for the calendar years 2027 through 2030?

Answer: The following formula is used:

(1) Valuation date account balance of Carl's deceased IRA account as of:	(2) Divisor for year	(3) Required minimum distribution amount determined for year
December 31, 2026	*2027 is 16.3	2027-divide (1) by (2)
December 31, 2027	*2028 is 15.6	2028-divide (1) by (2)
December 31, 2028	*2029 is 14.8	2029-divide (1) by (2)
December 31, 2029	*2030 is 14.0	2030-divide (1) by (2)

*Please note that if the surviving spouse is the sole beneficiary of the deceased spouse's IRA account, that the surviving spouse uses a recalculation method in determining the required minimum distributions that must be received from the deceased spouse's IRA account for each calendar year.

Reg. sec. 1.401(a)(9)-5 at A-5(c)(2) provides in relevant part as follows:

> If the surviving spouse of the [IRA owner] is the [IRA owner's] sole beneficiary, the applicable distribution period is measured by the surviving spouse's life expectancy using the surviving spouse's birthday for each distribution calendar year after the calendar year of the [IRA owner's] death up through the calendar year of the spouse's death.

The calculation single life expectancy for Carla for 2027 is determined as follows:

Age of Carla in Year	IRS single life expectancy factor at age
2027 is 73	73 is 16.3 used for 2027
2028 is 74	74 is 15.6 used for 2028
2029 is 75	75 is 14.8 used for 2029
2030 is 76	76 is 14.0 used for 2030

In the event that Carla lived for one day in the calendar year 2030, the required minimum distribution for the calendar year 2030 is based on the age that Carla would have attained in the calendar year 2030 had she lived.

Example 41

Question: What rules are triggered regarding the remaining balance in Carl's deceased IRA account after the death of Carla on December 15, 2030?

Answer: Carla is an "eligible designated beneficiary" under the Secure Act. The 10-year rule is triggered after the death of Carla.

Example 42

Assume that Carla selected her uncle Murray as the successor beneficiary of her interest in Carl's deceased IRA account. Further assume that Murray survived Carla.

Question: By what outside date must Murray receive the proceeds of Carl's deceased IRA account?

Answer: According to the new rule, the remaining interest in Carl's deceased IRA account must be received by Murray within 10 years after Carla, the eligible designated beneficiary passed away. Since Carla died on December 15, 2030, then Murray must receive the entire balance in Carl's deceased IRA account by no later than December 31, 2040.

Example 43

Assume the facts in Example 42 except that Carla selected her estate as the successor beneficiary of her interest in Carl's deceased IRA account.

Question: By what outside date must the legal representative of Carla's estate receive the proceeds of Carl's deceased IRA account?

Answer: By no later than December 31, 2040. The Secure Act requires that the eligible designated beneficiary's interest must be distributed under the 10-year rule. The Secure Act does not require that an individual be designated by Carla as the successor beneficiary of her interest in Carl's deceased IRA account.

Example 44

Assume the facts in Example 39 except that Carl failed to receive $20,000 of his required minimum distribution for the calendar year 2025 prior to his date of death in November 1, 2025.

Further assume that Carla, his surviving spouse, did not find out about this $20,000 shortfall until June 15, 2026. Carla then withdrew the $20,000 shortfall amount from Carla's deceased IRA account on July 1, 2026. Carla then filed IRS Form 5329 for the calendar year 2025 in which she requested a waiver of the 50% penalty of $10,000 ($20,000 x 50% = $10,000).

Question: Does Carla lose her status as an eligible designated beneficiary as a result of her not taking the $20,000 shortfall amount by December 31, 2025 as a result of a tax trap?

Answer: Technically yes.

The IRS provides in relevant part at reg. sec. 1.408-8 of A-5(a) as follows:

… the spouse is required to take a required minimum distribution for that year [the year of death of the IRA owner] with respect to the deceased IRA owner under the rules of A-4(a) of reg. sec. 1.401(a)(9)-5, to the extent such a distribution was not made to the IRA owner before death.

Further, according the IRS rules are indicated in reg. sec. 1.408-8 of A-5(b) a surviving spouse can elect to be treated as an IRA owner or be deemed to have elected to be an IRA owner. A deemed election is triggered if the surviving spouse fails to receive a timely required minimum distribution from the deceased IRA owner's account.

The IRS rules of A-4(a) of reg. sec. 1.401(a)(9)-5 provides that the unpaid required minimum distribution for the year of death of the IRA owner must be paid to a beneficiary of the IRA owner during the calendar year of the IRA owner's death.

Since Carla failed to receive the $20,000 shortfall amount by December 31, 2025, she is deemed under the IRS rules to have made an election to be treated as an IRA owner instead of as a beneficiary as of the year after Carl's death. In effect, Carla is treated as an IRA owner instead of an IRA beneficiary effective January 1, 2026 and thereafter. This is the rule that applies if the violation occurs in the year of death of Carl.

<u>Author's note:</u>

Please note that this deemed election is a huge tax trap for a surviving spouse who has no clue as to this issue.

That's why a surviving spouse like Carla should as soon as possible directly transfer Carl's deceased IRA account (after receiving the unpaid required minimum distribution amount attributable to the deceased spouse) to her existing IRA account or to a new IRA account established in her name.

Further, Carla after Carl's death should make sure that the beneficiaries of her IRA account(s) are consistent with her estate plan.

<u>Example 45</u>

Assume the facts in Example 44 except that Carla received the $20,000 shortfall amount by December 31, 2025. Further assume that Carla in the calendar year 2028 failed to receive her required minimum distribution amount in whole or in part in her capacity as a beneficiary of Carl's deceased IRA account for that year.

Question: Does Carla lose her status as an eligible designated beneficiary as a result of not taking her entire required distribution amount in her capacity as a beneficiary of Carl's deceased IRA for the calendar year 2028.

Answer: Yes. The only difference is that she is now treated under the IRS deemed election rule as an IRA owner and not as an eligible designated beneficiary retroactive to January 1, 2028, the year of the violation since that IRS violation took place in a given year after the year of Carl's death in the calendar year 2025.

<u>Example 46</u>

Question: Does the deemed election rules previously discussed apply even if Carla is the sole beneficiary of a trust that is the beneficiary of Carl's deceased IRA?

Answer: No. According to the IRS rules found in reg. sec. 1.408-8 of A-5(a) the deemed election rules previously discussed do not apply in the event that a trust is named as the beneficiary of an IRA even if the spouse is the sole beneficiary of the trust.

Author's note:

The deemed election rules apply under the IRS rules if the spouse is the sole beneficiary of the IRA and has an unlimited right to withdraw amounts from the IRA.

Example 47

Assume that Todd, an IRA owner selected his son, Joel, as the beneficiary of his IRA. Joel's date of birth is August 15, 2010.

Further assume that Todd passes away at age 58 on January 15, 2020 and is survived by his son, Joel.

Question: Is Joel considered to be an eligible designated beneficiary under the Secure Act?

Answer: Yes. This is so because Todd, the IRA owner, passed away after December 31, 2019 and is survived by Joel, his son, who has not reached maturity within the meaning of subparagraph (F) [of IRC Section 401(a)(9).]

Example 48

Assume the facts in Example 47 including the question and answer.

Question: Is the definition of the age of majority with respect to Joel clearly defined in the Secure Act?

Answer: No. The Secure Act merely provides that an eligible designated beneficiary includes a child of the employee [or IRA owner] who has not reached majority within the meaning of subparagraph (F) [of IRC Section 401(a)(9).]

Author's note:

What this means is that the IRS at some future date will define what the age of majority means with respect to a child who is the beneficiary of an employee or IRA owner.

Example 49

Question: What are the rules that apply to Joel up until the age that he reaches majority as defined by the IRS. This assumes that Joel does not pass away prior to attaining the age of majority.

Answer: Joel determines his required minimum distributions from Todd's deceased IRA account under the old life expectancy required minimum distribution rules until the year that includes the age that Joel reaches majority as determined by the IRS rules.

Author's note:

The House Ways and Means Committee Summary states in part as follows:

> Eligible [designated] beneficiaries include any beneficiary who, as of the date … or is a child of the employee (or IRA owner) who has not reached the age of majority [as determined under the IRS rules.]
>
> ***
>
> In the case of a child who has not reached the age of majority [determined under the IRS rules] calculation of the minimum required distribution under this exception is only allowed through the year that the child reaches the age of majority.
>
> ***
>
> If a child is an eligible [designated] beneficiary based on having not reached the age of majority [based on the IRS rules] before the employee's (or IRA owner) death, the 10-year rule applies beginning with the earlier of the date of the child's death or the date that the child reaches the age of majority [under the IRS rules.]

<u>Example 50</u>

Assume the facts in Example 47 including the question and answer.

Question: How are Joel's required minimum distributions determined for the calendar years 2021 through 2025?

Answer: The single life expectancy of Joel is determined as of the calendar year after the death of Todd. This is based on the attained age of Joel determined in the calendar year 2021 since Todd, his father, died in the calendar year 2020.

Joel attains age 11 on August 15, 2021 since his date of birth is August 15, 2010.

The IRS single life expectancy for age 11 is 73.8 years. This number is used in determining Joel's required minimum distribution for the calendar year 2021 and is reduced by one for each year thereafter including the year that Joel reaches the age of majority under the IRS rules.

The following formula is used in determining Joel's required minimum distributions for the calendar years 2021 through 2025:

(1) Valuation date account balance of Todd's deceased IRA account as of:	(2) Divisor for year	(3) Required minimum distribution amount determined for year
December 31, 2020	2021 is 73.8	2021-divide (1) by (2)
December 31, 2021	2022 is 72.8	2022-divide (1) by (2)
December 31, 2022	2023 is 71.8	2023-divide (1) by (2)
December 31, 2023	2024 is 70.8	2024-divide (1) by (2)
December 31, 2024	2025 is 69.8	2025-divide (1) by (2)

As you can see the number is reduced by one since Joel is an eligible designated beneficiary who is not a surviving spouse.

Upon Joel reaching the age of majority as determined by the IRS rules, then an additional 10-year rule is triggered.

The 10-year rule permits Joel to receive the remaining balance of Todd's deceased IRA account within 10 years after the year Joel reaches the age of majority as determined under the IRS rules.

<u>Example 51</u>

Assume the facts in Example 50 including the question and answer.

Question: Who receives the required minimum distributions on Joel's behalf since he is a minor?

Answer: This is a major issue since the IRA Agreement may place limitations on who can receive the required minimum distributions on a minor's behalf. The position of the IRA institution which maintains the IRA account may be liberal or conservative.

The financial institution may permit that the yearly required minimum distributions that Joel is entitled to while he is a minor (as determined under state law) to be paid to (1) a parent (2) a court appointed guardian (3) a custodian under the Uniform Transfer to Minors Act or (4) an adult person who has custody of Joel.

There is a further legal headache regarding what happens if Joel passes away while he is a minor (under state law) and fails to select a successor beneficiary with respect to his interest in Todd's deceased IRA account.

Many IRA agreements provide for default beneficiaries in the event that the beneficiary of an IRA account passes away during the payout period without having selected a successor beneficiary. The default option may be the estate of the deceased minor.

Joel as a minor is not legally competent to select a successor beneficiary.

Another issue is whether a guardian or other representative of the minor will go along with the extended payout period. A guardian may have to obtain a court order to go along with the extended payout period. Further, having a guardian appointed is both costly and a time consuming process.

<u>Example 52</u>

Assume the facts in Example 51 including the question and answer.

Question: What option is available to Todd in order to avoid the potential headaches discussed in Example 51?

Answer: Todd can structure an IRA trust for the benefit of Joel that covers the rules that apply if Joel passes away prior to reaching the age of majority as determined by the IRS; the rules that apply if Joel is under the 10-year rule; the rules that apply in the event Joel passes away while under the 10-year rule;

who Joel’s trust remainderman should be in the event Joel passes away prior to reaching the age of majority as determined by the IRS rules; and who Joel’s trust remainderman should be if he passes away while under the 10-year rule. Further, the trust provisions can provide for options as to who the minor’s representative could be regarding the receipt of required minimum distributions while Joel is a minor under state law. This is a way to avoid a cumbersome and costly guardianship proceeding.

<u>Example 53</u>

Question: Why is an IRA trust for the benefit of Joel worthwhile from an economic point of view?

Answer: The kiddie tax can be minimized while using the extended life expectancy period until such time that Joel reaches the age of majority as determined by the IRS rules. Further a sophisticated trustee can minimize the income tax liability of Joel under the 10-year rule by proper tax planning as well. Further, a trust provides greater asset protection for Joel as well.

The period of protection for Joel for the bulk of Todd’s deceased IRA account is up to the year that Jack attains majority under the IRS rules plus the period permitted under the 10-year rule.

<u>Example 54</u>

Assume that Murray, an IRA owner, passes away on March 1, 2025. Further assume that Murray’s date of birth is June 1, 1950. The beneficiary of his IRA is his grandchild, Blake. Assume that Blake’s date of birth is August 15, 2023.

Question: Is Blake considered to be a designated beneficiary or an eligible designated beneficiary under the Secure Act?

Answer: Blake is considered to be a designated beneficiary and not an eligible designated beneficiary. This is so because Blake is a grandchild, not a child of Murray.

<u>Example 55</u>

Assume the facts in Example 54 including the question and answer. Further assume that Murray failed to receive his required minimum distribution of $50,000 for the calendar year 2025 prior to his date of death on March 1, 2025.

Question: Who must receive Murray’s unpaid required minimum distribution of $50,000 attributable to Murray’s year of death and by what date?

Answer: According to the IRS rules, the beneficiary of Murray’s deceased IRA account must receive the unpaid $50,000 amount by the end of the calendar year that Murray died. Accordingly, that deadline is December 31, 2025. This is the end of the calendar year in which the IRA owner dies.

<u>Example 56</u>

Assume the facts in Example 55 including the question and answer. Further assume that Harold, Blake’s father, is permitted by the financial institution maintaining Murray’s deceased IRA account to receive distributions from Murray’s deceased IRA account in his capacity as a Custodian for Blake under the Uniform Transfers to Minors Act. Harold is lucky since the financial institution might have required that a guardian must be appointed to act on behalf of Blake. This would be both a costly and time consuming process.

Further that Harold, as Custodian is clueless about this technical issue involving the December 31, 2025 deadline. He finds out about it in November 2026 and immediately withdraws the $50,000 shortfall in November 2026.

Question: What action must be taken in order to avoid an IRS 50% penalty of $25,000 ($50,000 x 50% = $25,000) that Blake would otherwise face with respect to the IRS calendar year 2025 violation.

Answer: Blake's father would have to file a Form 5329 with the IRS for the calendar year 2025 requesting a waiver of the $25,000 IRS 50% penalty. It must be done since there is no statute of limitations on this penalty unless a Form 5329 is filed with the IRS.

<u>Example 57</u>

Assume the facts in Examples 55 and 56 including the questions and answers.

Question: Under the Secure Act what required minimum distribution rules apply to Blake?

Answer: The 10-year rule applies to Blake since he is a designated beneficiary and not an eligible designated beneficiary. So that means that Blake's representative must receive the remaining interest (after subtracting the $50,000 shortfall distribution discussed in Example 56) under the 10-year rule. Murray's deceased IRA account after subtracting to $50,000 amount must be distributed by the end of the calendar year which contains the tenth anniversary of the date of death of Murray, the IRA owner. The Secure Act provides under the general rule that the distribution under the 10-year rule must be made within 10 years after the death of the IRA owner to a designated beneficiary. It does not matter if the IRA owner dies before, on, or after the required beginning date.

Since Murray passed away on March 1, 2025, then the tenth anniversary of Murray's date of death is March 1, 2035. The end of the calendar year that contains the tenth anniversary of Murray's date of death is therefore December 31, 2035. Murray's deceased IRA account (after subtracting the $50,000 amount) must be paid to Blake's representative by no later than December 31, 2035. If it is not paid by that outside date, then the unpaid amount as of December 31, 2035 is subject to an IRS 50% penalty. Remember that Blake is only 12 years old in the calendar year 2035.

<u>Author's note:</u>

Once again, it is the author's opinion that the $50,000 amount attributable to the unpaid required minimum distribution with respect to Murray's year of death in 2025 cannot be subject to the 10-year rule.

<u>Example 58</u>

In the event that Murray's IRA is substantial, it is quite possible that the financial institution may require that a guardian be appointed to receive the distributions from Murray's deceased IRA account. If that happens then we run into significant costs and paperwork over the years until Blake reaches majority (in this case) under the state law.

<u>Example 59</u>

Assume that Murray's IRA account is substantial.

Question: Should Murray create an IRA trust for the benefit of Blake?

Answer: Yes. This is so because a trust can have many provisions that cover important issues. For example, the trustee may be directed to make partial distributions and/or to have the discretion to make partial distributions from Murray's deceased IRA. The trustee may be authorized under the terms of the trust to pay such amounts to a Custodian for Blake under the Uniform Transfers to Minors Act or to a parent of Blake on Blake's behalf. There is nothing that prohibits the trustee from selecting himself or herself as the Custodian for Blake under the Uniform Transfers to Minors Act unless it is not permitted under the terms of the trust document.

Further, the discretionary periodic distributions made to Blake's representative can save a substantial amount of kiddie tax if done properly and prior to the December 31, 2035 deadline.

In addition, the trust provisions can provide for a series of remainderman if Blake should pass away before Murray's deceased IRA account is paid out prior to the December 31, 2035 deadline.

Further, a knowledgeable trustee would be able to move quickly and make sure that the trust received the $50,000 amount discussed in Example 55 by December 31, 2025.

<u>Example 60</u>

Assume that Phil, an IRA owner, passes away on January 15, 2020. Phil's date of birth is October 15, 1952. The beneficiary of his IRA is his brother, Peter, whose date of birth is February 1, 1960. Assume that Peter survives Phil.

Question: Is Peter a designated beneficiary or an eligible designated beneficiary under the Secure Act?

Answer: Peter is considered to be an eligible designated beneficiary since he is an individual who is not more than 10 years younger than Phil, the IRA owner.

<u>Example 61</u>

Question: What rules apply to Peter as an eligible designated beneficiary?

Answer: Peter takes his required minimum distributions from Phil's deceased IRA account over a term-certain period commencing in the calendar year after the year of death of his brother Phil. Peter locks in the period in the calendar year 2021 (the year after Phil's death in 2020) by using the IRS single life expectancy number based on his age in the calendar 2021 and reduces that number by one for each year after 2021.

<u>Example 62</u>

Assume the facts in Example 61 including the question and answer.

Question: How is Peter's required minimum distributions from Phil's deceased IRA determined for the calendar years 2021 through 2025?

Answer: Since Peter's date of birth is February 1, 1960, then his attained age in 2021 is age 61. The IRS single life expectancy for age 61 is 26.2 years. Assume that Peter does not pass away during the 26.2 year term-certain period. Therefore, Peter can receive his required minimum distributions over a 26.2 term-certain period commencing in the calendar year 2021 and reduced by one for each year thereafter.

The following formula is used to determine Peter's required minimum distributions for the calendar years 2021 through 2025:

(1) Valuation date account balance of Phil's deceased IRA account as of:	(2) Divisor for year	(3) Required minimum distribution amount determined for year
December 31, 2020	2021 is 26.2	2021-divide (1) by (2)
December 31, 2021	2022 is 25.2	2022-divide (1) by (2)
December 31, 2022	2023 is 24.2	2023-divide (1) by (2)
December 31, 2023	2024 is 23.2	2024-divide (1) by (2)
December 31, 2024	2025 is 22.2	2025-divide (1) by (2)

<u>Example 63</u>

Assume that Peter passes away in the calendar year 2030 on November 1, 2030. Also assume that Peter received his required minimum distribution for the calendar year 2030 before his date of death on November 1, 2030.

Further assume that Peter forgot to select a successor beneficiary of his interest in Phil's deceased IRA account. According to the terms of the IRA Agreement of the financial institution that maintains Phil's deceased IRA account the default beneficiary of Peter's interest in Phil's deceased IRA account is Peter's surviving spouse, if any. Gail is Peter's surviving spouse.

Question: By what date must Gail receive the entire balance in Phil's deceased IRA account?

Answer: According to the 10-year rule under the Secure Act, Phil's deceased IRA account must be distributed within 10 years after the death of Peter, the eligible designated beneficiary. Since Peter died in the calendar year 2030, then Gail must receive the entire balance in Peter's deceased IRA account by no later than December 31, 2040 under the IRS rules.

<u>Example 64</u>

Assume the same facts in Example 63. Further assume that Peter failed to select a successor beneficiary of his interest in Phil's deceased IRA. However, according to the terms of the IRA Agreement of the financial institution that maintains Phil's deceased IRA, Peter's estate is the default beneficiary and not Peter's surviving spouse.

Question: By what date must the legal representative of Peter's estate receive the entire balance in Phil's deceased IRA account?

Answer: According to the 10-year rule under the Secure Act, the entire balance in deceased IRA account must be distributed within 10 years after the death of Peter, the eligible designating beneficiary. The outside date is therefore December 31, 2040 under the IRS rules. The Secure Act does not provide who should receive this amount. It could be an individual, an estate, a trust or a charity.

<u>Example 65</u>

Assume in Example 63, that Peter had a prenuptial (antenuptial) agreement whereby Gail waived any and all her rights to any assets that Peter has in the event of Peter's death.

Gail as a default beneficiary was entitled to receive Peter's interest in Phil's deceased IRA account pursuant to the terms of the IRA agreement that maintains Phil's deceased IRA account.

Question: Based on the above facts, who is entitled to the proceeds of Peter's deceased IRA account?

Answer: This is an issue that has to be determined by the Courts. An interesting state case involving a default IRA beneficiary and a prenuptial (antenuptial) agreement is an Ohio case, Kinkle v. Kinkle, 699 NE2d, 41, 42 (Ohio 1998) which held that an antenuptial (prenuptial) agreement waiving a spouse's interest in an individual retirement account controls over the beneficiary designation clause of an individual retirement account contract [which IRA contract was] entered into prior to the antenuptial agreement.

This case involved Harold (an IRA owner) who opened an individual retirement account in June 1992 with Fidelity. On the IRA application, Harold did not designate a beneficiary.

The Fidelity application states that if no beneficiary is designated, the beneficiary will be the surviving spouse or if none, then the decedent's estate. At the time Harold opened the IRA account, Harold was a widower with two adult children.

In December 1994, Harold married Mary. Prior to the marriage, they entered into an antenuptial agreement whereby each waived and released all rights to each others property. Harold included the Fidelity IRA as an individual asset in his inventory which was attached as an exhibit to the antenuptial agreement.

Harold passed away three months later. On September 8, 1995, Fidelity paid the funds in Harold's deceased IRA in the amount of $36,234 to Mary. In October 1995, Harold's children brought an action on behalf of Harold's estate in the state court to recover the IRA funds paid to Mary.

The trial court and the next level appeals court held for the estate. The case was further appealed to the current appeals court. The current appeals court made an interesting observation and stated as follows in its opinion:

> Since Harold did not designate a specific beneficiary, the beneficiary became his wife through the language of the IRA contract. Fidelity performed under the contract. At that point, the second contract, the antenuptial agreement governed by Ohio law came into play. The question is whether through an antenuptial agreement may waive her right to be a beneficiary under an IRA contract. We find that she may certainly do so.
>
> ***
>
> Mary, the would be rightful beneficiary of the IRA funds under the contract, therefore specifically waived an interest in them under the terms of the antenuptial agreement.

The current appeals court affirmed the judgment of the lower appeals court.

<u>Author's note:</u>

This case involved a state law issue and was not an ERISA case but an IRA default beneficiary issue under an IRA agreement. Had Harold specifically named Mary as the beneficiary of his IRA account on a beneficiary designation form after the marriage then Mary would have a much stronger case in her favor.

<u>Example 66</u>

Assume that Fred, an IRA owner, passes away on October 1, 2018. This date is prior to the effective date of the Secure Act. His date of birth is March 15, 1953. Assume that his daughter, Martha, is the beneficiary of Fred's IRA and that Martha survived Fred. Assume that Martha's date of birth is July 15, 1975. Further assume that Martha passes away on December 15, 2025. Assume that Martha received her required minimum distribution from Fred's deceased IRA account for the calendar year 2025 prior to her date of death on December 15, 2025.

Question: Since Fred, an IRA owner, died in the calendar year 2018, does the Secure Act have any special provisions that apply to this type of fact pattern?

Answer: Yes. The Secure Act has a transitional rule that applies to this type of situation. The House Ways and Means Committee Summary describes the transitional rule as follows:

> In the case of an employee (or IRA owner) who dies before the effective date (as described below) for the plan (or IRA), if the designated beneficiary of the employee (or IRA owner) dies on or after the effective date, the provision applies to any beneficiary of the designated beneficiary as though the designated beneficiary was an eligible beneficiary. Thus, the entire interest must be distributed by the end of the tenth calendar year after the death of the designated beneficiary. For this purpose, the effective date is the date of death of the employee (or IRA owner) used to determine when the provision applies to the plan (or IRA), for example, before January 1, 2020, under the general effective date. [There may be a different effective date if certain plans are involved.]

<u>Example 67</u>

Assume the facts in Example 66 including the question and answer.

Question: As of Fred's date of death on October 1, 2018 is Martha considered to be a designated beneficiary or an eligible designated beneficiary of Fred's deceased IRA account?

Answer: As of Fred's date of death, Martha is considered to be a designated beneficiary, not an eligible designated beneficiary since Fred, an IRA owner, died before January 1, 2020.

<u>Example 68</u>

Question: When Martha passes away, does her status as a designated beneficiary change?

Answer: Under the Secure Act, when Martha passes away on December 15, 2025, she is then treated as an eligible designated beneficiary after her death in 2025 for purposes of the transitional rule as discussed in Example 66. This is so because Fred, the IRA owner, died before January 1, 2020. A required minimum distribution for Martha's year of death would still apply.

<u>Example 69</u>

Question: How does Martha determine her required minimum distributions from Fred's deceased IRA account for the calendar years 2019 through 2025.

Answer: Martha must determine her single life expectancy under the IRS table based on the age that she will attain in the calendar year after the year of Fred's death 2018. Martha's date of birth is July 15, 1975.

Her attained age in the calendar year 2019 is therefore age 44. Under the IRS single life expectancy table, the life expectancy at age 44 is 39.8 years.

The following formula is used in determining Martha's required minimum distributions for the calendar years 2019 through 2025:

(1) Valuation date account balance of Fred's deceased IRA account as of:	(2) Divisor for year	(3) Required minimum distribution amount determined for year
December 31, 2018	2019 is 39.8	2019-divide (1) by (2)
December 31, 2019	2020 is 38.8	2020-divide (1) by (2)
December 31, 2020	2021 is 39.8	2021-divide (1) by (2)
December 31, 2021	2022 is 38.8	2022-divide (1) by (2)
December 31, 2022	2023 is 37.8	2023-divide (1) by (2)
December 31, 2023	2024 is 36.8	2024-divide (1) by (2)
December 31, 2024	2025 is 35.8	2025-divide (1) by (2)

Author's note

As of January 1, 2021 the IRS life expectancy tables were changed. So in 2019 at age 44, Martha's single life expectancy under the old rules was 39.8 years. However, the single life expectancy under the new rules for an individual age 44 in 2021 is 41.8 years.

The difference is 2 years (41.8-39.8 = 2). As of 2021 you don't use 37.8 years but use a 2 year bonus adjustment starting in 2021. So in 2021 you use 39.8 reduced by one for each year thereafter instead of 37.8. This adjustment is referred to as a transition rule by the IRS.

Example 70

Question: Prior to the Secure Act, over what period could Martha's successor beneficiary or default successor beneficiary, as the case may be, receive required minimum distributions from Fred's deceased IRA account?

Answer: Under the IRS old rules that existed prior to the Secure Act, Martha's successor beneficiary or default successor beneficiary would be able to use the remaining term-certain period that Martha had commencing in the calendar year 2026, as modified by the new tables as of 2021, so Martha's successor beneficiary or default successor beneficiary could use the remaining term-certain period of 34.8 years. It would not matter if an estate, a trust or an individual was the successor beneficiary or a default successor beneficiary.

Example 71

Question: Under the Secure Act, what rules apply on the death of Martha with respect to the distributions that must be made to Martha's successor beneficiary or default successor beneficiary as the case may be.

Answer: See the facts in Example 66 and the question and answer. Under the Secure Act, a transitional rule is triggered that treats Martha, a designated beneficiary as though she is an eligible designated beneficiary with respect to any beneficiary she may have. Accordingly, the 10-year rule applies to a successor beneficiary or default successor beneficiary, as the case may be, of Martha.

Example 72

Assume the facts in Example 71 including the question and answer. Further assume that Martha failed to select a beneficiary of her interest in Fred's deceased IRA account. Also assume that under the IRA agreement that maintains Fred's IRA account that the default successor beneficiary of Martha's interest in Fred's deceased IRA account is her estate.

Question: By what date must the legal representative of Martha's estate receive the entire balance in Fred's deceased IRA account?

Answer: As previously discussed the beneficiary of Martha's interest in Fred's deceased IRA account must be distributed within 10 years after the death of the eligible designated beneficiary. Since Martha died in the calendar year 2025, the outside date is therefore December 31, 2035.

Example 73

Assume the facts in Example 72 including the answer and question except Martha failed to receive her required minimum distribution of $20,000 for the calendar year 2025 prior to her date of death on December 15, 2025. Assume that the legal representative of her estate received it in March 2026.

Question: What action should the legal representative take regarding the shortfall distribution of $20,000?

Answer: The legal representative of Martha's estate should file a Form 5329 with the IRS for the calendar year 2025 requesting a waiver of the 50% penalty amount of $10,000 ($20,000 x 50% = $10,000)

Example 74

Assume facts in Example 73.

Question: Is the $20,000 shortfall amount as discussed above considered to be subject to the 10-year rule that permits the legal representative of Martha's estate to be able to defer the receipt of the remaining portion of Fred's deceased IRA account to December 31, 2035?

Answer: No. In the author's opinion, the portion subject to the outside distribution date of December 31, 2035 under the 10-year rule would not include the shortfall amount of $20,000 that is attributable to Mary's year of death in the calendar year 2025.

Example 75

Assume that Clark, a Roth IRA owner, dies on March 15, 2022. Further assume that Lois, his surviving spouse, is the beneficiary of his Roth IRA account.

Question: What action should Lois take regarding Clark's deceased Roth IRA account?

Answer: For estate planning and tax planning purposes, Lois should promptly transfer Clark's deceased Roth IRA account to a Roth IRA account maintained in her name. Lois should immediately select beneficiaries of said Roth IRA account that are consistent with her estate plan.

APPENDIX A

Updated Life Expectancy and Distribution Period Tables

Table I – Single Life Expectancy

Table II – Uniform Lifetime Table

Updated Life Expectancy and Distribution Period Tables

Used for Purposes of Determining Minimum Required Distributions

According to the IRS the following rules apply:

- The life expectancy tables and Uniform Lifetime Table under the proposed regulations would apply for distribution calendar years beginning on or after January 1, 2021.

- The proposed regulations include a transition rule that applies if an [IRA owner] died before January 1, 2021.

- Under the transition rule, the initial life expectancy used to determine the distribution period is <u>reset</u> by using the new Single Life Table for the age of the relevant individual in the calendar year for which life expectancy was set under the old rules. For distribution calendar years beginning on or after January 1, 2021, the distribution period is determined by reducing that initial life expectancy by 1 for each year subsequent to the year for which it was initially set.

- The transition rule applies in three situations:

    1) The [IRA owner] died before the required beginning date with a non-spousal designated beneficiary (so that the applicable distribution period is determined based on the remaining life expectancy of the designated beneficiary for the calendar year following the calendar year of the [IRA owner's] death);

    2) The [IRA owner] died after the required beginning date without a designated beneficiary (so that the applicable distribution period is determined based on the remaining life expectancy of the [IRA owner] for the year of the IRA owner's death); and

    3) The [IRA owner], who is younger than the designated beneficiary died after the required beginning date (so that the applicable distribution period is determined based on the remaining life expectancy of the [IRA owner] for the year of the IRA owner's death).

Example

The proposed regulations illustrate the application of this transition rule with an example involving an IRA owner who died at age 80 in 2018 with a designated beneficiary (who was not the [IRA owner's] spouse) who was age 75 in the year of the IRA owner's death. For 2019, the distribution period that applies is 12.7 (the period applicable for a 76 year old under the Single Life Table under the current rules and for 2020, it is 11.7 years (the original distribution period reduced by 1 year. For 2021, taking into account the life expectancy tables under the proposed regulations and applying the transition rule, the applicable distribution period would be 12.0 years (the 14.0 year life expectancy for a 76 year old under the Single Life Table in the proposed regulations reduced by 2 years.

TABLE I

Effective January 1, 2021

Single Life Table

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	84.5	31	54.3	62	25.3	93	4.6
1	83.7	32	53.4	63	24.5	94	4.2
2	82.7	33	52.4	64	23.6	95	3.9
3	81.7	34	51.4	65	22.8	96	3.7
4	80.8	35	50.5	66	22.0	97	3.4
5	79.8	36	49.5	67	21.2	98	3.2
6	78.8	37	48.6	68	20.4	99	3.0
7	77.8	38	47.6	69	19.5	100	2.8
8	76.8	39	46.6	70	18.7	101	2.6
9	75.8	40	45.7	71	17.9	102	2.5
10	74.8	41	44.7	72	17.1	103	2.3
11	73.8	42	43.8	73	16.3	104	2.2
12	72.8	43	42.8	74	15.6	105	2.1
13	71.9	44	41.8	75	14.8	106	2.1
14	70.9	45	40.9	76	14.0	107	2.1
15	69.9	46	39.9	77	13.3	108	2.0
16	68.9	47	39.0	78	12.6	109	2.0
17	67.9	48	38.0	79	11.9	110	2.0
18	66.9	49	37.1	80	11.2	111	2.0
19	66.0	50	36.1	81	10.5	112	2.0
20	65.0	51	35.2	82	9.9	113	1.9
21	64.0	52	34.3	83	9.2	114	1.9
22	63.0	53	33.3	84	8.6	115	1.8
23	62.0	54	32.4	85	8.1	116	1.8
24	61.1	55	31.5	86	7.5	117	1.6
25	60.1	56	30.6	87	7.0	118	1.4
26	59.1	57	29.7	88	6.6	119	1.1
27	58.2	58	28.8	89	6.1	120+	1.0
28	57.2	59	27.9	90	5.7		
29	56.2	60	27.1	91	5.3		
30	55.3	61	26.2	92	4.9		

TABLE II

Effective January 1, 2021

Uniform Lifetime Table

Age of Employee	Distribution Period	Age of Employee	Distribution Period
70	29.1	97	7.8
71	28.2	98	7.3
72	27.3	99	6.8
73	26.4	100	6.4
74	25.5	101	5.9
75	24.6	102	5.6
76	23.7	103	5.2
77	22.8	104	4.9
78	21.9	105	4.6
79	21.0	106	4.3
80	20.2	107	4.1
81	19.3	108	3.9
82	18.4	109	3.7
83	17.6	110	3.5
84	16.8	111	3.4
85	16.0	112	3.2
86	15.2	113	3.1
87	14.4	114	3.0
88	13.6	115	2.9
89	12.9	116	2.8
90	12.1	117	2.7
91	11.4	118	2.5
92	10.8	119	2.3
93	10.1	120+	2.0
94	9.5		
95	8.9		
96	8.3		

APPENDIX B

Articles and Informational Materials

on Retirement Distribution Compliance Issues

Non-Compliant Trusts and Circular 230 Issues

By Seymour Goldberg

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Please note that whenever the word trust is used it shall mean a trust which is the beneficiary of an IRA in whole or in part.

Many individuals have accumulated a considerable amount of wealth in their individual retirement accounts (IRAs). This can happen because the IRA account holder rolled over or directly transferred retirement assets that were accumulated in his or her qualified plan accounts such as a 401(k), a 403(b) arrangement or a 457(b) governmental plan to his or her IRA account.

These retirement accounts may represent the major portion of a taxpayer's wealth and must be considered in developing an estate plan for the client. Often clients are concerned about the welfare of their beneficiaries after they are gone.

As a result of the Supreme Court opinion in *Clark v. Rameker* issued on June 12, 2014, it was held that inherited IRAs are not considered to be "retirement funds" that are protected under the bankruptcy code. This opinion is significant especially if the onspouse beneficiary of an inherited IRA account has actual or potential problems with his or her creditors.

Some states have enacted legislation that protect inherited IRAs from creditors of the nonspouse beneficiary. These states include Alaska, Arizona, Florida, Missouri, North Carolina, Ohio and Texas. The nonspouse beneficiary, however, must satisfy certain domiciliary requirements in order to protect his or her inherited IRA accounts in a protected state. There is nothing to stop additional states from amending their laws from time to time to protect inherited IRAs from creditors of the nonspouse beneficiary.

The Supreme Court did not address the issue regarding a spouse beneficiary who treats the IRA as a beneficiary IRA and does not transfer or roll over the IRA into a spousal rollover IRA. It is generally best for the surviving spouse to transfer or roll over the deceased spouse's IRA to his or her own IRA to the extent permitted by law. The surviving spouse, however, may not roll over or transfer an unpaid required minimum distribution attributable to the deceased IRA owner to his or her own IRA. Many practitioners suggest that a trust be established for the beneficiary of an inherited IRA from an asset protection point of view. If the deceased IRA owner's account is payable to a spendthrift trust, then the trust is generally protected from creditors of the trust beneficiary under Section 541(c)(2) of the Bankruptcy Code.

If a trust is used for asset protection purposes but flunks the IRS stretch payment rules, then the trustee of the non-compliant trust may have significant liability issues with both the trust beneficiaries and the IRS.

The problem is that in order to take advantage of the stretch payment rules with respect to a trust, the trust must satisfy certain IRS post-death trust compliance rules and also must be drafted in a manner that satisfies the IRS regulations and IRS letter rulings. If a trust involves a QTIP trust, then it must also satisfy

Revenue Ruling 2006-26.

Accordingly, there are stringent rules that apply to a trust for a nonspouse beneficiary and there are much more complex rules that apply when a trust is created for the benefit of a surviving spouse if a QTIP trust is involved. A credit shelter trust can also be established for a surviving spouse as well. The author has reviewed a number of IRA trusts for nonspouse beneficiaries and found them to be noncompliant from an IRS point of view and/or from a drafting point of view. In order to satisfy a key IRS compliance rule regarding any type of trust, the trustee must file certain paperwork with the IRA financial institution by no later than October 31 following the year of the IRA owner's death.

The trustee must send a copy of the trust document or certain trust certification paperwork to the IRA financial institution by no later than the October 31 deadline mentioned above.

The post-death IRS trust documentation requirement must be satisfied with the IRA institution by no later than October 31 following the year of death of the IRA owner. Under the IRS rules the trustee of the trust must either:

1. Provide the IRA institution with a final list of all beneficiaries of the trust (including contingent and remainderman beneficiaries) with a description of the conditions on their entitlement as of September 30 of the calendar year following the calendar year of the IRA owner's death; certify that, to the best of the trustee's knowledge, this list is correct and complete and that certain requirements described in the regulations are satisfied; and agree to provide a copy of the trust instrument to the IRA institution upon demand; or

2. Provide the IRA institution with a copy of the actual trust document for the trust that is named as a beneficiary of the IRA owner under the IRA agreement as of the IRA owner's date of death. The author generally recommends that the second method be used since it is not as complicated as the first method.

No matter which method is used, the trustee should document the fact that the paperwork was timely satisfied with the IRA institution by the October 31 deadline. This should be done with a transmittal letter that is sent to the IRA institution by certified mail, return receipt requested.

The failure of the trustee to satisfy the post-death IRS trust documentation requirement is a fatal error. It prevents the trustee from using the life expectancy of the appropriate trust beneficiary in determining the required minimum distributions that must be made from the deceased IRA owner's account to the trust. There is currently no authority under the IRS rules to remedy this oversight.

The author has been involved in continuing education programs involving trusts as IRA beneficiaries for over 15 years and found that many advisors were not aware of the October 31 post-death IRS documentation compliance deadline regarding these trusts. This is not only a problem for the IRA advisor but is also a major problem for the tax return preparer who prepares the fiduciary income tax return for the trust. If it turns out that the trustee of the trust is improperly using a stretch payment of the trust beneficiary incorrectly, then the trustee can have significant liabilities to the trust beneficiaries and to the IRS. This can occur because the trustee failed to timely satisfy the postdeath IRS trust documentation requirement.

Obviously, the fiduciary income tax return preparer of the trust should look into this issue and advise the trustee accordingly. If the fiduciary income tax return preparer finds out about this fatal error after the October 31st deadline, then the fiduciary income tax return preparer must immediately advise the trustee about the issue.

Example 1

Facts

Assume John, an IRA owner, designated a trust as the beneficiary of his IRA. His grandson, Joey, is the trust beneficiary of the trust. Assume that John died on July 1, 2012 at age 68. Joey is age 18 in 2012. Further assume that the trust started to receive required minimum distributions from John's deceased IRA account commencing in 2013 based on Joey's IRS single life expectancy as determined in the year after John's death.

Since Joey is age 19 in 2013, the trustee assumed that the single life expectancy of Joey as determined in 2013 could be used in determining the stretch IRA distributions to the trust. As a result the trustee uses the IRS single life expectancy table for an individual age 19 in determining required minimum distributions that is made from John's deceased IRA to John's trust for the benefit of Joey. The IRS single life expectancy for an individual age 19 is 64.0 years.

Assume that Jack, the trustee of John's trust, failed to timely file the post-death IRS trust documentation paperwork with the IRA institution by the October 31, 2013 deadline. Jack was never advised to do so by his then professional advisor.

Question 1:
May the trustee of John's trust use Joey's termcertain IRS single life expectancy of 64.0 years commencing in 2013 in determining the required minimum distributions that are made from John's deceased IRA to John's trust?

Answer:
No. According to the IRS regulations, the postdeath IRS trust documentation requirement (among other requirements) must be timely satisfied in order to use the IRS single life expectancy of Joey in determining the required minimum distributions that are made to John's trust.

Question 2:
Based on the violation of the October 31, 2013 deadline requirement, by when must John's deceased IRA account be paid to John's trust?

Answer:
By no later than December 31, 2017. However, John's deceased IRA account does not have to pay any amount to John's trust for the calendar years 2013 through 2016. All that matters is that John's deceased IRA account is cleaned out by December 31, 2017.

Question 3:
What is the reason for the answer of December 31, 2017?

Answer:

John died on July 1, 2012 at age 68. This date of death is before John's required beginning date. Since John's trust does not satisfy one of the rules that allows Joey's IRS single life expectancy to be used, it is as if John died before his required beginning date without a designated beneficiary. In essence, John's IRA trust is a non-compliant trust.

Since John died before his required beginning date without a designated beneficiary, the five-year rule is operative. John's trust must receive John's entire IRA account by no later than December 31, 2017.

Question 4:
Assume that Murray is the new IRA advisor to the trustee of John's trust and is also a CPA who is retained in March 2019 to prepare John's IRA trust fiduciary income tax return for the year 2018. Also assume that John's trust for the calendar years 2016 and 2017 reflects stretch payments based on the use of Joey's remaining term-certain single life expectancy. Murray CPA finds out from Jack trustee in 2019 that Jack trustee never filed the post-death IRS trust documentation paperwork with the IRA institution. What action should Murray CPA take?

Answer:
Murray CPA must immediately notify Jack, the trustee of John's trust, about the potential tax penalties that can be imposed on the trust.

For example, if the balance in John's IRA as of December 31, 2017 amounts to $300,000, then the potential penalty is a 50% penalty on the shortfall amount of $300,000. Therefore, the 50% potential penalty amounts to $150,000. Under the five-year rule, John's entire deceased IRA account balance had to be paid out to John's trust by no later than December 31, 2017. Since this was not done, Jack the trustee has a major IRS penalty problem to the extent of $150,000, plus delinquency penalties and interest.

Question 5:
What should Murray CPA recommend to Jack trustee to possibly mitigate the $150,000 excise tax penalty?

Answer:
Murray CPA should tell Jack trustee to immediately close out John's deceased IRA account in its entirety and pay it to John's trust. If done in 2019, then this would trigger a fiduciary income tax liability to the trust for 2019 to the extent such IRA distribution is not timely paid to Joey under the terms of John's trust.

After that is done, the Jack trustee should file a Form 5329 for the calendar year 2017 for the John trust and request that the 50% penalty of $150,000 be waived. According to the regulations, the IRS can waive the 50% penalty on the basis of reasonable error. The penalty can be waived by the IRS if the payee establishes to the satisfaction of the IRS the following:

1. The shortfall in the amount of the distributions was due to reasonable error; and
2. Reasonable steps are being taken to remedy the shortfall.

The IRS instructions to IRS Form 5329 explains the procedure for filing for the waiver. It is important that John's IRA be closed out as soon as possible after the error is discovered by Murray CPA in 2019. This assumes that Jack trustee acted promptly as well after Murray CPA brought it to his attention.

Question 6:
If Jack trustee is not cooperative in making the correction and filing the Form 5329 for 2017, then what should Murray CPA do?

Answer:
Murray CPA should indicate to Jack trustee that according to the 2011 Tax Court opinion in *Paschall v. Commissioner*, there is no statute of limitations on an IRA penalty in the absence of filing a Form 5329 for 2017. In effect, the IRS can assert the 50% penalty excise tax at any time if a Form 5329 is not filed with the IRS for 2017, the year of the shortfall.

Important Author's note
According to IRS reg. sec. 54.4974-2 at Q-5, an additional 50% penalty is imposed for each subsequent year after December 31, 2017 if as of December 31 of such subsequent year there is a remaining balance. The 50% penalty will apply with respect to such remaining balance. A Form 5329 would then have to be filed for such subsequent year. A waiver should be requested for such subsequent year as well. Accordingly Jack should file Form 5329 for 2018 as well.

Question 7:
If Jack trustee fails to cooperate with Murray CPA's suggestions, then what must Murray CPA do?

Answer:
Murray CPA cannot prepare a 2018 fiduciary income tax return for John's trust by improperly using Joey's remaining term-certain single life expectancy. Murray CPA must resign from the engagement once Murray CPA knows of the error and Jack trustee refuses to take the action that Murray CPA suggested. This resignation is necessary from both an ethics point of view as well as under the rules that are found in Circular 230.

Question 8:
What provision under Circular 230 is on point?

Answer:
Treasury Department Circular No. 230 covers regulations governing practice before the Internal Revenue Service, Section 10.21. Knowledge of Client's Omissions is applicable and states as follows:

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service knows that the client has not complied with the revenue laws of the United States or has made an error or omission from any return, document, affidavit or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error or omissions.

Question 9:
What additional provision in Circular 230 should Murray CPA be concerned with?

Section 10.22 in Circular 230 covers diligence and states in part as follows:
(a) In general a practitioner must exercise due diligence – In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters ….

Question 10:
What other provision effective June 12, 2014 in Circular 230 should practitioners be concerned about?

Answer:
As of June 12, 2014, new final regulations were issued by the IRS with respect to Circular 230. Section 10.35 is one of the changes that is of major importance to practitioners and follows:

§ 10.35 Competence
(a) A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area or studying the relevant law.

(b) Effective/applicability date. This section is applicable beginning June 12, 2014.

Author's note
Practitioners may be in violation of the Circular 230 provisions if they are not aware of the IRA compliance issues. These issues may include improper rollovers, excess contributions, required minimum distribution violations and improperly preparing a fiduciary income tax trust return of a non-compliant trust.

Example 2

Facts
Assume the facts in Example 1 except that John would have attained age 73 in the year of his death in 2017 had he not died. John died after receiving his entire required minimum distribution for the calendar year 2017. Also assume Jack, the trustee of John's trust, failed to timely file the post-death IRS trust documentation paperwork with the IRA institution by the October 31, 2018 deadline.

Question 1:
Can Jack the trustee receive IRA distributions from John's deceased IRA account over Joey's then single-life expectancy which is a 59.1 year term-certain period commencing in 2018?

Please note that Joey is age 24 in the calendar year 2018. The IRS single life expectancy at age 24 is 59.1 years.

Answer:
No. See previous discussion regarding this fatal noncompliance error that was made by Jack trustee with respect to John's trust.

Question 2:
Over what period may Jack trustee receive required minimum distributions from John's deceased IRA?

Answer:
Since John died in 2017 after his required beginning date, then Jack, trustee of John's trust, may receive required minimum distributions under the remaining life expectancy rule. This remaining term-certain

period is a 13.8 year period commencing in 2018 and reduced by one for each year thereafter.

Author's note

Had John died in 2017 prior to receiving his entire required minimum distribution for the year 2017, then the unpaid required minimum distribution for 2017 must be paid to John's trust as well.

Question 3:
How is the remaining term-certain period of 13.8 years determined?

Answer:
Since John died after his required beginning date having a non-compliant trust as the beneficiary of his IRA, then for post-death IRA distributions you look tentatively at the attained age that John would have reached in the year of death had he not died. You then take the following steps:

1. John's attained age in 2017 had he not 73 died (assume age 73).

2. IRS single life expectancy in 2017 (used 14.8 to determine post-death IRA distributions
if John died on/or after his required beginning date since you have a non-compliant trust as the beneficiary of an IRA).

3. The remaining term-certain period for 13.8 distributions from John's deceased IRA to the non-compliant trust is 14.8 years -1 or 13.8 years commencing in 2018.

Author's note

The term-certain period commencing in 2018 is 13.8 years and is reduced by one for each year thereafter. The 59.1 year term-certain period with respect to Joey's life expectancy is lost because of this non-compliance error. See discussion in Example 2, Question 1 above.

Please note that the remaining life expectancy rule described above applies when an IRA owner dies on or after his/her required beginning date having designated as his/her beneficiary the estate, a non-compliant trust or a nonspouse beneficiary who is older than the IRA owner.

Further author's note

A trust can be non-compliant as well if the trust is not properly drafted. This could happen if the provisions in the trust document do not satisfy the IRS regulations and/or the IRS rulings.

Example 3

Facts

Martin, an IRA owner, designates as his IRA beneficiary the Martin trust for the benefit of his daughter, Jane. Martin is age 72 in the year of his death. His date of birth is October 15, 1945. He died on November 1, 2017. He received his entire required minimum distribution from his IRA for the calendar year 2017 before the date of his death. The trust document provides that Jane shall receive the income from the trust each year.

The trust remainderman of the Martin trust is the XYZ Charity. Jane is age 19 in 2017 and the trustee of the trust is Clark.

Clark, the trustee, has been advised by his IRA advisor Jeff to timely file the trust document with the IRA institution by the October 31, 2018 deadline. Clark does so and believes that Jane's term-certain single life expectancy can be used in determining the required minimum distributions that can be made to Martin's trust.

Jane is age 20 in 2018 and her IRS single life expectancy is 63.0 years. Steve CPA calculates the required minimum distribution based on the 63.0 year stretch payment period and $9,206.00 is received by Martin's trust in 2018. This computation is based on Martin's deceased IRA account balance as of December 31, 2017 of $580,000 divided by 63.0 ($580,000 ÷ 63 = $9,206).

Steve CPA then tells Clark, the trustee, to pay out the $9,206 from the Martin's trust to Jane and deducts that amount on the fiduciary income tax return for the calendar year 2018.

Question 1:
May Clark, the trustee, use Jane's single life expectancy in determining the required minimum distributions that must be made to Martin's trust?

Answer:
No. According to the IRS rules, Jane is an income beneficiary and not the beneficiary of the required minimum distributions according to the terms of the IRA trust. If the trust beneficiary of a trust is an income beneficiary, then under the IRS rules, the single-life expectancy of the oldest beneficiary of the trust is used in determining the required minimum distribution payout period. Since the XYZ Charity is the trust remainderman, then there is a stretch payment rule problem since a charity has no life expectancy. The charity is considered to be the oldest trust beneficiary. Because of this issue, the 63.0 year life expectancy of Jane cannot be used for IRS stretch payment purposes.

Question 2:
Assume the facts in Example 3 except that Clark, trustee of Martin's trust, has discretion pursuant to the terms of the trust to invade principal on behalf of Jane. Would that change your answer to question 1?

Answer:
No. Clark as trustee has discretion to invade principal under the terms of the trust document but is not mandated to pay the required minimum distributions to Jane each year. Under the IRS rules, the single life expectancy of Jane may not be used in determining the stretch payments to Martin's trust. This is so since Jane is not considered to be the oldest trust beneficiary. Charity is the oldest beneficiary and has no life expectancy.

Question 3:
Based on the above, over what term-certain period must Clark as trustee use in determining the required minimum distributions that must be made from Martin's deceased IRA account to Martin's trust?

Answer:
Clark as trustee of Martin's trust uses the deceased IRA owner's remaining life expectancy. These rules

were previously explained. This is so because Martin died after his required beginning date at age 72. Under the remaining life expectancy rule, Clark the trustee can receive required minimum distribution over 14.5 year term-certain period commencing in 2018 and reduced by one for each year thereafter.

Question 4:

Assume that Clark, the trustee of Martin's trust, received a $40,000 required minimum distribution during the calendar year 2018. This was determined by dividing Martin's deceased IRA account balance as of December 31, 2017 of $580,000 by 14.5 ($580,000 ÷ 14.5 = $40,000) of $40,000.
How much must Clark the trustee pay to Jane, the mandated income beneficiary of the Martin trust For the calendar year 2018?

Answer:

Under the state trust laws the definition of income for fiduciary accounting purposes is often not the same as the definition of income for income tax purposes. Most jurisdictions define trust accounting income to be 10% of the required minimum distribution amount that is paid to the Martin trust. Accordingly, Clark trustee under the 10% rule would distribute 10% of $40,000 or $4,000 to Jane, the mandated income beneficiary for the calendar year 2018.

Question 5:

What drafting approach could have been used to allow Martin's trust to use Jane's term-certain single life expectancy in determining the required minimum distributions that are paid from Martin's deceased IRA account to Martin's trust?

Answer:

If the trust document provides that the required minimum distributions received by the trust must be paid to Jane each year and Clark the trustee timely satisfied the post-death IRS trust documentation requirements by the October 31, 2018 deadline, then Martin's trust can use the term-certain single-life expectancy of Jane. Thus, the Martin trust could then receive required minimum distributions from Martin's deceased IRA account over a 63.0 year term-certain period commencing in 2018. This number would then be reduced by one for each year thereafter.

Author's Note

If the two rules described above are met, then the life expectancy of all other trust beneficiaries are ignored and Jane's term-certain single life expectancy account is used in determining the required minimum distributions from Martin's deceased IRA to Martin's trust.

Question 6:

Should Steve CPA know about the state trust law's 10% rule when he prepares the fiduciary income tax return for the Martin trust?

Answer:

It would appear to be yes. The AICPA "Practice Guide for Fiduciary (Trust) Accounting, a Guide for Accountants Who Perform Fiduciary Accounting Services," issued December 2007 by the AICPA Tax Division, states in part in the Executive Summary as follows:

• Fiduciary Tax Return Preparers must realize that taxable income and fiduciary accounting income are not the same. Accountants who unwisely prepare tax returns using only Forms 1099 and a check register

face undaunted malpractice exposure to trustees and beneficiaries. Recent IRS regulations recognize changes in fiduciary accounting concepts in tax return reporting.
• Reading and Understanding the Terms of the Trust Instrument and/or Will is the initial step in preparing a fiduciary accounting. The instrument overrides local law (e.g., statutes in the state of the trust's or estate's situs).
• Accountants who Perform Fiduciary Accounting Services need to be knowledgeable of the Uniform Acts and Model Codes as adopted in the state of situs because these provisions and case law provide guidance as to local law if the trust or will is silent or poorly drafted. Seeking advice or counsel from knowledgeable attorneys can also be helpful and resourceful. In the introduction to the practice guide, the following comments are made:

The challenges facing accountants who provide accounting and services for trusts and estates include:
A. Lack of familiarity with estates, trusts and fiduciary accounting principles.
B. ****
C. ****
D. Lack of consistency among the 50 states [plus District of Columbia] because each has its own statutes and legal interpretations vary from state to state.

Conclusion

Using an IRA trust for asset protection purposes is a challenging engagement. To effectively represent clients in connection with such matters, practitioners should be well versed in the applicable rules, as illustrated by the various examples set forth above.

Seymour Goldberg, CPA, MBA, JD, a senior partner in the law firm of Goldberg & Goldberg, P.C., Long Island, New York, is Professor Emeritus of Accounting, Law and Taxation at Long Island University. He was formerly associated with the Internal Revenue Service and has been involved in conducting continuing education outreach programs with the IRS. He has authored guides for the American Bar Association and the American Institute of Certified Public Accountants on IRA compliance issues. His IRA guides can be found in well over 100 law school libraries. Mr. Goldberg can be reached at (516) 222-0422 or by email at info.goldbergira@gmail.com. You may also visit his website at TrustEstateProbate.com.

Oversight for IRA Trusts

By Seymour Goldberg

Ed Slott, CPA; Ed Slott's IRA Advisor; and Smart Subscriptions, LLC has granted permission to Seymour Goldberg, CPA, MBA, JD to transmit the following article from Ed Slott's IRA Advisor (January 2020) via any means at his discretion

Seymour Goldberg, senior partner at Goldberg & Goldberg, a law firm in Melville, NY, has written two practitioner guides for the American Bar Association on IRA compliance issues. He is concerned about IRA trust violations under the IRS rules. An IRA trust is a trust that is the beneficiary of an IRA. The issue involves timely delivery of certain paperwork to the institution that maintains the decedent's IRA account after the death of the IRA owner. According to Goldberg's conversations with the SEC, that issue is an IRS compliance issue, over which the SEC has no jurisdiction. "Therefore, it is up to the IRS and/ or Congress to address this, in my opinion, systemic noncompliance issue," says Goldberg.

He further states, "I believe the IRS and/or Congress should provide for a reasonable IRS Voluntary Compliance IRA Correction Program to protect innocent IRA trustees who may have violated this compliance rule." The key problem involves paperwork that the trustee must send to the IRA institution by October 31 of the year after the IRA owner's death. "Of the two permissible methods," says Goldberg, "I prefer the simpler one: sending a copy of the trust document to the IRA institution.

The issue [regarding IRA trust violations] involves timely delivery of certain paperwork to the institution that maintains the decedent's IRA account after the death of the IRA owner.

The other method is more complicated, requiring sending the IRA institution a list of all trust beneficiaries, along with additional specific required statements." Goldberg has found that most trustees, if not all, are "clueless" as to this rule. "Most trustees don't read IRS Publication 590-B or the IRS regulations to find out about this technical rule," Goldberg says.

What noncompliance issue will be raised, if such paperwork isn't delivered on time? If the IRA trust has a non-spouse beneficiary, RMDs won't be able to be stretched out over the life expectancy of the appropriate beneficiary.

If RMDs have been stretched in this manner, without the paperwork being in place, back taxes and possible penalties may be assessed.

There is no statute of limitations that protects the trustee. Avoiding such problems by sending a copy of the trust document to the IRA institution might sound straightforward, but that's not always the case.

"Some IRA institutions may not be interested in obtaining trust documentation," says Goldberg. "They may open a trust account without the required trust documentation."

Even if the IRA institution does not want to receive the IRA trust paperwork and perhaps analyze the terms of the trust, advisors should make sure that required documentation is sent to the IRA institution by the deadline. Goldberg asserts that the trustee should keep records of the timely submission of the required paperwork to the IRA institution.

“This should be done with a transmittal letter that is sent to the IRA institution by certified mail, return receipt requested,” he says.

Advisors working with IRA trust non-spouse beneficiaries should explain the importance of meeting the October 31 deadline, if extended tax deferral is desired. Take all necessary steps to see that the documentation is delivered on time and retain delivery records.

What's more, if an advisor discovers, for example, that a new client is the beneficiary of an IRA trust that has been taking life expectancy-based RMDs for years, even though the required paperwork was not filed on time, Goldberg believes that the advisor should notify the trustee about the noncompliance. “One way to possibly mitigate the financial damage,” Goldberg says, “would be to close the IRA and pay the balance to the IRA trust. The trustee should file Forms 5329, requesting that the 50% penalty for insufficient RMDs for the respective years be waived.” These requests might be granted if it can be illustrated that the shortfalls resulted from reasonable error, and the mistake is being remedied.

To Track SECURE, Consider an IRA Trust

Guest IRA Expert

Seymour Goldberg, CPA, MBA, JD Goldberg & Goldberg, PC Melville, NY

The new Setting Every Community Up for Retirement Enhancement (SECURE) Act introduces a 10-year rule for many beneficiaries of IRAs and employer-sponsored retirement plans. Following this rule will require extensive tracking and failure to comply could generate a penalty equal to 50% of the amount involved.

One way to address this risk is to name a trust as IRA beneficiary, shifting tracking responsibility from the retirement plan beneficiary to the trustee of the IRA trust. Depending on a client's choice of beneficiary, it may be an astute move to begin discussions of an IRA trust this year.

Eligible Beneficiaries

Effective for deaths occurring in 2020 and later years, certain beneficiaries remain eligible for life expectancy-based required minimum distributions (RMDs). These eligible beneficiaries are surviving spouses, disabled and chronically ill individuals, minors (until they reach the age of majority), and individuals who are less than 10 years younger than the deceased IRA account owner.

The old rules, with certain modifications, apply to such beneficiaries. Indeed, stretching RMDs, tax-deferred, may become even more appealing for some heirs, under new IRS life expectancy tables.

Done in a Decade

For all other individual beneficiaries, including most adult sons and daughters, the new 10-year rule will be effective. There will be no annual RMDs but the inherited retirement account must be emptied within 10 years following the year of death of the IRA owner.

Indeed, one IRA-related issue created by the SECURE Act relates to this 10-year rule. Technically, the new law indicates that designated beneficiaries can wait for 10 years before taking any distributions. Realistically, though, it's likely that the intent of the new law includes keeping the old law's rules on year-of-death RMDs.

Example: Suppose Alice dies in July 2020 at age 80 and leaves her IRA to her 50-year-old daughter Jenny, who is neither disabled nor chronically ill. Jenny would be subject to the 10-year rule with no distributions required until December 31, 2030.

That said, suppose that Alice had been taking $3,000 a month from her IRA, to satisfy her 2020 RMD. At her death, she had received 7 monthly payouts, for a total of $21,000.

Jenny, the IRA beneficiary, probably is still expected to withdraw the $15,000 RMD balance by the end of 2020, under the old rules. Hopefully, the U.S. Treasury Department will release some written guidance for clarification.

Missing the Mark

Assuming that a year-of-death RMD is required, and Jenny complies, she would have to withdraw all the remaining money from Alice's IRA (after a timely payout of the $15,000 remaining year-of-death RMD, in this example) by the end of 2030.

If Jenny takes no interim distributions, seeking maximum potential long-term investment buildup, she might face a steep income tax bill for 2030. However, 10 years of untaxed investment compounding could still bring her a substantial payout, after tax.

On the surface, this sounds straightforward. Inherit the money (and pay any remaining year-of-death RMD), let the account build for 10 years, distribute all the money, pay the tax, and emerge with a nice pile of cash.

Except, who will make sure that Jenny actually follows the plan? Not the IRA custodian, because financial firms have no obligation to do so. As things stand now, an IRA beneficiary probably will receive no notice of future mandated account liquidation by the end of the 10th year, from any source.

Perhaps Jenny's tax preparer (or some other advisor) will timely inform her of the year-of-death RMD and the 2030 deadline, but there is no assurance that will be the case. Even if Jen is so informed, there is no certainty that she'll be working with the same advisor in 2030, and will receive a timely reminder.

Will Jenny, herself, remember? Perhaps, but many things can happen in 10 years. Jenny might lose some of her mental capacity.

She might be so involved with family concerns that this inherited IRA slips her mind. And so on. If this IRA still exists for even one day in 2031, the entire amount could be subject to a 50% penalty.

Untimely Second Death

In another scenario, Jenny might die in, say, 2028, before the 10- year deadline, without emptying this inherited IRA. *What will happen to this account?* (Note: Any contingent beneficiaries of the original IRA account owner will not be recognized, once Jenny has inherited the account.)

Ideally, Jenny will have filled out a successor beneficiary form, naming her two children, soon after inheriting the IRA from her mother. If so, this inherited IRA could pass to Jenny's two children.

Will those new beneficiaries know they have two more years of untaxed investment buildup, followed by a full payout in 2030? Will they mistakenly believe that the 10-year clock starts over, giving them until 2038 to cash in? Or will they be totally ignorant about any distribution rules for this IRA?

Keep in mind that the SECURE Act is very much in the news now, with many articles in print and online, so advisors are all-too-well aware of the 10-year rule. The first chance for violation of this rule won't occur until 2030, and no one can know what will be happening in the world then, so the media focus on this deadline might be scant.

Unintended Successors

The preceding paragraphs assume that Jenny, the primary IRA beneficiary, completes a successor beneficiary form, naming her children.

In reality, this may not happen, so many IRAs will not have designated successor beneficiaries. In these situations, where the original beneficiary dies in the gap period with money still in the IRA but with no completed successor beneficiary form, the IRA custodian's default rules will apply to naming successors, and those provisions will vary from one financial firm to another. Alice's IRA may then pass to Jenny's husband – *even if Jenny and her husband are in the midst of hostile divorce negotiations* – rather than to Alice's beloved grandchildren.

Other scenarios also could result in an IRA passing to someone that the IRA owner would not have chosen. The IRA instead could pass to the original beneficiary's estate, with uncertain consequences – *and perhaps a more extensive probate process.*

What's more, such an unintended successor beneficiary might not realize that the original beneficiary was part-way through a 10-year countdown. The deadline could be missed, possibly resulting in steep taxes and penalties.

In yet another possible situation, suppose that Jenny's two children have succeeded Jenny as IRA beneficiaries after Jen's death, as explained. Further, suppose that one (or both) of the successor beneficiaries dies before 2030, leaving an IRA that has not yet been depleted.

If so, the same sequence of events will unfold. With a successor beneficiary form in place, a new co-beneficiary or co-beneficiaries will replace the one who died.

If there is no completed successor beneficiary form – *a likely outcome* – the IRA custodian's default rules will determine the replacement successor beneficiary. At this point, there may be little chance that the 10-year rule will be followed, so the 50% penalty on insufficient distributions may be triggered after 2030.

Time for a Trust

If clients plan to leave their retirement assets to recipients who are not eligible for life expectancy-based RMDS and are unwilling to subject such future beneficiaries to the risks described here, one way to address the problem is to name a trust as beneficiary of their IRA or employer plan account. Then, retain competent counsel to draft the trust.

Such an IRA trust might call for no payouts to the IRA trust beneficiary during the first 9 years, then a full distribution to the trust beneficiary during year 10.

The trustee also could be given the ability to pay out some cash to the trust beneficiary prior to full depletion of the IRA account.

With this arrangement, or something similar, the trustee will become responsible for following the 10-year rule created by the SECURE Act. Assuming the named trustee is a human, successor trustees could be named to step in if the original trustee dies or becomes incompetent.

Such a trust might be established immediately, as an IRA owner or plan participant could die at any time. Moreover, the trust creation should be handled by a knowledgeable estate planning attorney, as the SECURE Act poses challenges.

Show Them the Money

Advising clients to name a trust as IRA beneficiary is one thing, but convincing them to pay upfront for a trust may be a bit more of a challenge.

An experienced estate planning attorney might spend 10-15 hours to produce a solid IRA trust that meets a client's needs. The total cost would be the actual amount of hours involved, multiplied by the relevant billing rate, so the initial outlay could be thousands of dollars.

Fortunately, the IRA owner won't have to bear continuing administrative costs, if this is a newly-created trust that becomes effective at the IRA account owner's death. The future costs to the trust can be worthwhile, if the trustee helps avoid SECURE Act snares.

The bottom line is that advisors' clients (and future retirement account beneficiaries) may be at-risk if they flunk the 10-year test. Similarly, headaches may also arise when an eligible designated beneficiary is the beneficiary of a retirement account. Advisors should be warning clients about potential future consequences.

Advisor Action Plan

σ Discover the identities of clients' beneficiaries for their IRAs and employer-sponsored retirement plans.

σ See if the beneficiaries are not eligible for life expectancy-based RMDs, as explained in this article.

σ Inform clients with ineligible designated beneficiaries that the 10-year rule will apply to those beneficiaries, under the SECURE Act.

σ Suggest to these clients that naming an IRA trust may be a worthwhile outlay of time and money, because their beneficiaries could be spared potentially adverse tax penalty consequences.

Seymour Goldberg, CPA, MBA, JD a senior partner in the law firm of Goldberg & Goldberg, P.C., Long Island, New York, is Professor Emeritus of Accounting, Law and Taxation at Long Island University. He has taught many CLE and CPE programs at the state and national level as well as CLE courses for the American Bar Association, New York State Bar Association, City Bar Center for Continuing Legal Education, NJICLE, local bar associations and law schools. Mr. Goldberg has been quoted in major publications including the New York Times, Forbes and the Wall Street Journal. He was formerly associated with the IRS and has been involved in conducting continuing education outreach programs with the IRS. He has authored guides for the American Bar Association and the American Institute of Certified Public Accountants on IRA compliance issues. Mr. Goldberg is the recipient of Outstanding Discussion Leader Awards from both the AICPA and the Foundation for Accounting Education. His IRA guides can be found in well over 100 law school libraries. Mr. Goldberg can be reached at info.goldbergira@gmail.com or 516-222-0422. You may also visit Mr. Goldberg's website at TrustEstateProbate.com.

IRA TRUST INSTRUCTIONS

1. The trustee sends a copy of the IRA trust to the IRA custodian by no later than October 31st of the year following the IRA owner's year of death. (Do not remove staples but merely copy all the pages of the IRA trust and send it to the appropriate individual or department in the IRA institution). This is an IRS approved method of satisfying the IRS post-death trust documentation requirements. See reg. sec. 1.401(a)(9)-4, A-6(b).

   A covering letter should accompany the mailing of the IRA trust together with proof of mailing.

2. Assume that John is the IRA owner and Mary, his daughter, is the beneficiary of his IRA trust. Mary is age 40 and is not disabled or chronically ill at the time of John's death on July 1, 2022.

   On death of the IRA owner, the decedent's IRA account should be titled:

   > John Smith deceased IRA f/b/o
   > the John Smith Trust f/b/o
   > Mary Smith dated December 14, 2020
   > (use the trust EIN number on the IRA account)
   > or
   > John Smith Trust f/b/o Mary Smith
   > dated December 14, 2020 as beneficiary of
   > John Smith deceased IRA
   > (use the trust EIN number on the IRA account)

Author's Note:

I recommend that the IRA beneficiary form condition the selection of the trust as the IRA beneficiary on the survival of Mary Smith, the trust beneficiary and provide for alternate beneficiaries if Mary Smith fails to survive John Smith

3. Establish a trust account which should be titled:

   > John Smith Trust f/b/o Mary Smith
   > dated December 14, 2020
   > (use the trust EIN number on the trust account)

4. The trust must receive distribution from the decedent's IRA pursuant to the terms of the trust document. In all events under Secure, the decedent's IRA has to be paid out in its entirety to the trust by no later than the end of the tenth year following the year of death of John.

   Important Author's Note

   In the event that an IRA owner dies on or after his/her required beginning date, then to the extent of any unpaid required minimum distribution attributable to his/her year of death that was not paid to the IRA owner before his/her date of death, then said amount should be paid as soon as possible to the trust which has been named as the beneficiary of the deceased IRA owner's account.

Further, the trustee should then take whatever action is necessary to the extent of the trustee's discretion to distribute in whole or in part to the trust beneficiary said amount to minimize fiduciary income taxes with respect to said amount.

<u>Suggestion</u>

If the owner died on July 1, 2022, then a copy of the IRA trust must be sent to the IRA institution by no later than October 31, 2023. It should be sent within a reasonable period of time after the IRA owner's death. Do not wait until the last minute.

5. The trust provision may provide that the trustee of John's trust may have the absolute discretion to withdraw periodic sums from John's deceased IRA account from time-to-time for the health, education, maintenance and support of Mary and pay said sums to Mary. However, in all event John's deceased IRA account must be withdrawn from John's deceased IRA account and paid to the trust by no later than the end of the tenth year following the year of death of John. That deadline would be December 31, 2032 since John died on July 1, 2022. That deadline must be satisfied in order to avoid the 50 percent tax penalty.

6. The trust provisions can also be designed in a manner whereby the trustee is given the absolute discretion to pay to Mary in whole or in part the (entire) amount received by the trust from John's deceased IRA account in 2032. This assumes that Mary is then surviving in 2032.

7. Regarding item 6, if the trustee does not pay out all the funds received from John's deceased IRA in 2032 to Mary, then the trust may incur a significant fiduciary income tax liability. However, by retaining the funds in the trust, then the after-tax funds being retained in the trust have the advantages of both asset protection and estate tax protection.

8. If the terms of the trust provide that trust expenses shall be paid by the trustee, then the trustee withdraws additional sums from the IRA to cover these trust expenses. These expenses are then paid by the trustee to the appropriate payee. The trust (except in an IRA QTIP trust) could say the IRA distributions paid to the trust are credited to principal and not to income in whole or in part and that expenses are charged to principal and not charged to income in whole or in part. This approach makes sure that there is sufficient funds in the trust to pay expenses that would otherwise be charged to income. This provision will help in the event that there is a contested accounting down the road.

CUSTOMIZED SAMPLE BENEFICIARY FORMS

When IRA's are payable to a trust to be revised by client to meet the client's wishes

James Gordon Traditional IRA

Account No.

XYZ Institution

Rider

Primary Beneficiary:

Mary Gordon, my wife if she survives me.

Contingent Beneficiary:

In the event that my wife, Mary Gordon, shall fail to survive me, then in that event my contingent beneficiaries shall be as follows:

1) 50% of my traditional IRA shall be payable to the James Gordon trust f/b/o Martha Gold dated July 15, 2020 if Martha Gold shall survive me. In the event that Martha Gold shall fail to survive me, then in that event said referred to 50% of my traditional IRA shall be payable in equal shares to the then surviving of those named individuals herein who are: Brett Gold, Ruth Gold and Harold Gold. If only one named individual is then surviving, then in that event this said 50% of my traditional IRA shall be payable to such surviving named individual.

2) 50% of my traditional IRA shall be payable to the James Gordon trust f/b/o Joan Grant dated July 15, 2020 if Joan Grant shall survive me. In the event that Joan Grant shall fail to survive me, then in that event said referred to 50% of my traditional IRA shall be payable in equal shares to the then surviving of those named individuals herein who are: Ann Grant, Sam Grant and Cole Grant. If only one named individual is then surviving, then in that event this said 50% of my traditional IRA shall be payable to such surviving named individual.

Any name change by such named individuals shall not have any effect on his/her designation as a named individual.

In the event that any named individual beneficiary has not attained the age of twenty-one (21) at the time that such amount is payable to him or her as the case may be, then in that event his/her share of the traditional IRA shall be payable to a Custodian for such named individual under the New York Uniform Transfers to Minors Act until age twenty-one (21) and directly to such named individual on or after attaining the age of twenty-one (21).

The executor of my estate shall be authorized to select the Custodian for such named individual under the New York Uniform Transfers to Minors Act who shall be an adult person. Further, my executor may in his/her discretion select himself/herself as the case may be as Custodian for such named individual under the New York Uniform Transfers to Minors Act.

Dated: July 15, 2020

____

James Gordon

James Gordon Traditional IRA

Account No.

XYZ Institution

Rider

Primary Beneficiary:

In the event that I am survived by my daughter, Martha Gold, then in that event my traditional IRA account shall be payable to the James Gordon Trust f/b/o Martha Gold dated July 15, 2020 as may be amended from time to time.

Contingent Beneficiary:

In the event that I am not then survived by my daughter, Martha Gordon, then in that event my traditional IRA shall be payable in equal shares to the then surviving individuals of those named herein who are: Brett Gold, Ruth Gold and Harold Gold.

If only one named individual is then surviving, then in that event my entire traditional IRA account shall be payable to such surviving named individual.

Any name change by such named individuals shall not have any effect on his/her designation as a named individual.

In the event that any named individual beneficiary has not attained the age of twenty-one (21) at the time that such amount is payable to him or her as the case may be, then in that event his/her share of the traditional IRA shall be payable to a Custodian for such named individual under the New York Uniform Transfers to Minors Act until age twenty-one (21) and directly to such named individual on or after attaining the age of twenty-one (21).

The executor of my estate shall be authorized to select the Custodian for such named individual under the New York Uniform Transfers to Minors Act who shall be an adult person. Further, my executor may in his/her discretion select himself/herself as the case may be as Custodian for such named individual under the New York Uniform Transfers to Minors Act.

Dated: July 15, 2020

____
James Gordon

James Gordon Traditional IRA

Account No.

XYZ Institution

Rider

Primary Beneficiary:

In the event that I am survived by my daughter, Joan Grant, then in that event my traditional IRA account shall be payable to the James Gordon Trust f/b/o Joan Grant dated July 15, 2020 as may be amended from time to time.

Contingent Beneficiary:

In the event that I am not then survived by my daughter, Joan Grant, then in that event my traditional IRA shall be payable in equal shares to the then surviving individuals of those named herein who are: Ann Grant, Sam Grant and Cole Grant.

If only one named individual is then surviving, then in that event my entire traditional IRA account shall be payable to such surviving named individual.

Any name change by such named individuals shall not have any effect on his/her designation as a named individual.

In the event that any named individual beneficiary has not attained the age of twenty-one (21) at the time that such amount is payable to him or her as the case may be, then in that event his/her share of the traditional IRA shall be payable to a Custodian for such named individual under the New York Uniform Transfers to Minors Act until age twenty-one (21) and directly to such named individual on or after attaining the age of twenty-one (21).

The executor of my estate shall be authorized to select the Custodian for such named individual under the New York Uniform Transfers to Minors Act who shall be an adult person. Further, my executor may in his/her discretion select himself/herself as the case may be as Custodian for such named individual under the New York Uniform Transfers to Minors Act.

Dated: July 15, 2020

____
James Gordon

ADVANTAGES OF TRUSTS AS IRA BENEFICIARY

Advantages of the trust as a beneficiary:

1. If the IRA death benefits are payable directly to a designated beneficiary, then the death benefits may be accelerated at any time by the designated beneficiary.

2. If the IRA death benefits are significant and payable to the trust, then a knowledgeable trustee may take advantage of the extended payout period rules that are provided for under the Secure Act. The IRS trust documentation requirements must be satisfied by October 31st of the calendar year following the IRA owner's year of death.

3. A mature trustee will control the investments while the assets are in the IRA.

4. If IRA death benefits are payable to a trust they may be protected from the creditors of the designated beneficiary under state law or in a divorce proceeding.

5. If IRA death benefits are payable to a spendthrift trust they generally should be protected if the designated beneficiary declares bankruptcy provided that the spendthrift trust is recognized under state law. Most jurisdictions recognize spendthrift trusts.

6. If IRA death benefits are payable to a trust for the benefit of a minor, it avoids the jurisdiction of the probate court or a similar court that has jurisdiction over the minor's assets.

7. If IRA death benefits are payable directly to minor, then the probate court or a similar court is involved. The probate court or a similar court may not go along with an extended payout period of the IRA distributions.

8. A client should consider making provisions in his/her will and/or other legal documents that exonerate nonprobate assets such an IRA from the payment of the IRA's share of the estate tax liability provided that there are sufficient other assets and that this provision is consistent with the client's estate plan.

9. Exonerating the IRA and other retirement assets from any estate tax liability will permit more tax deferred growth of the IRA and other retirement assets and the tax-free growth of Roth IRAs. However, this exoneration approach is at the expense of other beneficiaries of the estate.

10. A trust for adult child may be necessary if the adult child cannot handle money or would not otherwise reimburse the executor of the estate for the estate tax liability attributable to the IRA on a voluntary basis.

11. The children or grandchildren benefit from growth of IRA instead of the surviving spouse. This should save a considerable amount of estate taxes on the subsequent death of the spouse.

12. The trust may be used as an exemption trust for estate tax purposes.

13. The trust may be used to take advantage of the GST estate tax exemption.

14. The trust may be used to provide that the trust remaindermen are the lineal descendants of the grantor of the trust.

15. Roth IRA trusts can avoid significant fiduciary income tax issues.

16. If a Roth IRA trust is desired, then supply the drafting attorney of the Roth IRA trust with a copy of IRS Form(s) 8606 to indicate when your traditional IRA was converted to a Roth IRA. If IRS Form(s) 8606 cannot be found, then other documentary evidence regarding your Roth IRA conversion history should be obtained and given to the attorney.

DISADVANTAGES OF TRUSTS AS IRA BENEFICIARY

Disadvantages of the trust as a beneficiary:

1. The practitioner may not be familiar with the IRS rules involving IRA trusts.

2. The practitioner may not be familiar with the post-death IRS compliance rules that apply to IRA trusts.

3. The practitioner may not be aware of how to integrate the state trust laws under the Uniform Principal and Income Act with the IRS rules that involve an IRA trust.

4. The practitioner may use a boilerplate IRA trust document that is inconsistent with the IRS rules.

5. The practitioner may not be aware of the mechanics of titling an inherited IRA that is payable to a trust after the death of the IRA owner.

Statute of Limitation Issues Involving IRA Penalties

According to a 2011 Tax Court opinion in Paschall v. Commissioner, the IRS may be able to assess penalties involving IRA issues including excess contributions to IRA accounts at any time. This could happen, for example, if the taxpayer violates certain IRA distribution rules including excess contributions to IRA accounts without filing a Form 5329 to alert the IRS regarding the issue.

In the Paschall case, the taxpayer made excess contributions to his Roth IRA for a number of years that would otherwise have been barred for income tax purposes by the three-year statute of limitations. However, the taxpayer failed to file IRS Form 5329 for each year that he filed his Form 1040.

According to the Tax Court opinion, if the taxpayer fails to file Form 5329 with the IRS, then in the absence of adequate disclosure of the facts to establish the liability, the IRS can assess taxes under IRC Section 4973 for excess contributions made to an IRA at any time. In addition, the taxpayer was held liable for additions to tax under Section 6651(a)(1) because of his failure to timely file Form 5329.

According to the Tax Court opinion, if Form 5329 is not filed by the taxpayer, then the IRS is not in essence given sufficient notice than a penalty issue involving an excess contribution made to an IRA may be applicable.

In Frick v. Commissioner, T.C. Memo. 1989-86, the Tax Court opinion stated, in part, that "taxpayers who have made excess contributions to an IRA are liable for an excise tax prescribed by section 4973, and are required to file Form 5329 each year that they have excess contributions."

In the Frick case, the Tax Court concluded, in part that Frick failed to timely file the excise tax returns that he was required by law to file. In addition, based on the facts in the Frick case, the Tax Court held that he was liable for the addition to tax (under Section 6651[a][1]) for failure to file Form 5329.

These Tax Court opinions are significant because the following IRA penalties must be disclosed on IRS Form 5329 as well:

- Additional tax on early distributions
- Additional tax on excess contributions to traditional IRAs
- Additional tax on excess contributions to Roth IRAs
- Additional tax on excess accumulation in qualified retirement plans (including IRAs)
- According to the instructions on Form 5329, the taxpayer may request a waiver of the excess accumulation tax by following the procedures discussed in the instructions to Form 5329

Addition to the Tax:

IRC Section 6651(a)(1) states that there is an addition to tax in case of a failure to file a timely return (considering any extension period) unless it is shown (to the IRS) that such failure is due to reasonable cause and it is shown (to the IRS) that such failure is due to reasonable cause and not due to willful neglect. According to the IRC, the addition to tax is 5 percent of the amount of the tax required to be shown on the return if the failure is for not more than one month, with an additional

5 percent for each additional month (or fraction of a month) that the failure to file continues, up to 25 percent of the amount of tax that is required to be shown on the return.

Author's note:

The Paschall case is more important than one would think. Although many taxpayers, according to the IRS, have made excess contributions to IRA accounts, many taxpayers have violated the required minimum distribution rules as well.

If a taxpayer violates the required minimum distribution rules and fails to file Form 5329, then the taxpayer is at risk with respect to a retroactive IRC §4974 additional tax. This penalty is a 50 percent additional tax on the amount of the shortfall of a required minimum distribution amount.

Based on the Paschall opinion, there is no statute of limitations that is applicable if the taxpayer fails to file Form 5329 reflecting the additional tax item under IRC §4974. This item is currently shown on Part IX of Form 5329.

The IRS is aware of the fact that many taxpayers have violated the required minimum distribution rules. These rules apply to retirement plans, traditional IRAs, inherited traditional IRAs, and inherited Roth IRAs.

Although most IRA penalties are generally statutory, the penalty of the 50 percent additional tax under IRC §4974 is subject to a waiver. According to IRC §4974(d), the IRS has the authority to waive this additional tax if the shortfall was due to a reasonable error and reasonable steps are being taken to remedy the shortfall.

IRS Form 5329 provides for a waiver of the 50 percent additional tax. The instructions to IRS Form 5329 explain how a taxpayer applies for a waiver.

Obviously tax preparers will have a lot of paperwork to do if the tax preparer determines that the client has a violation of the excess contribution rules and/or a violation of the required minimum distribution rules.

In the event that the tax preparer becomes aware of a tax violation, he/she must advise the client about the issue according to Circular 230. Circular 230 involves the IRS regulations governing practice before the Internal Revenue Service. Pursuant to Circular 230, section 10.21, "Knowledge of Client's Omissions," the practitioner who "knows that the client has not complied with the revenue laws of the United States or has made an error in or an omission from any return . . . must advise the client promptly of the fact of such noncompliance, error or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error or omission."

Based on the Paschall opinion, the taxpayer who has an IRA violation should take prompt action and file the Form 5329 and resolve the IRA penalty issue.

The tax preparer should caution the client about the statute of limitations issue and recommend that the client confront the IRA penalty issue. In the event that the client does not take any action, then the tax preparer should consider resigning from the engagement. A tax preparer who does not resign risks problems with the IRS at a later date.

In the event that the taxpayer dies, then his/her legal representative who is aware of the IRA penalty issue should take prompt action and resolve any IRA penalty issue before distributing the assets from the decedent’s estate to the estate beneficiaries.

If the legal representative of the estate is aware of the IRA penalty issue and distributes the assets of the estate rendering the estate insolvent, then the legal representative can be held personally liable if the IRS pursues the IRA penalty issue against the estate, the legal representative of the estate, and/or the beneficiaries of the estate.

Internal Revenue Manual (IRM)
Discusses the Statute of Limitations
for Form 5329

IRM 4.71.27.10 (11-07-2017)

Statute of Limitations for Forms 5329 provides as follows:

1. The statute of limitations (SOL) for assessment of taxes expires the later of, three years from the due date of the Form 5329 return or the date the return is filed.

    a. If a Form 5329 is not filed, there is no SOL date.

    b. A return is deemed filed on its due date if filed on or before its due date.

2. The statutory period for assessment of tax is six years from the date the return is filed when a determination is made that there has been an omission of more than 25% of the tax due. See IRC 6501(c)(3).

IRM 4.71.27.2 (11-07-2017)

Form 5329 Due Dates

1. Form 5329 is due at the same time the taxpayer's Form 1040 is due, including extensions.

2. If the taxpayer did not have an extension to file his/her Form 1040 or the taxpayer is not required to file a Form 1040 for that year, the due date would be April 15th of the year following the year in which the tax is attributable.

Practitioners must become aware of the tax-free IRA rollover rules that are applicable as of January 1, 2015. This is necessary in order for practitioners to protect their clients from major tax problems and penalties if clients violate the new IRA rollover rules that start in 2015.

The following is a brief analysis of the old rules:

(1) The IRS in Publication 590 for many years indicated that if you multiple IRAs, that it was permissible to do multiple IRA rollovers if you followed the rules set out in IRS Publication 590.

(2) The old rules as described in IRS Publication 590 stated the following:

> Waiting period between rollovers. Generally, if you make a tax-free rollover of any part of a distribution from a traditional IRA, you cannot, within a 1-year period, make a tax-free rollover of any later distribution from that same IRA. You also cannot make a tax-free rollover of any amount distributed, within the same 1-year period, from the IRA into which you made the tax-free rollover. The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA.
>
> Example. You have two traditional IRAs, IRA-1 and IRA-2. You make a tax-free rollover of a distribution from IRA-1 into a new traditional IRA (IRA-3). You cannot, within one year of the distribution from IRA-1, make a tax-free rollover of any distribution from either IRA-1 or IRA-3 into another traditional IRA.
>
> However, the rollover from IRA-1 into IRA-3 does not prevent you form making a tax-free rollover from IRA-2 into any other traditional IRA.
> This is because you have not, within the last year, rolled over tax-free, any distribution from IRA-2 or made a tax-free rollover into IRA-2.

Based on IRS Publication 590, taxpayers could have multiple IRA rollovers during a 1-year period since the 1-year limitation rule was applied on an IRA by IRA basis. In essence, each IRA maintained by an IRA owner would have a separate 1-year period as described above. The old rules were widely known by practitioners, financial institutions and consumers. The old rules could be used as an income tax planning technique in order to provide a tax-free and penalty free loan to a taxpayer if the taxpayer had a number of separate IRAs.

(3) The new rules

The old rules were used by many until the Tax Court spoke in <u>Bobrow v. Commissioner</u> in 2014. In the <u>Bobrow</u> case the Tax Court held that one-year limitation rule under Internal Revenue Code Section 408(d)(3)(B) applied on an aggregate basis and not on an IRA by IRA basis.

The IRS in Publication 590-A explains how the IRA rollover rues will work starting in 2015 and states as follows:

> **Application of one-rollover-per-year limitation**. Beginning in 2015, you can make only one rollover from an IRA to another (or the same) IRA in any 1-year period regardless of the number of IRAs you own. The limit will apply by aggregating all of an individual's IRAs, including SEP and SIMPLE IRAs as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of the limit. However, trustee-trustee transfers between IRAs are not limited and rollovers from traditional IRAs to Roth IRAs (conversions) are not limited.
>
> **Example.** John has three traditional IRAs; IRA-1, IRA-2, and IRA-3. *** On January 1, 2015, John took a distribution from IRA-1 and rolled it over into IRA-2 on the same day. For 2015, John cannot roll over any other 2015 IRA distribution, including a rollover distribution involving IRA-3. This would not apply to a conversion.

The IRS has issued two announcements involved the application of the one-rollover-per-year limitation in IRA rollovers.

These announcements are Announcement 2014-15 and 2014-32.

The IRS decided that it was best to have the new rules for administrative purposes become effective as of January 1, 2015 and not applied on a retroactive basis.

IRS Announcement 2014-32 was fairly comprehensive and made the following points:

1. Amounts received from an IRA will not be included in the gross income of a distributee to the extent that the amount is paid into an IRA for the benefit of the distributee under the 60-day rollover rule.

   <u>Author's note:</u>

   Publication 590-B indicates that certain distributions are not eligible for rollover.

   For example, amounts that must be distributed (required minimum distributions) during a particular year are not eligible for rollover treatment.

2. The Internal Revenue Code at Section 408(d)(3)(B) is the key section involved under the one- rollover-per-year limit on IRA rollovers.

3. The IRS announcement stated that an individual receiving an IRA distribution on or after January 1, 2015 cannot roll over any portion of the distribution into an IRA if the individual has received a distribution from any IRA in the preceding 1-year period that was rolled over into an IRA, but subject to transitional rules for certain prior transactions.

4. The IRS in Publication 590 and the IRS proposed regulations had previously provided

that the IRA rollover rules were based on an IRA by IRA basis. However, the Tax Court in Bobrow v. Commissioner, a 2014 opinion held that the one-rollover-per-year limit applied on an aggregate basis and not on an IRA by IRA basis.

5. The IRS will apply the Bobrow interpretation of the law under Section 408(d)(3)(B) for distributions occurring on or after January 1, 2015.

6. A rollover from a traditional IRA to a Roth IRA (a conversion) is exempt from the one-rollover- per-year rule. It is not considered in applying the one-rollover-per-year rule to other rollovers.

7. A rollover from a Roth IRA to any Roth IRA [including the same Roth IRA] would preclude any other Roth IRA rollovers to any Roth IRA under the 1-year rule. It would also preclude any rollovers from one traditional IRA to a traditional IRA [including the same traditional IRA] under the 1-year rule.

8. A rollover from a traditional IRA to any traditional IRA [including the same traditional IRA] would preclude any other traditional IRA rollovers under the 1-year rule. It would also preclude any rollover from any Roth IRA to a Roth IRA [including the same Roth IRA] under the 1-year rule.

9. According to the IRA for purposes of Announcement 2014-32 the term "traditional IRA" includes a simplified employee pension under IRC Section 408(k) and a Simple IRA under IRC Section 408(p).

10. The IRS indicated that the one-rollover-per-year limitation does not apply to a rollover to an IRA from a qualified plan. In addition, the IRS also indicated that the one-rollover-per-year limitation does not apply to a rollover to a qualified plan from an IRA.

11. The one-rollover-per-year limitation rule does not apply to trustee-to-trustee transfers.

A violation of the one-rollover-per-year-limit on IRA rollover will lead to headaches. Not only may the violation of the rollover limitation rule trigger taxable events (income taxes and possible accuracy penalties and early distribution penalties) but it may in many instances be treated as an excess contribution that was made to the receiving IRA as well. An excess contribution to an IRA is subject to a 6 percent penalty tax that is ongoing on the excess amount that it remains in the IRA at the end of each year. A special correction rule, however, applies to the first year that an excess contribution is made.

The IRS issued information release IR-2014-107 on November 10, 2014. The release states in part the following:

> Although an eligible IRA distribution received on or after January 1, 2015 and properly rolled over to another IRA will still get tax-free treatment, subsequent distributions from any of the individual's IRAs (including traditional and Roth IRAs) received within one year after that distribution will not get tax-free rollover treatment.

According to IRC Section 408(d)(3)(B) the tax-free rollover rules do not apply to any amount . . . received by an individual from an individual retirement account or individual retirement annuity if at any time during the 1-year period ending on the day of such receipt such individual received any other amount . . . from an individual retirement account or an individual retirement annuity which was not includible in gross income. . .

<u>Spousal IRA Rollovers and the One-Per-Year-Limit on IRA Rollovers</u>

Based on the above legal analysis, spousal IRA rollovers would fall with the one-per-year limit on IRA rollovers. The Tax Court opinion and the law clearly indicates that any amount received by an individual from an individual retirement account or individual retirement annuity [regarding tax-free rollovers] is subject to the one-per-year limit on IRA rollovers.

Obviously, the law does not distinguish between a spousal rollover from a decedent's IRA and a rollover from the spouse's own IRA. The law is inclusive and covers any IRA distribution received by an individual under the one-per-year limit on IRA rollovers.

One cannot argue that a spouse is not an individual with respect to a spousal IRA rollover. Further, it cannot be successfully argued that upon the death of an IRA owner survived by a spouse beneficiary that the spouse is not the legal owner of the decedent's IRA as a matter of law.

Of course, the spouse beneficiary of the decedent's IRA is the legal owner of the decedent's IRA as of the date of death of deceased IRA owner. The surviving spouse is the beneficiary of a non-probate asset and as such owns the deceased IRA owner's account.

This legal position is consistent with Revenue Procedure 89-52 in which the IRS clearly indicates in the context of an inherited IRA that is payable to nonspouse beneficiaries, that each beneficiary will own a fifty percent share of the IRA.

Once an IRA owner dies survived by a spouse beneficiary, then the deceased IRA owner's account is maintained for the benefit of the surviving spouse within the purview of Section 408(d)(3) of the Internal Revenue Code. If this were not the case, the spousal rollover of IRA would not be valid under the Internal Revenue Code. As previously discussed on the death of IRA owner survived by a surviving spouse, the owner of the deceased IRA owner's account is then the surviving spouse. At that time, the deceased IRA owner's account is then maintained for the surviving spouse and should be subject to the one-per-year limit on IRA rollovers.

Based on the above analysis, the following are examples of issues that a surviving spouse should be aware of:

Comprehensive example

John is an IRA owner who dies at age 68 on May 1, 2020 survived by his spouse Mary. His spouse Mary is age 65 in 2020 and has her own IRA. She is also the beneficiary of John's IRA.

Assume that Mary receives an IRA distribution of $100,000 from her own IRA on February 1, 2020 and rolls it over to another IRA in her name on March 1, 2020.

In addition, on June 15, 2020 she receives a distribution from John's deceased IRA of $200,000 and rolls it over to her own IRA on July 1, 2020

Question 1: Has Mary violated the one-per-year limit on IRA rollovers?

Answer: Yes. Since Mary received a distribution of $200,000 from John's deceased IRA account on June 15, 2020, she is in violation of one-per-year limit on IRA rollovers.

The reason is that under the one-per-year limit in IRA rollovers, Mary could not rollover tax-free any IRA distribution she receives during the one-year measuring period rule under the Internal Revenue Code. Since Mary received IRA distribution from her own IRA on February 1, 2020, then under the aggregation rule, she would have to wait until at least February 1, 2021 in order to take another IRA distribution which would be eligible for tax-free rollover treatment.

Question 2: Assume the facts in Question 1. What are the tax consequences that are triggered as a result of the $200,000 rollover by Mary on July 1, 2020?

Answer: According to the IRS and the law, Mary would have to report the $200,000 amount in income for the calendar year 2020. In addition, she is subject to an excess contribution tax penalty of 6% unless corrected in the manner required by the IRS.

Question 3: How can the taxable event described in the answer to question 2 be avoided?

Answer: Mary should arrange for John's deceased IRA to be directly transferred from John's deceased IRA account to Mary's IRA.

Although the Bobrow case covers traditional IRAs, the language in Bobrow and in the Internal Revenue Code is broad enough to include all IRAs, including a decedent's IRA that is payable to a surviving spouse.

Common Errors In Retirement Distribution Planning

In general the following common errors often take place when dealing with the retirement distribution rules from an estate planning point of view:

- Failure to timely update and/or review your existing beneficiary forms on file with the IRA institution and the employer sponsored retirement plan.

- Failure to periodically review your existing legal instruments to determine whether the retirement assets are charged with an allocable portion of the estate tax upon your death or are exonerated from the estate tax liability allocable to the retirement assets. If exonerated, then make sure that there are sufficient other assets to pay the estate tax allocable to the retirement assets.

- Exonerating the retirement assets from any estate tax liability will permit more tax deferred growth of the retirement assets and tax-free growth of Roth IRAs. However, this exoneration approach is at the expense of other beneficiaries of the estate.

- Failure to do an estimated estate tax liquidity analysis to determine the extent of your estate tax liability and the source of payment of the estate tax liability.

- Failure of your beneficiaries to know how the inherited IRA distribution rules work after your death.

- Failure of your surviving spouse to know about the spousal rollover rules or direct transfer rules after your death.

- Failure of your surviving spouse to timely implement the spousal rollover rules or direct transfer rules after your death.

- Failure to know that an unpaid required minimum distribution must be paid for the year of death of the plan participant or IRA owner.

- Failure to know that Roth IRAs are subject to post-death required minimum distribution rules.

- Failure to know that retirement distribution post-death payments paid to a beneficiary are generally not subject to the IRS 10 percent early distribution penalty.

- Failure to know that unpaid inherited IRAs are generally included in the gross estate of the beneficiary for estate tax purposes when the beneficiary subsequently dies.

- Failure to know that an IRA beneficiary may timely disclaim an inherited IRA.

- Failure to know that a minor should not generally be directly designated as the beneficiary of a retirement account.

- Failure to use the Uniform Transfers to Minors Act in a manner permitted under state law as the beneficiary of an IRA.

- Failure to have a Power of Attorney that provides for the retirement distribution transactions including rollovers and beneficiary designations.

- Failure of your beneficiaries to know about the separate account rule if there are multiple beneficiaries of your retirement accounts.

- Failure to know that a rollover from a previously tax qualified plan that has not been timely updated is not valid and subject to significant IRS penalties.

- Failure to know that a specifically designed trust may be the beneficiary of retirement assets provided that the IRS rules are satisfied.

- Failure to know that IRS penalties apply to beneficiaries of inherited IRAs when post-death required minimum distributions are not timely made.

- Failure to maintain paperwork on the inherited payout period for the beneficiaries.

- Failure to know that the federal estate tax attributable to retirement accounts may be deducted by the beneficiaries on a pro rata basis.

- Failure to know how the IRA trust works when the beneficiary of an IRA is a trust.

- Failure to know that certain IRS trust documentation requirements must be satisfied with the IRA financial institution by no later than October 31st of the year following the IRA owner's death.

- Failure to know that the Pension Protection Act of 2006 permits a nonspouse beneficiary of an eligible retirement plan to establish an inherited IRA. Certain trusts may qualify for this relief as well. These provisions apply to nonspouse beneficiaries with respect to amounts payable from a qualified retirement plan, governmental section 457 plan, and a 403(b) tax sheltered annuity. If the paperwork is done correctly and spousal consent, if applicable, is obtained, then a trust can be the beneficiary of a participant's death benefit from an eligible retirement plan.

  According to the IRS the provision was optional under the 2006 Act and not mandatory. However, under the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) this provision is mandatory for plan years commencing after December 31, 2009.

- Failure to know about the One-Per-Year Limit on IRA Rollovers. See IRS Announcement 2014-32.

- Failure to know that the surviving spouse may not rollover a required minimum distribution attributable to the decreased (spouse) IRA owner.

- Failure to know that Roth IRA conversions can no longer be recharacterized under the Tax Cuts and Jobs Act.

- Failure to file IRS Form 5329 with the IRS when there is a client who has not taken required minimum distributions.

- Failure to be aware of statute of limitations issues if IRS Form 5329 is not filed for the client who has not taken required minimum distributions.

- Failure to be aware of the personal liability of the fiduciary for debts to the U.S. Government on death of IRA owner or death of IRA beneficiary if unpaid required minimum distributions were not taken by IRA owner or the beneficiary of the inherited IRA as the case may be.

Why Many Beneficiary Forms Are Defective

The author became aware of the fact that many IRA beneficiary forms were incomplete or defective in 1990. It was at a time that a CPA asked me to review an IRA beneficiary form of a major financial institution for his client. The form provided that each child would receive 50% of the client's IRA account. I then looked to see what provisions were made in the IRA beneficiary form if the child predeceased the IRA owner to make sure that the child's issue would receive the predeceased child's share. I was shocked to discover that the IRA beneficiary form provided that the surviving child would receive 100% of the IRA proceeds and that the issue of the predeceased child would be cut out. Flash forward, the author has corrected many canned IRA beneficiary forms to date to avoid this problem.

During the last ten years or so many IRA institutions have upgraded their IRA beneficiary forms so that the issue of a predeceased child, if any, will receive the share allocated to the predeceased child. That's the good news. The bad news is that there may be many IRA beneficiary forms that were executed by the IRA owner before the revised forms came out. That means that unless the IRA owner is alert, he/she may have the old forms on file with the IRA institution.

How could many IRA owners make such a mistake? It's easy and here are some of the reasons:

1. Taxpayers often think that the IRA assets are disposed of by their will. That's not true for the most part since an IRA is a nonprobate asset and is not governed by a will. The beneficiary designation determines who is entitled to the IRA proceeds upon the death of the IRA owner, not the will. The exception is when there is no beneficiary designation on file with the IRA institution or the IRA owner for whatever reason selected his/her estate as the beneficiary of his/her IRA. In that case the IRA proceeds will generally be governed by the will provisions unless the IRA plan document provides for default beneficiaries. If the IRA is payable to the deceased IRA owner's estate, then the benefits of the long-term stretch IRA payments are generally lost.

2. It is possible that a number of IRA institutions may need to upgrade their beneficiary forms to provide for the predeceased child situation previously discussed.

3. A number of IRA institutions have sophisticated beneficiary forms that are excellent. The problem there is that they are so sophisticated that they are difficult for the average person to follow.

4. Many taxpayers are intimidated by IRA beneficiary forms and they tend not to read the fine print that is boilerplate. In essence the canned language in your IRA beneficiary form acts as a will for your IRA assets.