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Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter - Archive Message #770

Date:	**18-Oct-21**
From:	**Steve Leimberg's Employee Benefits and Retirement Planning Newsletter**
Subject:	**James M. Kane: A Novel SECURE Design for a Tax-Deferred Retirement Accounts Conduit Trust**

"This newsletter addresses a novel written irrevocable trust planning option under the current SECURE Act (effective beginning December 20, 2019). The SECURE Act eliminated the prior-law longer pay-out stretch option and, in general terms, allows only a 10-year payout period for non-spouse beneficiaries who inherit a retirement account from a deceased primary owner. There are some other limited exceptions that allow a longer payout than this 10-year period that I do not address for purposes of this newsletter."

James Kane provides members with commentary that examines a retirement account trust design for both Roth and non-Roth IRA accounts.

Attorney James M. Kane, with the Atlanta law firm **KaneTreadwell Law LLC** [www.ktlawllc.com), is primarily a tax and trust controversies/litigation lawyer. Prior to law school James was a Revenue Agent with the IRS's large-case examination division in Atlanta, This combined tax, trust, and litigation experience gives James a broad perspective for identifying, understanding, and addressing complex trust issues and disputes along with the resulting tax and non-tax factors that ideally must together be taken into account. James also assists other lawyers as both a consulting and expert witness in both tax and non-tax litigation matters where trusts are at the center of the dispute, and handles trust, estate, asset protection, and prenuptial (postnuptial) planning, with his planning work influenced heavily by the various hurdles James sees in the controversy / litigation arena. James is licensed in Georgia, North Carolina, and New York. He has 20+ years' experience previously with Atlanta law firms Sutherland, Asbill & Brennan and Chamberlain, Hrdlicka, White, Williams & Aughtry. James attended Emory University Law School and has undergraduate finance (University of Georgia) and graduate business (Georgia State University) degrees. Although he never worked as a CPA, James held a CPA certificate during his time with the IRS. James was the winner of the 2016 Heckerling Tax Court Brief writing contest. James' outside interests include studying jazz guitar. Google also: James Kane Legal Blog

Here is his commentary:

EXECUTIVE SUMMARY:

This newsletter addresses a novel written irrevocable trust planning option under the current SECURE Act (effective beginning December 20, 2019). The SECURE Act eliminated the prior-law longer pay-out stretch option and, in general terms, allows only a 10-year payout period for non-spouse beneficiaries who inherit a retirement account from a deceased primary owner. There are some other limited exceptions that allow a longer payout than this 10-year period that I do not address for purposes of this newsletter.

COMMENT:

This planning centers on both Roth *and* non-Roth income tax-deferred retirement accounts, such as, but not limited to, corporate or self-employed ("Keogh") pension, profit-sharing, defined-benefit, and stock bonus plans, SEPs, 403(b) plans, IRA and Roth IRA plans, 401(k) and Roth 401(k) plans, 457 plans. This trust design can work collectively for both Roth and non-Roth accounts.

> An Example: You have decent sized non-Roth and Roth IRAs. You presently have four children, all different ages. The SECURE Act tax-law limitations generally now eliminate — after your death — the longer life-expectancy payout periods for beneficiaries for these retirement accounts; now limited in most cases to a 10-year maximum payout period. What is an effective planning option for your retirement accounts in this situation? For purposes of this blog post, I use both a Roth IRA and non-Roth IRA as examples.

For both these Roth and non-Roth IRA accounts, I recently designed a written tax-deferred retirement accounts trust that is a good SECURE option. NOTE: this newsletter is not a primer with fundamentals on how to set-up and use a trust for retirement accounts. It merely highlights key points to consider for this recent new trust design.

The essence of this retirement account trust design is that:

(1) The trust agreement is a sprinkle trust that allows the trustee to make trust beneficiary distributions of periodic retirement account withdrawals to and among the named class of beneficiaries, depending on their needs, own marginal income tax rates, etc., in equal, unequal, or in no amount as to the class members;

(2) This is a key design point: The trust agreement must be drafted purposely so as to avoid each trust beneficiary from having substantially separate and independent trust shares. The reason is to enable trust distributions to carry out DNI *only* to those beneficiaries who, in a given year, actually receive distributions from the trust. Otherwise, for example, separate and independent shares can result in one beneficiary ending up with a trust distribution in excess of the trust's total DNI, causing the trust to be taxed on such income at the trust's substantially higher compressed marginal income tax rates. By contrast, the goal is for the trustee to sprinkle distributions from the trust to and among the class of trust beneficiaries depending on their needs, their own marginal income tax rates, etc.
As a relevant aside, creating separate and independent trust shares for retirement accounts trusts — now and prior to SECURE — requires that the retirement account beneficiary designation itself refer to separate trusts; e.g., 1/3 of my IRA at my death is payable to the Jane Doe Trust; 1/3 to the Susan Doe Trust; and 1/3 to the Sam Doe Trust, etc. My point here is that it is not easy under my proposed SECURE trust planning simply to fall inadvertently into an independent and separate share regime for this kind of retirement trust planning (see, e.g., IRS Private Letter Ruling 200317041). But, nonetheless, one optimally needs to understand these concepts in order to avoid a separate trust share situation for this SECURE trust design.

(3) In broad terms this SECURE retirement trust will be named as *the retirement account beneficiary; and treated as a* pass-through "conduit" trust. This means, again generally, that any periodic

retirement account withdrawal the trustee obtains from a retirement account must — within that same taxable year — be sprinkled on out from the trust to and among *one or more* of the trust beneficiaries;
(4) One important point ideally is that this trust should not be used to accumulate withdrawals from non-Roth retirement accounts. Otherwise, a trust's withdrawal from a non-Roth retirement account, if the trust thereafter holds and accumulates that withdrawal within the trust itself without distribution to a trust beneficiary, will cause the trust to be liable for income tax on that withdrawn amount at the trust's own substantially higher, compressed income tax rates; than if taxed to a trust beneficiary at his or her lower marginal income tax rates.

As to the above income tax, generally a trust's receipt of income is not taxable to the trust itself in situations where (under the tax law) that trust income is shifted out to a trust beneficiary by a distribution of that trust income as a trust distribution out to a recipient beneficiary. For 2021, a trust that pays its own income tax (when the trust itself holds undistributed taxable income) hits the top 37% marginal income tax rate beginning at $13,050 of trust taxable income; for a single individual, this 37% marginal rate kicks in when that individual's taxable income is more than $523,600.

(5) But, contrary to the preceding point, note the following Roth account exception is important for this SECURE trust design: As stated above, the trust is a "conduit" trust for non-Roth tax-deferred retirement accounts. However, the trust also includes an express exception clause that allows the trustee to accumulate (thus disregard the conduit mandate) for any Roth account distributions the trustee receives. The trustee can accumulate and invest these Roth distributions for later distribution to the trust beneficiaries, well outside the 10-year SECURE distribution period;

(6) Back to broader comments. This SECURE trust design must still meet the requirement that all beneficiaries are qualified beneficiaries so as to avoid application of the five (5) year payout no-beneficiary distribution rule, rather than the 10-year rule;

(7) As to any mandated conduit distributions from the trustee to the beneficiaries, this trust design provides additional flexibility for the trustee to deal with minor-age or disabled trust beneficiaries, etc., using the following (or similar) trust provision:

> The Trustee may (without court approval) make distributions of any portion of a distribution required or permitted to be made to any person under this trust agreement in any of the following ways: (i) to the person directly; (ii) by distribution in further trust in the manner provided under section 20.1; (iii) to the guardian of the person or the person's property; (iv) as to such distribution by selecting and designating an individual or financial institution to serve as Custodian for such minor beneficiary under the Uniform Transfers/Gifts to Minors Act of any state; or (v) by reimbursing the individual who is actually taking care of such person (even though the individual is not the legal guardian) for expenditures made by the individual for the benefit of such person. Written receipts from the persons receiving such distributions (other than if held in continuing trust under section 20.1) shall fully and completely discharge the Trustee from any further responsibility for such expenditures. The Trustee shall not exercise any power under this section 17.7 in a manner that would cause any trust holding S corporation stock not to qualify as a permitted shareholder of that stock for federal income tax purposes.; and

(8) Finally, under the SECURE Act's 10-year distribution mandate, the trustee has the option to make *no withdrawals* from the retirement accounts until late in the 10th-year so as to let those accounts continue to be invested income-tax deferred within the retirement accounts until later withdrawn. In essence, this substantively allows for an accumulation of tax-deferred value continuing within the retirement accounts during the 10-year period, although this SECURE trust is ostensibly a conduit trust during that same 10-year period.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

James M. Kane

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