PRESENTED AT

THE UNIVERSITY OF TEXAS SCHOOL OF LAW

23RD ANNUAL ESTATE PLANNING, GUARDIANSHIP AND ELDER LAW CONFERENCE

AUGUST 5-6, 2021

ESTATE PLANNING FOR RETIREMENT PLANS IN VIEW OF THE SECURE ACT

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TABLE OF CONTENTS

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I. INTRODUCTION

A. Background: Pre-SECURE Act Law Applicable to Retirement Plans

1. History of ERISA and Code Section 401(a)(9)

The following is an excerpt from the author's article, *The Killing of Community Property*, which was published by Texas Tech Law School's *Estate Planning and Community Property Law Journal* in Volume 11, Fall 2018. All footnotes from the following excerpt have been omitted from this outline:

"Private pensions developed primarily after World War II. Few rules governed the administration of pension plans until the passage of ERISA in 1974. Pension plan abuses, such as mismanagement and theft—of which there were many "high profile cases" during the 1950s and 1960s, and other problems (e.g., bankruptcy of the employer)—primarily influenced the passage of ERISA.

"ERISA was passed primarily as a labor law. ERISA is administered by both the Department of Labor (DOL) and the Treasury Department. Although two separate federal agencies co-administer ERISA, and although ERISA provisions appear in both the Labor Code and the Internal Revenue Code, according to one commentator, "the tax aspects [of ERISA] were secondary."

"ERISA focuses on protecting employees, pension plans, and other retirement plans so that qualified plan Participants can be assured of having income during retirement. When ERISA was passed, its primary goals were stated to be the following: (1) to achieve national uniformity in the administration of qualified plans, (2) to reduce the administrative burden on plan administrators, and (3) to insure the payment of retirement benefits for retirees and their "beneficiaries."

"Because of the chaos in the administration of employee benefit plans prior to the passage of ERISA, Congress wanted to provide "uniform rules" at a national level applicable to all qualified plans. In addition, to protect Participants and retirement plans, the duties imposed on administrators of qualified employee benefit plans greatly increased. Thus, the first two stated goals of ERISA were designed (i) to provide clear rules for the administration of qualified plans and (ii) to make it easier for plan administrators to follow the rules. Further, those two goals were designed to eliminate situations in which plan administrators were at risk of paying out benefits twice due to competing claims. The first two goals of ERISA are primarily administrative goals. Consistent with those goals, a significant portion of ERISA is devoted to administrative matters, such as reporting, record keeping, and disclosure.

"The third stated goal of ERISA concerns two sub-goals: (i) making sure retired Participants receive the qualified plan benefits they were promised or earned, so that they will have income during retirement, and (ii) making sure that the beneficiaries of those Participants receive the benefits to which they are entitled as promptly as possible after the Participant's death. The first of those two sub-goals directly responded to pre-ERISA abuses in the management of pension plans. For example, ERISA includes specific participation, vesting, and benefit accrual provisions. It also includes insurance provisions in the case of terminated plans. The first sub-goal of the third stated goal of ERISA correlates highly with the legislative history of and reasons for passing ERISA: to provide income to retired workers (and their spouses) during their retirement years.

"Turning to the second sub-goal of the third stated goal of ERISA, while it is important to insure the prompt payment of qualified plan benefits to beneficiaries of Participants who die, this is more incidental to the original purpose of ERISA—to protect Participants themselves by also protecting the Participants' plans, and to insure Participants have income during retirement." Gerstner, *The Killing of Community Property*, Id at 36-38.

Natalie Choate states the following in her book, *Life and Death Planning for Retirement Plans* 25 (6th Ed. 2006)*:*

> "Congress wants tax-favored retirement plans to be *retirement plans*, not estate-building wealth transfer vehicles. To that end, Congress enacted § 401(a)(9) [of the Internal Revenue Code], which compels certain annual 'minimum required distributions' (RMDs) from plans beginning generally at age 70 ½ or, if earlier, death. § 401(a)(9) and its related regulations are called the 'minimum distribution rules.'"

Interestingly, Natalie also wrote this in the forward to the Sixth Edition of her book, in a "proposed letter" to her Congressman:

> "Congress should abolish the 'life expectancy payout' for distributions of inherited retirement benefits, replacing it with a flat 10- or 20-year payout that would apply to all plans and beneficiaries." Id at 19.

2. The Treasury Regulations

Section 401(a)(9) of the Code (the "minimum distribution rules") did not provide sufficient detail in regard to numerous distribution issues relating to retirement plans. Thus, on July 27, 1987, thirteen years after ERISA and Section 401(a)(9) became law, the first set of proposed regulations interpreting Section 401(a)(9) were published. Those proposed regulations were subsequently modified in December 1997 and again in January 2001. The "final" regulations released in April 2002 further modified the minimum distribution rules, providing much needed simplification and clarification of some issues, but also leaving many questions still unanswered. Some of the post-April 2002 questions have been "answered" by subsequent laws, such as the Tax Equity and Fiscal Responsibility Act of 1982 [TEFRA] (P.L. 97-248), the Deficit Reduction Act of 1984 [DEFRA] (P.L. 98-369), and the Pension Protection Act of 2006 [PPA] (P.L. 109-280). However, many interpretive issues relating to distributions from retirement plans that have arisen subsequent to April 2002 have been addressed in private letter rulings, which cannot be cited as precedent by anyone except the taxpayer who obtained the particular ruling, but which, taken together, help to shed light on the Internal Revenue Service's interpretation of the minimum distribution rules.

3. Terms Used in this Outline

Code (or "IRC"): References to the "Code" or "IRC" mean the Internal Revenue Code of 1986, as amended.

Minimum Distribution Rules (or, "MRD Rules"): The minimum distribution rules or the MRD Rules include primarily Section 401(a)(9) of the Code and applicable Treasury Regulations.

Participant: This term will be used to refer to the employee or retiree who participates in a qualified employee benefit plan or in a governmental or tax exempt employee plan subject to the MRD Rules and also to the named owner of an IRA (of any type).

Retirement Plan: Unless otherwise specifically noted, the term retirement plan will include qualified employee benefit plans that constitute "defined contribution plans," IRAs (of all types), 403(b) annuities, and governmental and tax exempt employee benefit plans subject to the MRD Rules. The MRD Rules specifically apply to the foregoing retirement plans: *See* IRC §§ 401(a)(9), 403(b)(10), 408(a)(6), and 457(d)(2).

Inherited Retirement Plan: Although, in the vast majority of cases, what a beneficiary receives on the Participant's death is an "inherited IRA," the term inherited retirement plan will refer to both an inherited IRA and an inherited employee benefit plan.

RMD and RMD: Both terms refer to the same thing: the minimum required distribution or the required distribution (i.e., the minimum amount that must be distributed from a retirement plan or inherited retirement plan in a particular year). The Code uses the term "MRD," but in over 400 IRS rulings, the IRS uses the term "RMD." In addition, most practitioners use the term "RMD." So, except when referring to the "MRD Rules," this outline will use the term "RMD."

5 year rule and 10 year rule: Although the Code and Regulations both refer to the "5-year rule," in this outline, both the 5 year rule and the 10 year rule will be expressed without a hyphen.

NOTE: To simplify understanding of the concepts discussed in this outline, it will be assumed that the Participant is male and gender references will be made accordingly. Additionally, it is beyond the scope of this outline to discuss special needs trusts or discretionary trust language that would protect government benefits for a person with a disability. The reader should be aware that any reference to a disabled beneficiary includes the caveat to consider protecting potential or existing government benefits.

B. Legislative History of the SECURE Act

The SECURE Act—Setting Every Community Up for Retirement Enhancement Act of 2019—was originally introduced in the United States House of Representatives (the "House") as H.R. 1994 on March 29, 2019. After moving out of the House Ways and Means Committee, the SECURE Act passed the House on May 23, 2019. [https://www.govtrack.us/congress/bills/116/hr1994] Ultimately, the substance of the SECURE Act was included in the 2020 appropriations bill, H.R. 1865, which saw most of its activity late in 2019. On December 19, 2019, the agreed bill passed the Senate after final changes in the House. [https://www.govtrack.us/congress/bills/116/hr1865] The following day, December 20, 2019, H.R. 1865 (containing the SECURE Act) was signed into law by the President (the SECURE Act will sometimes simply be referred to as the "Act"). These new amendments affecting retirement plans (some of which did not end up with an actual provision in the Code) applied almost immediately – "to plan years beginning after December 31, 2019." *See* Section 401(b) of the Act.

For purposes of this topic, the most important provisions of the SECURE Act are found in Sections 114 and 401 of the Act. Section 114 of the Act makes changes to the RBD. Section 401(a) of the Act makes changes to Section 401(a)(9) of the Code (by adding new sub-section (H) and modifying sub-section (E)). Section 401(b) of the Act provides the effective date rules. These provisions of the Act are shown in Exhibit A.

C. Application

The retirement plan changes made by the SECURE Act apply to "defined contribution plans," 403(b) annuities, certain governmental and tax exempt employee plans and pre-tax IRAs (because these plans are subject to IRC 401(a)(9)). *See* IRC §§ 401(a)(9),

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First appeared as part of the conference materials for the
23rd Annual Estate Planning, Guardianship and Elder Law Conference session
"Estate Planning for Retirement Plans in View of the SECURE Act"