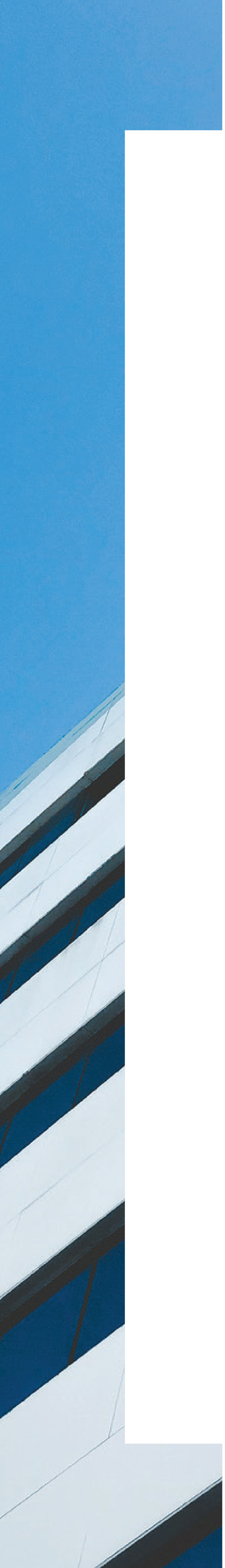
BERNSTEIN

SECURE-ing Your Legacy

The Impact of the SECURE Act on Special Needs Planning



The enactment of the SECURE Act[1] in 2019 dramatically altered the treatment of retirement accounts inherited after December 31, 2019. As a result, most beneficiaries can no longer "stretch" distributions from inherited retirement accounts over their lifetime by taking an annual required minimum distribution (RMD) based on their life expectancy. Instead, the entire retirement plan must be fully distributed within 10 years of the participant's death—often accelerating the recognition of income taxes by decades, and potentially increasing the effective tax rate on such distributions. The Act's full distribution requirements and the resulting taxation are a disappointing, and potentially costly turn of events for participants who hold nearly $34.9 trillion in retirement accounts as of mid-2021.[2]

Yet the SECURE Act did incorporate a major exemption to the new RMD rules. Individuals who are disabled[3] or chronically ill[4] represent two of the five classes of "eligible designated beneficiaries" who may still stretch distributions from inherited retirement accounts over their lifetimes.[5] This benefit also extends to retirement accounts left to properly drafted Special Needs Trusts (SNT)[6] providing an important exception for families with disabled beneficiaries.

The special treatment of trusts established for the benefit of disabled and chronically ill individuals may prompt tax-sensitive participants to reconsider leaving their retirement accounts in trusts for disabled beneficiaries. Yet the potential for tax savings should be weighed carefully, as each family's individual goals and circumstances tend to influence decisions about beneficiary designations. Whether the family prioritizes optimizing income tax savings, maximizing the spending capacity of the SNT, or promoting a uniform estate distribution among beneficiaries will drive which, if any, estate plan modifications to pursue.

This paper will review planning considerations for inherited retirement accounts post-SECURE Act, exploring the opportunity to maximize the value of inherited retirement assets when a disabled beneficiary is involved. It will also consider the impact of different asset types on an SNT's spending potential along with how a Charitable Remainder Trust (CRT) could foster a more equivalent estate distribution among disabled and non-disabled beneficiaries.

Key Terms

For this paper, EDB is assumed to refer to either a "disabled" or "chronically ill" individual, defined as:

Disabled Individual: "Section 72(m)(7) provides that 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..."[7]

Chronically Ill: "…any individual who has been certified by a licensed health care practitioner as—(i) being unable to perform…at least 2 activities of daily living for a period of at least 90 days…or (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment." [8]

1 Pub. L. 116-94. For the sake of brevity, through this paper the SECURE Act is sometimes referred to as "the Act."

2 https://www.ici.org/system/files/2021-05/2021_factbook.pdf

3 Within the meaning of § 72(m)(7). All section references are to the Internal Revenue Code of 1986 (Code), as amended, or the Treasury regulations thereunder, unless otherwise specified.

4 Within the meaning of § 7702B(c)(2), except that the requirements of subparagraph (A)(i) thereof shall only be treated as met if there is a certification that, as of such date, the period of inability described in such subparagraph with respect to the individual is an indefinite one which is reasonably expected to be lengthy in nature.

5 The other three classes are the participant's surviving spouse, a child of the participant who has not reached majority, and an individual who is not more than 10 years younger than the participant.

6 Also often referred to as supplemental needs trusts.

7 § 1.72-17A(f)(1).

8 § 7702B(c)(2).

Planning for Inherited Retirement Accounts: Pre-SECURE Act

Prior to 2020, a family could stretch an inherited retirement account over the lifetime of an individually named beneficiary—creating the potential for years, if not decades, of additional tax-deferred growth. Planning for a disabled beneficiary, however, has always been more complicated. In most cases, directly naming a disabled individual as the beneficiary of a retirement account, or of any inheritance for that matter, would not be prudent. Loss of eligibility for government benefits and asset protection are just two of the potential implications. Instead, families should generally leave retirement assets intended to benefit a disabled person to a Special Needs Trust (SNT) .[9]

Understanding Special Needs Trusts

Special needs trusts serve three primary functions for their disabled beneficiaries: 1) preserving access to government benefits, 2) fiscal management, and 3) asset protection. The primary programs for providing financial assistance to disabled individuals are means tested whereby owning more than $2,000 in assets or receiving limited amounts of income could lead to disqualification from accessing important benefits.[10] Among a few other exceptions (namely a house and a car, for example), assets held in a special needs trust are excluded from these calculations and thus will not impact the beneficiary's eligibility.[11] While assets in the trust should never be distributed directly to the disabled beneficiary,[12] payments can be made from the trust directly to those providing goods and services in support of the beneficiary. Beyond benefits preservation, SNTs also serve an important role in protecting assets and ensuring that they remain available for the beneficiary's care.

Types of SNTs

There are two primary types of special needs trusts: the first-party special needs trust and the third-party special needs trust.[13] A first-party special needs trust is established with property that the disabled individual either owns or has a legal right to. These trusts, which must be established before the beneficiary reaches age 65,[14] are typically funded with direct inheritances, divorce settlements, and/or personal injury awards. First-party SNTs must be used solely for the disabled individual's benefit and are subject to a Medicaid "payback" provision requiring the trust to reimburse the state for medical expenses following the beneficiary's death.[15] First-party trusts are grantor trusts. Thus, all income is taxable at the beneficiary's individual tax rate. On the other hand, a third-party special needs trust is created by, and funded with, assets from someone other than the disabled beneficiary. Importantly, these trusts are not subject to the "payback" rules, and there is no maximum age of the beneficiary for their establishment.

A Note on SNT Taxation

A first-party special needs trust will always be a grantor trust and thus taxable to the disabled beneficiary. However, a third-party special needs trust can either be structured as a grantor trust (provided it's established and funded during the grantor's lifetime), or as a non-grantor trust. The taxation of a grantor trust is relatively straightforward. A grantor trust is a disregarded entity for tax purposes, so all income is taxable to the grantor at the grantor's individual tax rates. The taxation of a non-grantor trust, specifically a non-grantor SNT, is a bit more complex. A non-grantor trust must pay trust income taxes on all retained income. All distributed income is taxed as income to the beneficiary.

The tax brackets of a non-grantor trust are highly compressed relative to an individual taxpayer. Income retained by the trust may be subject to higher tax rates than an individual receiving the same level of income. Importantly, income distributed from a third-party non-grantor SNT for the benefit of the disabled beneficiary will be taxed at the beneficiary's individual tax rates. And while distributions made in support of the beneficiary represent taxable income to them for tax purposes, it is not income to them for benefits purposes. So long as the distribution is not made directly to the disabled beneficiary and does not pay for the beneficiary's food and shelter, income that is carried out through distributions will not result in a disruption of benefits.[16]

9 For the sake of brevity, through this paper a special needs trust is sometimes referred to as an "SNT." In addition, unless otherwise specified, all references to SNTs in this paper are to third-party special needs trusts.

10 For example, Supplemental Security Income (SSI), which provides cash to meet basic needs for food, clothing, and shelter for aged, blind, and disabled people, is not available for individuals who own more than $2,000 in countable assets, such as bank accounts and securities, in their own name. See 42 U.S.C. § 1382 (a)(3)(B). Qualifying for SSI can be a prerequisite for accessing other benefits. In most states, someone who qualifies for SSI is automatically eligible for Medicaid and other important benefits. Thus, establishing a special needs trust to protect access to government benefits can be important, even for a high-net-worth family, because the disabled family member's needs could change, and because certain desirable benefits may not be available to the disabled family member unless the family member is SSI eligible.

11 42 U.S.C. § 1382b (a); Social Security Administration's Program Operations Manual System (POMS) SI 01120.200.D.2.

12 Disbursements from the trust to a third party that result in the beneficiary receiving non-cash items (other than food or shelter) are not income if those items would become a totally or partially excluded non-liquid resource if retained into the month after the month of receipt (see POMs SI 00815.550 and SI 01110.210).

13 Although beyond the scope of this paper, there is a third category of special needs trusts known as pooled trusts. These trusts can either be funded by the disabled beneficiary themselves or a third party. The trusts combine the assets of multiple beneficiaries and the assets are managed by a nonprofit organization. They are typically chosen by families who do not have sufficient assets to justify establishing a standalone special needs trust. See 42 U.S.C. § 1396p (d)(4)(A), POMs SI 01120.201.

14 42 U.S.C. § 1396p(c)(2)(B)(iv).

15 42 U.S.C. § 1396p (d)(4)(B)(ii); POMS SI 01120.203.B.1 (2021). The Omnibus Budget Reconciliation Act of 1993 imposed the Medicaid payback on trusts executed after such Act's enactment. See Section 13611(e)(2)(C) of the Act.

16 Disbursements from the trust to a third party that result in the beneficiary receiving non-cash items (other than food or shelter) are not income if those items would become a totally or partially excluded non-liquid resource if retained into the month after the month of receipt (see POMs SI 00815.550 and SI 01110.210).

Assuming the SNT is properly structured, distributions from a retirement account left to the trust could both be stretched over the lifetime of the disabled beneficiary (even prior to the SECURE Act) while also being retained within the trust so as not to jeopardize the beneficiary's access to benefits.[17] The downside is that income retained by a non-grantor trust is subject to more burdensome taxation.

Keep in mind that the tax system in the US is progressive, meaning higher tax rates are applied to increasingly higher amounts of income. These income thresholds are called tax brackets. Individuals currently have seven tax brackets, whereas taxable trusts have only five. While the top rate for both is 37%, due to this compression, income in a taxable trust will reach the top bracket well before individual income does.

As a result, the taxes paid by a trust will be much higher than that paid by an individual for the same level of income. For example, each dollar of income received by an individual would pass through each of the individual tax brackets—often referred to as a bracket run—starting at 10% for the first $10,275 of income and topping out at 37% for income exceeding $539,899. In contrast, a trust triggers the top marginal tax rate of 37% at just $13,450. Ultimately, applying the individual tax brackets—rather than the trust tax brackets—to $539,000 of income saves over $35,000 in income taxes (**Display 1**).

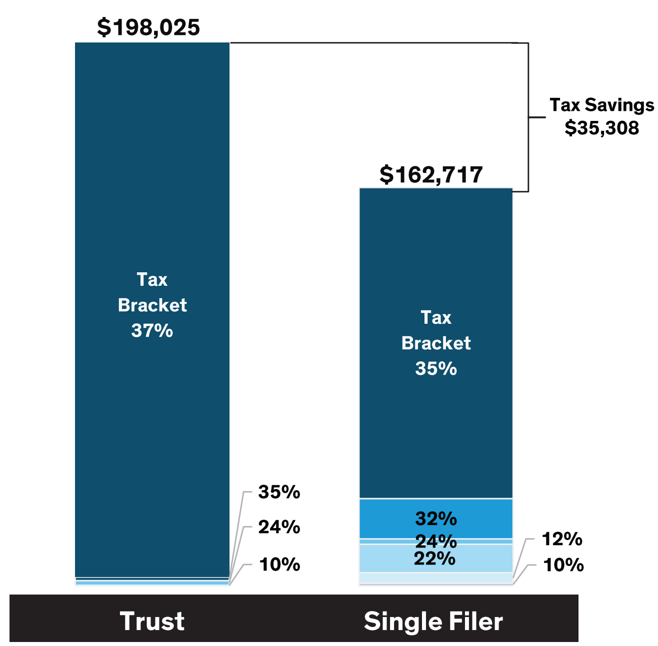
This tax inefficiency has historically led most families to name an individual, rather than a trust, as the beneficiary for their retirement accounts. Doing so allowed them to gain from the continued tax deferral afforded by the lifetime stretch without the added cost exacted by more punitive tax brackets.

DISPLAY 1: TAX BRACKETS FOR INDIVIDUALS ARE MORE FAVORABLE THAN THOSE FOR TRUSTS

2022 Income Tax Brackets
Trusts and Estates

Income Range		Tax Rate
$13,451	or More	37%
$9,851	$13,450	35%
$2,751	$9,850	24%
$0	$2,750	10%

Value of Bracket Run (Single Filer)
$539,900 Income (Real)



Source: IRS and AB

17 A trust must qualify as a "see-through" trust to have IRA assets distributed out over more than five years or over the life expectancy of the deceased participant. These so-called see-through trusts can either be structured as conduit trust or accumulation trusts. With regards to planning for a disabled beneficiary, a SNT should be structured as an accumulation trust. An accumulation trust allows the trustee to accumulate retirement account distributions within the trust for the benefit of the beneficiary. A conduit trust is required to distribute all available income, including distributions from retirement accounts, directly to the trust beneficiary which could result in an immediate reduction or termination of benefits for a disabled beneficiary. See sidebar "To Conduit or to Accumulate" on page 7.

Implications of the SECURE Act

Before SECURE, many estate planners would direct retirement assets only to non-disabled beneficiaries—usually outright and free of trust—to maximize tax deferral over the beneficiaries' lifetimes. SNTs would be funded, to the extent possible, using nonretirement assets to avoid potentially adverse minimum distribution rules. Arguably, SECURE reverses those tendencies by severely restricting the potential for a lifetime stretch. Unless an exception applies, retirement plans must be fully distributed by December 31 of the year containing the 10-year anniversary of the participant's death (**Display 2**). An Eligible Designated Beneficiary (EDB), on the other hand, can continue to stretch the distributions out over his or her lifetime.

DISPLAY 2: MODIFICATIONS TO POST-DEATH REQUIRED MINIMUM DISTRIBUTION RULES

Under the SECURE Act, retirement plans must distribute all assets to designated beneficiaries by December 31 of the year containing the 10th anniversary of the participant's death, unless an exception applies.[I] There are three classes of plan beneficiaries that govern the timing of distributions, as well as exceptions.

Class	Description	Rule
Non-designated beneficiaries	No individual beneficiary designated or the participant designated their estate or other non-individual beneficiary (such as a charity or trust not meeting certain requirements).[II]	The entire retirement account must be fully distributed • within five years of the participant's death, if the participant dies before reaching age 72[III] • based on the participant's remaining fixed life expectancy at the time of death[IV] if the participant dies after age 72
Designated beneficiaries	The participant designates an individual or trust meeting several requirements imposed by Treasury regulations as beneficiary of their retirement account.[V]	The entire account must be distributed by December 31 of the year containing the 10th anniversary of the participant's death, unless the beneficiary is an eligible designated beneficiary.[VI]
Eligible designated beneficiaries (EDBs)	There are five types:[VII] 1. A surviving spouse 2. Minor child of the participant—10-year rule begins when the child reaches the age of majority.[VIII] 3. Disabled individuals[IX] 4. Chronically ill individuals[X] 5. Individuals that are less than 10 years younger than the participant	The account can be stretched over the EDB's lifetime. At the EDB's death, any remaining assets must be distributed by December 31 of the year containing the 10th anniversary of the EDB's death.[XI]

Time Horizon Matters

The value of stretching out the required distributions from an inherited retirement account over a disabled beneficiary's lifetime depends on many factors. Yet, one of the most significant factors may also be the most difficult to predict: the lifespan of the disabled individual. The longer the beneficiary lives after inheriting the IRA, the longer the required distributions from the retirement account can be stretched, thereby increasing their associated income tax deferral. Once the EDB dies, the remaining retirement account must be distributed within 10 years. Redirecting inherited retirement accounts to an EDB with a long-life expectancy could add decades of tax deferral beyond the 10-year period afforded to a "designated beneficiary." On the other hand, a change of course may not be warranted in cases where the EDB's life expectancy is considered short. Families should evaluate their individual circumstances before redrafting their estate plan.

I SECURE Act, § 401(a)(1).

II Reg. §§ 1.401(a)(9)-4, A-5(b), 1.401(a)(9)-4, A-5(a), 1.401(a)(9)-4, A-3. All section references are to the Internal Revenue Code of 1986 (Code), as amended, or the Treasury regulations thereunder, unless otherwise specified.

III § 401(a)(9)(B)(ii), Reg. § 1.401(a)(9)-3, A-4.

IV § 401(a)(9)(B)(i), Reg. §§ 1.401(a)(9)-2, A-5, 1.401(a)(9)-5, A-5(a)(2).

V § 401(a)(9)(E), Treas. Reg. § 1.401(a)(9)-4, A-1.

VI § 401(a)(9)(H)(i)(I).

VII § 401(a)(9)(E)(ii).

VIII § 401(a)(9)(E)(ii)(II).

IX Within the meaning of § 72(m)(7). Upon his/her death, the 10-year rule begins.

X Within the meaning of § 7702B(c)(2). Upon his/her death, the 10-year rule begins.

XI § 401(a)(9)(H)(iii).

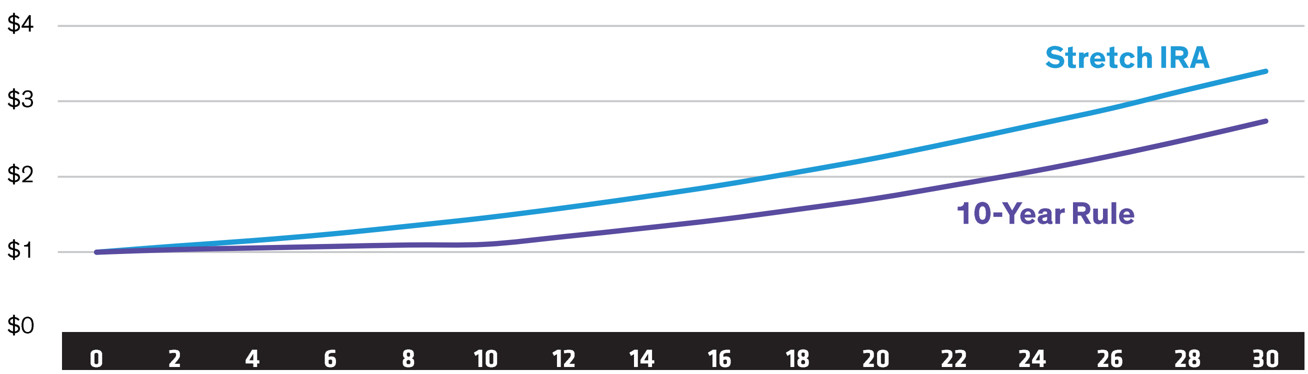
How much does accelerating the distribution horizon matter? Assuming a $1.0 million IRA is left outright to a 50-year-old EDB, the lifetime stretch delivers $661,000, or 24.1% more wealth over a 30-year period relative to the 10-year distribution rule that would apply to a DB[18] **(Display 3)**. From this perspective, it's clear why the loss of the stretch becomes problematic, prompting families to look for ways to reduce the impact of the new rule.

Yet, this analysis doesn't tell the full story; we have not accounted for the embedded tax liability in the IRA account left to the EDB. When adjusting for the impact of taxes, the wealth gap between the EDB and the DB narrows materially to just $395,000—or 14.4% more wealth in the stretch case (**Display 4**). While less of a disparity than initially appeared, it may still be worth designing an estate plan in a way that seeks to reduce SECURE's impact further.

DISPLAY 3: THE NEW 10-YEAR RULE APPEARS VERY COSTLY FOR BENEFICIARIES...

$1 Million Inherited IRA—Median Pretax Accumulation, 50-Year-Old Beneficiary

70% Stocks, 30% Bonds | Nominal (USD Millions)

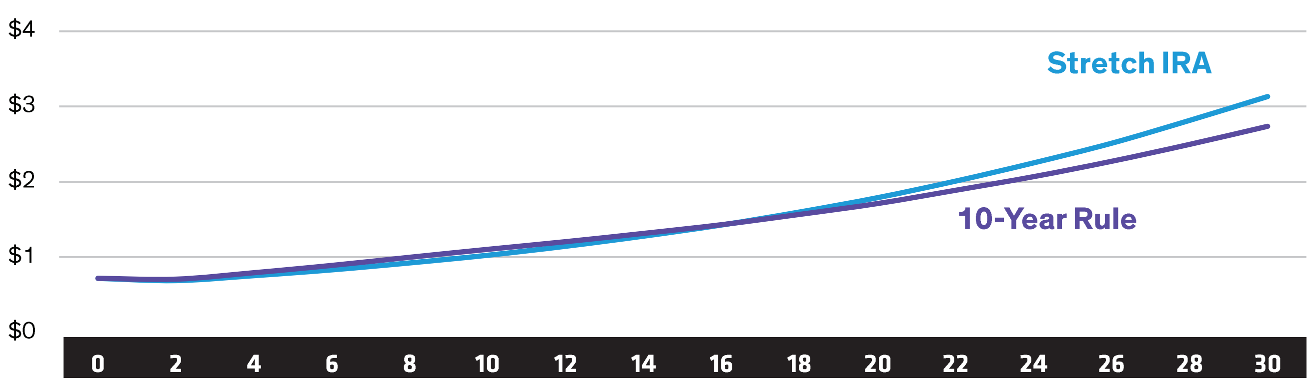


Inherited IRA values are displayed pretax. Distributions from the inherited IRA are subject to individual tax rates assuming the beneficiary has additional income of $450,000 and is married, filing jointly, and is subject to a 5% state income tax rate. The after-tax proceeds are reinvested into a portfolio of 70% global stocks and 30% bonds. "Stretch IRA" illustrates pretax beneficiary wealth assuming a lifetime stretch under pre-SECURE Act rules (e.g., designated beneficiary is age 50, divisor is 34.2 and reduced by one each subsequent year). "10-Year Rule" illustrates pretax beneficiary wealth assuming even distributions from the inherited IRA over 10 years. Projections based on AB's estimates of the range of returns for the applicable capital markets over the periods analyzed. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on the Bernstein Wealth Forecasting System in the Appendix for further details.

DISPLAY 4: ...YET COSTS MODERATE CONSIDERABLY AFTER ADJUSTING FOR DEFERRED TAX LIABILITY

Spendable Dollars from a $1 Million Inherited IRA—Median After-Tax Accumulation, 50-Year-Old Beneficiary

70% Stocks, 30% Bonds | Nominal (USD Millions)



Inherited IRA values are displayed after-tax. Distributions from the inherited IRA are subject to individual tax rates assuming the beneficiary has additional income of $450,000 and is married, filing jointly, and is subject to a 5% state income tax rate. The after-tax proceeds are reinvested into a portfolio of 70% global stocks and 30% bonds. "Stretch IRA" illustrates after-tax beneficiary wealth assuming a lifetime stretch under pre-SECURE Act rules (e.g., designated beneficiary is age 50, divisor is 34.2 and reduced by one each subsequent year). "10-Year Rule" illustrates after-tax beneficiary wealth assuming even distributions from the inherited IRA over 10 years. Projections based on AB's estimates of the range of returns for the applicable capital markets over the periods analyzed. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** See Notes on the Bernstein Wealth Forecasting System in the Appendix for further details.

18 In the case of the post-SECURE Act "10-Year Rule," the IRA is distributed in equal installments over the full 10-year period. The tax savings afforded by the ability to run the income from each of the annual distributions through the tax brackets outweighs the potential benefit of the increased tax deferral associated with taking a lump sum distribution in year 10.

To Conduit or to Accumulate

While retirement assets should be left to a special needs trust (rather than to a disabled individual outright), IRA assets left to a trust may face an accelerated distribution requirement. If the participant dies before age 72, the IRA must be fully distributed within five years of the participant's death. If the participant dies after reaching age 72, distributions must be taken within a period based on the participant's remaining fixed life expectancy at the time of death.

With that said, an exception exists for a so-called "see-through" trust. Here, individual trust beneficiaries may be considered for the purpose of determining the required distribution horizon.[19] See-through trusts established for the benefit of a Designated Beneficiary ("DB") are generally required to fully distribute all retirement assets by December 31 of the 10th year following the participant's death.[20] On the other hand, qualifying trusts for the benefit of Eligible Designated Beneficiaries (EDBs)—and more specifically, chronically ill or disabled individuals—may be able to stretch out the required distributions for the trust-held IRA over the beneficiary's lifetime.

See-through trusts come in two types: conduit trusts and accumulations trusts (**Display 5**). Conduit trusts have traditionally been more popular because they conform to Treasury Regulations (and are therefore guaranteed to qualify as a see-through trust). However, the conduit trust structure requires that all funds distributed to the trust from an IRA be dispersed outright to the beneficiary in the same calendar year. Unfortunately, this may disqualify the beneficiary from receiving government benefits. An accumulation trust, on the other hand, is based solely upon informal IRS guidance. As such, it is not guaranteed to qualify as a see-through trust. However, if the trust does qualify for such treatment, it can be structured to ensure that the beneficiary maintains their eligibility.

DISPLAY 5: TO CONDUIT OR TO ACCUMULATE?

Conduit trust

- The trustee cannot accumulate retirement account distributions but instead must immediately distribute any distributions from the retirement account to the individual trust beneficiary.
- Guaranteed to qualify as a see-through trust.[I]
- Can be stretched over the eligible designated beneficiary's lifetime (if the conduit beneficiary is an EDB).
- At the eligible designated beneficiary's death, the retirement account must be distributed by December 31 of the year containing the 10th anniversary of the EDB's death.[II]

Accumulation trust

- The trustee can be given the power to accumulate distributions from retirement accounts; not required to fully distribute.
- The trust is not guaranteed to qualify as a see-through trust because all successor beneficiaries must be considered, and it can be difficult to figure out who to disregard as mere potential successors.[III]
- Unlikely to qualify as an eligible designated beneficiary since all the trust's beneficiaries must be considered. An exception is granted if the trust is for the exclusive benefit of disabled or chronically ill beneficiaries during their life.[IV]

I Reg. § 1.401(a)(9)-5, A-7(c)(3).
II § 401(a)(9)(H)(iii).
III Reg. § 1.401(a)(9)-5, A-7(c).
IV §401(a)(9)(H)(iv).

19 Reg. § 1.401(a)(9)-4, A-5(a).
20 To qualify as a see-through trust, the trust must meet four criteria: 1) the trust is a valid trust under state law or would be but for the fact that there is no corpus, 2) the trust is irrevocable or will become irrevocable, by its terms, upon the death of the participant, 3) with respect to the trust's interest in the participant's benefit, the beneficiaries are identifiable from the trust instrument, and 4) the documentation is provided to the plan administrator in a timely manner. See Reg. § 1.401(a)(9)-4, A-5(b).

Disabled Beneficiaries Can Still Stretch

As discussed, cases with a disabled beneficiary represent a notable exception to the SECURE Act's 10-year distribution requirement. Considered one of the five classifications of Eligible Designated Beneficiaries,[21] a retirement account left for the benefit of a disabled person can still qualify for a lifetime stretch.

To reiterate, a family who wishes to benefit a disabled family member should consider leaving any inheritance—including retirement accounts—to a third-party special needs trust. While the SECURE Act upheld the 5-year distribution requirement for non-qualifying trusts, the IRS will look through to the disabled beneficiary of a "see-through" SNT trust and allow distributions to be made over the beneficiary's life expectancy.[22] As a result, the conventional wisdom to allocate retirement assets to non-disabled beneficiaries may prove unwise.

Prior to SECURE, both an SNT and a non-disabled beneficiary could qualify for a lifetime stretch. However, the non-disabled beneficiary had a better chance of maximizing the after-tax value of the inherited retirement accounts given the more graduated tax brackets that apply. Now, families are left wondering if the opportunity to spread distributions out over their disabled beneficiary's lifetime more than compensates for a potentially more punitive taxation (due to holding the IRA distributions captive in a non-grantor SNT). Does the chance to stretch warrant adjusting an estate plan and replacing non-disabled IRA beneficiaries with a special needs trust or even a Charitable Remainder Trust? The answer will depend not only on individual circumstances but also on the family's goals.

Goal #1: Minimize Taxes

Many reasonably assume that the best way to maximize the after-tax value of an inherited IRA is to choose the path that results in a longer deferral horizon. However, as with many estate-planning questions, the solution depends on individual circumstances. Two of the most significant factors include tax rates and time horizon.

Let's look at an example. Assume we have a $1.0 million IRA that will either be left to:

1. a designated beneficiary subject to a 10-year distribution requirement, or
2. an accumulation SNT whereby the trust can stretch distributions over the lifetime of a 50-year-old eligible designated beneficiary with a normal life expectancy.

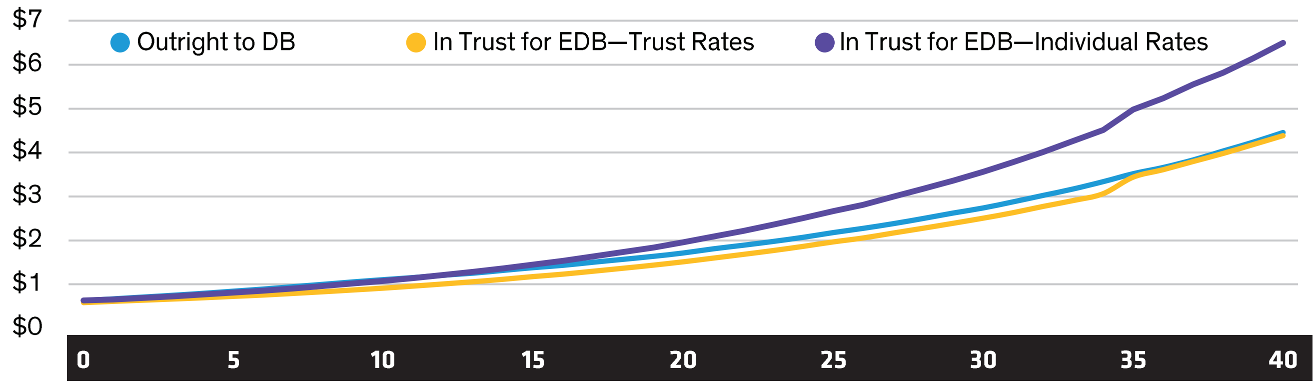
The IRA is invested in a 70% stock and 30% bond portfolio, with the net required distributions from the retirement accounts reinvested in the same manner. No spending or income beyond what's generated by the investments has been incorporated into our analysis.

Leaving the IRA to the designated beneficiary results in 13.3% more after-tax wealth after 20 years compared to leaving the IRA to the SNT (**Display 6**). Assuming RMDs are retained by the SNT, any benefit of the stretch is outweighed by the compressed tax brackets of the taxable trust. The longer the disabled beneficiary lives, the more this wealth gap narrows since the cost of the higher tax rates is offset to a greater extent by more years of tax-deferred growth. However, the eligible designated beneficiary needs to live more than 40 years to be at parity.

DISPLAY 6: THE VALUE OF THE "STRETCH" DEPENDS ON THE BENEFICIARIES' TAX RATE

After-Tax Value of $1 Million Inherited IRA—Median Accumulation of Various Beneficiaries*

Nominal (USD Millions)



* "Median" results represents the 50th percentile of 10,000 trials in our Wealth Forecasting System.
The "Outright to DB" scenario assumes a $1.0 million inherited IRA is left outright to a designated beneficiary that is distributed evenly over the first 10 years of the analysis to a taxable portfolio. Assumes a married couple with annual income of $450,000 and a state tax rate of 5%. The two "In Trust for EDB" scenarios assume a $1.0 million inherited IRA is left to an accumulation SNT with an initial distribution factor of 34.2. "Trust Rates" assumes all income is subject to top marginal tax rates and a state tax rate of 5%. "Individual Rates" assumes all income gets the benefit of a full bracket run at the individual rates of the disabled beneficiary and a state tax rate of 5%. All portfolios are modeled with an allocation of 70% global stocks and 30% bonds. **Based on Bernstein's estimates of the range of returns for the applicable capital markets. Data does not represent past performance and is not a promise of actual or range of future results.** See Notes on the Bernstein Wealth Forecasting System in the Appendix for further details. Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

21 There are five types of Eligible Designated Beneficiaries: 1) a surviving spouse, 2) minor child of the participant- 10-year rule begins when the child reaches the age of majority, 3) disabled individuals, 4) chronically ill individuals, and 5) individuals that are less than 10 years younger than the participant. § 401(a)(9)(E)(ii); § 72(m)(7); § 7702B(c)(2).

22 Absent the "see-through" qualifications, IRA assets would otherwise need to be distributed by December 31 of the year containing the fifth anniversary of the participants death.

Admittedly, it's an extreme case to assume that the required distributions from the IRA are fully retained within the SNT and thus don't have the opportunity to have some of the income subjected to the more progressive individual tax brackets. It is possible to envision a scenario where at least some, if not all, of the RMDs are taxable at beneficiary rates.

Keep in mind, a third-party non-grantor trust pays taxes only on retained income (like other non-grantor trusts). Income that flows out through distributions in support of the beneficiary is taxed at his or her rates. Suppose the level of financial support for the beneficiary was high enough to withdraw the entire required distribution. Given the more progressive nature of the individual tax brackets relative to those that apply to taxable trusts, it's conceivable that the taxes owed on the required distributions are far less than what was previously illustrated.

Let's revisit our prior example, assuming that the required distributions within the SNT are taxed at individual rates with the benefit of a full bracket run. After just 20 years, leaving the IRA to the SNT has nearly 14% more wealth than leaving it to the designated beneficiary. The wealth advantage widens to over approximately 30% after 30 years and a whopping 46% after 40 years (**Display 6, previous page**).

Note that even absent sufficient withdrawal needs, other mechanisms could enhance the taxability of retirement account distributions within the SNT. In some instances, families may opt to sweep income out of the third-party SNT into a first-party grantor SNT. The potential for tax savings is appealing, though the strategy is not without complexity. Without proper planning, the distribution to the first-party SNT could temporarily suspend some government benefits and may require court supervision of the assets. Plus, upon the death of the beneficiary, the first-party SNT will be required to reimburse the state for Medicaid expenses incurred by the beneficiary. This creates incentive to use the funds in the first-party SNT for the beneficiary before the funds in the third-party SNT. Families need to independently determine whether the preferential tax status of the first-party SNT justifies the complexity of the multi-trust strategy.

A similar outcome can be achieved by moving income from a third-party SNT to an ABLE account, a tax-advantaged savings account for people with disabilities. Provided the balance does not exceed $100,000, ABLE account assets are not included for purposes of determining benefits eligibility.[23] If the balance does rise above that threshold, benefits may be suspended though not necessarily terminated. Most importantly, the assets in the account grow tax-free provided the distributions are used for "qualified disability" expenses.[24]

While cheaper to establish and administer than a first-party SNT, an ABLE account's opportunity for tax-free growth may be somewhat limited. Anyone can contribute, including a first-party SNT, but aggregate contributions from all sources cannot exceed $16,000 (as defined by the federal annual exclusion limit).[25] However, for smaller amounts, an ABLE account could present an interesting alternative to the first-party SNT.

Whether leaving the IRA to the SNT creates the most tax-efficient outcome depends on many factors, including beneficiary tax rates, time horizon, and in some cases, the family's appetite for complexity. Under the right set of circumstances, some families seeking to maximize tax savings may benefit from naming their SNT as a beneficiary of one or more of their retirement accounts

Goal #2: Maximize Distributions

For some families, optimizing a disabled beneficiary's financial security overrides maximizing the after-tax value of an inherited IRA. With this goal in mind, it's important to consider the impact that various types of assets have on the SNT's ultimate spending potential. Focusing solely on the inherited IRA, we've shown that naming the SNT as the beneficiary works better in some circumstances. But if we shift our attention to the SNT's spending capacity, is it better to source funding from retirement assets or taxable assets?

Let's consider another illustration. Imagine two scenarios where a special needs trust stands to inherit—the first is sourced fully from taxable assets while the second receives an IRA where required distributions will be stretched over the life expectancy of the 50-year-old disabled beneficiary. Because we are aiming to maximize the distribution potential of the trust, we will assume that all portfolio income will benefit from a full individual taxpayer bracket run.

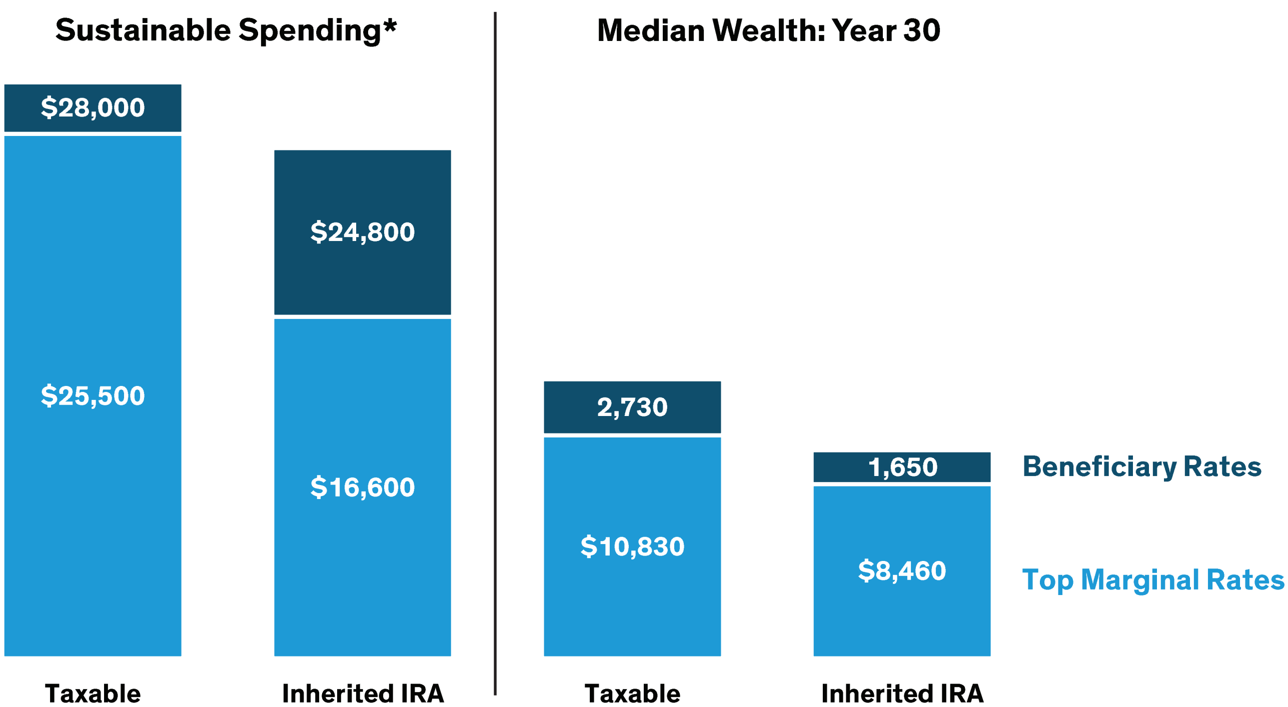
23 POMS Section 01130.740.C.3.
24 Code § 529A.(a) and § 529A.(c)(1)(B).
25 Code § 529A.(b)(2)(B); see also Code § 2503(b)(1) and Code § 2503(b)(2).

Our analysis shows that the taxable portfolio can support $28,000 of after-tax spending, per $1.0 million, over a 30-year horizon with a 90% level of confidence—13% more than a similarly sized inheritance of traditional IRA assets (**Display 7**). Additionally, the SNT is expected to have 34% more in remaining wealth (assuming average markets). The spending and remaining wealth gap widens if we take a more conservative stance on the SNT's taxation. Assuming top marginal trust rates are applied to all income, the additional spending capacity of the taxable asset inheritance increases by nearly 54%. The potential for tax-deferral fails to overcome having to pay income taxes on distributions from traditional IRA assets.

For families looking to maximize the spending capacity of their SNT—or conversely, minimize the level of funding required to support a given level of spending—funding the trust with taxable assets could improve support for the disabled beneficiary. Taxable assets in the estate of the participant should not only qualify for a step-up in cost basis, but under current tax law, long-term capital gains and qualified dividends are taxed at more favorable rates than distributions from a traditional IRA. This additional security could justify the modest cost to other beneficiaries in certain cases.

DISPLAY 7: SUSTAINABLE SPENDING LEVELS ARE IMPACTED BY ASSET TYPE AND TAX RATES

Nominal (USD Thousands)



*Sustainable spending represents the amount that can be withdrawn from the portfolio over 30 years, adjusted with inflation, with a 90% level of confidence. Beneficiary rates assumes federal tax rates are automatically calculated based on portfolio income and assumes a state tax rate of 5%. Top marginal rates assumes top marginal federal tax rates and a state tax rate of 5%. The inherited IRA scenario assumes an initial distribution factor of 34.2.

Based on AB's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual or range of future results. Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. See Notes on the Bernstein Wealth Forecasting System in the Appendix for further details.

Goal #3: Equalize the Beneficiaries

Up to this point, we've focused on ways to maximize total family wealth, but this may not be every family's goal. Some may prioritize the equal treatment of all beneficiaries. A strategy that favors equality could resonate when earmarking all retirement assets for one class of beneficiaries leads to a highly disproportionate estate distribution.

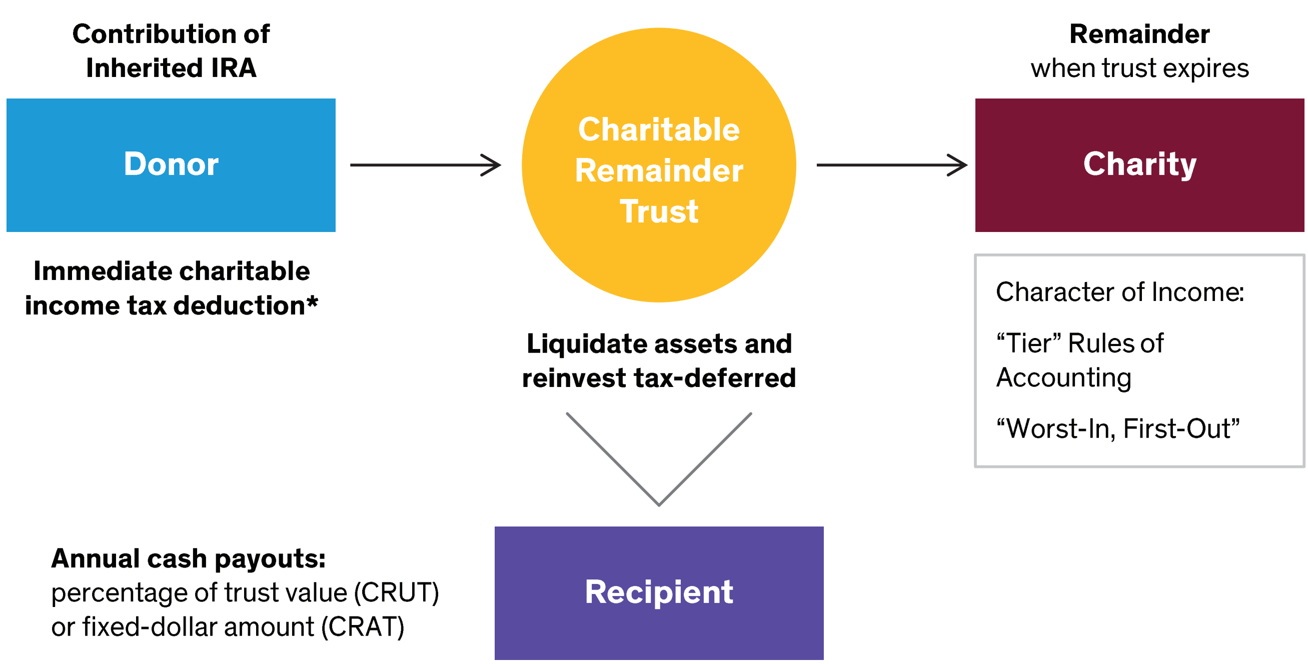
With a narrower emphasis on equality, families must address the differences in distribution requirements from inherited retirement accounts for their beneficiaries. IRA assets left to an SNT should qualify for a lifetime stretch. IRA assets left to a designated beneficiary will not. Could a Charitable Remainder Trust (CRT) be used to simulate the stretch for a DB in a way that mimics that of the eligible designated beneficiary? Possibly, but not without a cost.

A Charitable Remainder Trust is an effective way to defer the realization of taxes on income recognized within the trust over the beneficiary's lifetime or for a term of up to 20 years (**Display 8**). In the context of an inherited IRA, the CRT can simulate the benefits of a lifetime stretch.

For instance, the IRA participant could die, naming a charitable remainder trust as the IRA beneficiary and a DB as the beneficiary of the CRT. Since the trust itself is a non-taxable entity, the IRA can be instantly liquidated inside the trust without triggering an immediate tax liability to the CRT or its beneficiaries. The trust then makes taxable distributions—either based on a percentage of trust assets or a fixed dollar amount—to the beneficiary over the life of the trust. The beneficiary remits taxes on the payouts based on how the income was earned in the trust, typically on a worst-in, first-out basis whereby the most highly taxed income comes out first.[26] Income from the IRA liquidation will be carried out through the CRT payouts prior to capital gains or trust corpus and will be taxed at ordinary income rates. While the IRA was immediately distributed within the trust in full, the recognition of the income tax liability will stretch over a much longer period. The exact length will depend on the specific terms of the trust: namely, the lifetime of the beneficiary and distribution rate.

Of course, this isn't the end of the story. There is a cost associated with recreating the stretch for designated beneficiaries which comes in the form of limited access to liquidity, tax, and legal complexity, and most notably, an additional beneficiary.

DISPLAY 8: HOW A CHARITABLE REMAINDER TRUST DEFERS *AND* AVOIDS TAXES



*The income tax deduction is not the total amount contributed but rather the present value of what is expected to pass to charity. The calculation of the present value takes into account the value of the contributed assets, the discount rate (based on the Section 7520 rate) and the term of the trust (for lifetime trusts, a life expectancy table is used). See Sections 7520 and 664 of the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder.

Source: AB

26 § 664(b)

Let's address each in turn, starting with concerns about liquidity and complexity. The contribution to the trust is irrevocable, and the beneficiary is only entitled to the periodic predefined distributions, typically made on an annual or quarterly basis. This structure may prove prohibitive for families lacking ample access to other pools of liquidity. In addition, the ongoing tax and legal fees required to administer the trust may only be economical for sizeable contributions.

And now for the elephant in the room: the additional beneficiary. Given the structure's name, it should come as no surprise that a charity may also benefit from some of the trust's wealth. Upon the termination of the trust—either at the end of the fixed term or upon the death of the beneficiary—any assets remaining in the trust must pass to the charity specified in the trust document. Depending on how long the beneficiary lives, the size of the distributions, and the performance of the assets within the trust, this could ultimately become a relatively small or rather sizeable donation. It should be noted that funding the trust will create a charitable deduction for the donor (or the donor's estate) based on the portion of the trust's initial assets that the IRS assumes will go to charity.

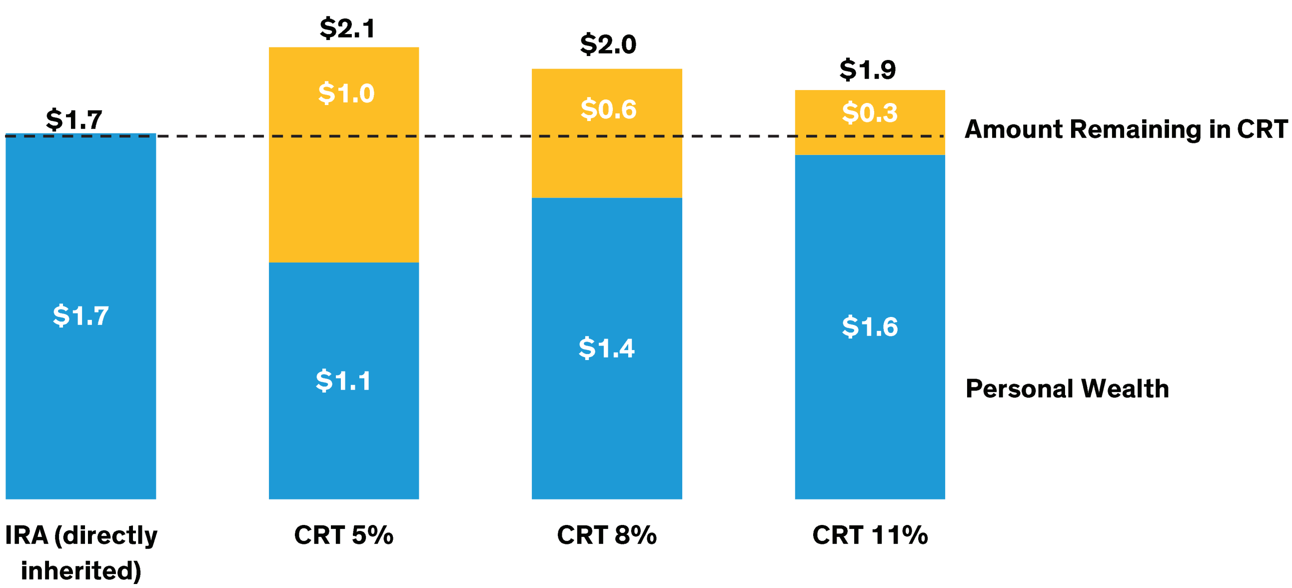
Does the value of the synthetic stretch justify the incremental costs and complexity associated with a CRT? Let's consider how this might play out. Ola intends to split her estate—which includes a $4.0 million IRA—equally between her two children. One of her children, Phoebe, is disabled, so her inheritance will be left to a third-party SNT. As an EDB, the inherited IRA will be distributed within the SNT over Phoebe's lifetime. Ola's other child, Kai, is a designated beneficiary. The inherited IRA will be subject to the 10-year distribution rule if left outright to him. Given how costly the loss of the stretch is for a designated beneficiary (as illustrated in **Display 3**), Ola considers leaving 50% of her IRA to a CRT for the benefit of Kai.

Looking at a snapshot after 20 years, the median value of Kai's portfolio would be $1.7 million, assuming he directly inherits the IRA in equal installments over the required 10-year period without a CRT (**Display 9, far left bar**). The three bars to the right show Kai's personal portfolio value—based on three different CRT payout rates—along with the charity's expected interest assuming Ola leaves the IRA to a lifetime CRT for Kai's benefit. In all cases, Kai accumulates less wealth when the IRA is left to the CRT, despite his ability to stretch the taxable

DISPLAY 9: A CRT CAN CREATE ADDITIONAL TOTAL WEALTH, BUT MORE OF THE BENEFIT MAY ACCRUE TO CHARITY OVER THE NEAR TERM

Total Value of Personal Assets and CRT Remainder—Median Values Year 20*

Nominal (USD Millions)



*"Median" means 50th percentile results of 10,000 trials in our Wealth Forecasting System. Based on AB's estimates of the range of returns for the applicable capital market (as of June 30, 2021) over the next 20 years.

The data illustrated above is the total of taxable and non-taxable personal assets over the next 20 years. The IRA scenario assumes the IRA is distributed evenly over the first 10 years of the analysis and the distributions are reinvested in a taxable portfolio. The "CRT" scenarios assume a lifetime CRT for a single person who is 50 years old with a 5%, 8%, or 11% payout. Charity's Interest is the amount left in the CRT at the end of 20 years. All assets were modeled with an allocation of 70% global stocks and 30% bonds. **Data do not represent past performance and are not a promise of actual future results or a range of future results.** The tax accounting rules for CRUTs are complicated and should be fully understood before making decisions on this strategy. Bernstein does not provide legal, tax, or accounting advice. See Notes on the Bernstein Wealth Forecasting System in the Appendix for further details.

distributions over a longer horizon than permitted by the SECURE Act. The CRT appears favorable only if Ola values naming a charity as an additional beneficiary.

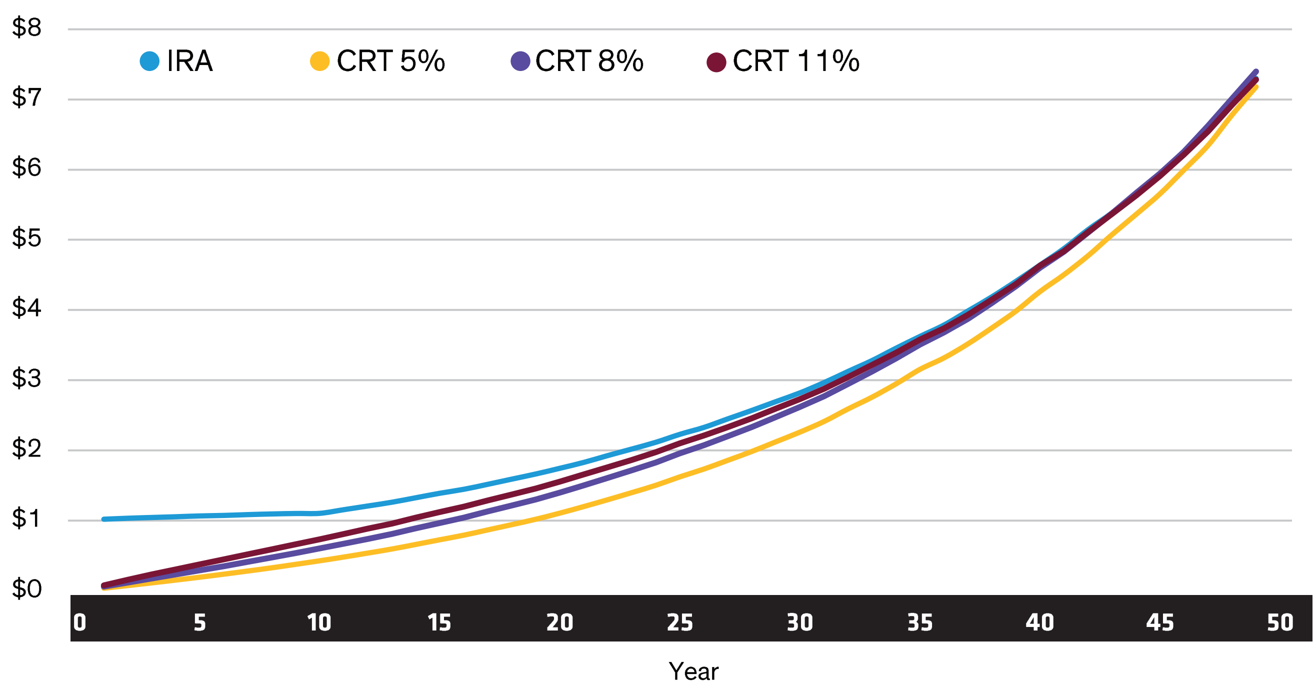
If the CRT terminates earlier, the charity will receive an even larger share of the wealth, potentially disinheriting future generations. On the other hand, if Kai lives long enough to draw sufficient funds to his side of the ledger through ongoing CRT distributions, his personal wealth could potentially approach, if not eclipse, the amount he could realize without the CRT. Here, this "crossover" point is projected to occur at year 50 for the 5% payout, year 40 for the 8% payout, and year 35 for the 11% payout (**Display 10**).

We should acknowledge that while the stretch achieved via the CRT more closely resembles that of the eligible designated beneficiary, it is still not equal. Ola may choose to go one step further and leave the entire IRA to a CRT with both Phoebe and Kai as beneficiaries. Of course, the CRT should not directly list Phoebe as a beneficiary as the unitrust distributions could disrupt her government benefits. Fortunately, while most trusts cannot be named as a permissible beneficiary of a CRT, an exception exists for SNTs. By naming both the SNT and Kai as beneficiaries of the CRT, Ola ensures that each child receives an equal distribution from the CRT—at least during their lifetimes. The flip side is that the larger the CRT, the greater the potential for charity to ultimately receive a disproportionate share of the wealth in the event of an untimely death of one of her children.

Introducing a CRT to an estate plan adds complexity, adds a charitable beneficiary, and limits the estate beneficiary's access to liquidity. Many families are likely to feel that these drawbacks outweigh the potential value of a synthetic stretch. And sticking with a more traditional pro-rata approach among beneficiaries may be their best option. However, for families with a strong charitable intent and/or those for whom retirement accounts represent their most significant estate asset, a CRT may help equalize after-tax distributions for both "designated" and "eligible designated" beneficiaries.

DISPLAY 10: OVER TIME, LEAVING THE IRA TO A CRT COULD YIELD MORE PERSONAL WEALTH

Total Value of Personal Assets—Median Values*
Nominal (USD Millions)



*"Median" means 50th percentile results of 10,000 trials in our Wealth Forecasting System. Based on AB's estimates of the range of returns for the applicable capital market (as of June 30, 2021) over the next 50 years.The data illustrated above is the total of taxable and non-taxable personal assets over the next 50 years. The IRA scenario assumes the IRA is distributed evenly over the first 10 years of the analysis and the distributions are reinvested in a taxable portfolio. The "CRT" scenarios assume a lifetime CRT for a single person who is 50 years old with a 5%, 8%, or 11% payout. The above does not account for any remainder left to charity. All assets were modeled with an allocation of 70% global stocks and 30% bonds. Data do not represent past performance and are not a promise of actual future results or a range of future results. The tax accounting rules for CRUTs are complicated and should be fully understood before making decisions on this strategy. Bernstein does not provide legal, tax, or accounting advice. See Notes on the Bernstein Wealth Forecasting System in the Appendix for further details. Numbers may not sum due to rounding.

Summary

The SECURE Act dramatically altered the landscape for inherited IRAs. The 10-year forced distribution requirement leaves years—if not decades—of tax deferral on the table. The lifetime stretch afforded to eligible designated beneficiaries is a compelling exception that may inspire an estate planning course correction for families with disabled beneficiaries.[27] Under the right set of circumstances (a long time horizon, the opportunity for a full single-filer bracket run, and sufficient funding to support the disabled beneficiary's spending needs), leaving retirement assets to a properly structured SNT could yield more total family wealth. Nevertheless, families will need to evaluate their circumstances and priorities before making any substantial changes to their estate plans as a result.

27 Based on a Section 7520 rate of 3.6%.

The lifetime stretch afforded to eligible designated beneficiaries is a compelling exception that may inspire an estate planning course correction for families with disabled beneficiaries.

The author would like to thank Joshua L. Brothers, J.D. and Katrina B. Durkin, J.D. for their invaluable insights in reviewing this paper.

Notes on the Bernstein Wealth Forecasting System^{SM}

The Bernstein Wealth Forecasting System^{SM} uses a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation and produces a probability distribution of outcomes. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts: (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.

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