# Best Planning Ideas for 2025 – Index of Supporting Materials

Estate Planning Council of St. Louis
January 9, 2025

A. Impact of the Election on Accounting, Insurance, Investments, and Estate Planning
N/A

B. SECURE Act final and proposed regs on IRAs in trust
   A. Gorin, Steven B., *Drafting under the SECURE Act.*

C. The impact of *Connelly* and *Huffman* on life insurance-funded buy-sells
   A. *Connelly v United States*, 602 US 257 (06/06/2024).
   B. Demeros, Georgia L. and Gorin, Steven B., *Buy-Sell Agreements after Connelly*.
   C. *Huffman v. Commissioner*, T.C. Memo. 2024-12

D. Innovations in Tax Aware Investing
   A. Dole, Elliot, *slides from presentation*.

E. Planning for state estate tax
N/A

F. Use of Internal Revenue Code §1035 to redeploy assets for estate planning purposes
N/A

G. Income Tax Planning: Impact of residency change
N/A

H. Modifying irrevocable trusts in light of 2023 CCA, *Anenberg*, and *McDougal*
   A. 2023 CCA 202352018 - Chief Counsel Advice regarding gift tax consequences of modifying grantor trusts to add reimbursement clause.
   B. Gorin, Steven B. and Kaufman, Beth S., *Trust Modification: Planning in Light of CCA 20235018*.
   C. *Estate of Anenberg v. Commissioner*, 162 T.C. No. 9 (2024)
   D. *McDougall v. Commissioner*, 163 T.C. No. 5 (9/17/2024)

I. Bonus Material (Will not be discussed in detail)
   A. 89 FR 104915 – Proposed Regulations to Circular 230
      - Steve will be discussing these (a) in his quarterly newsletter, and (b) as a segment in his no-cost quarterly webinars:
        - January 28 at noon (through Thompson Coburn) – subscribe here: https://www.thompsoncoburn.com/subscribe/
        - February 5 at 8 am and February 17 at 4 pm (through CPA Academy) https://www.cpaacademy.org/

**Drafting under the SECURE Act**

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This document may be cited as Gorin, [number and name of part as shown in the Table of Contents], "Drafting under the SECURE Act" (printed 2/12/2020), available by emailing the author at sgorin@thompsoncoburn.com. The author also publishes "Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications," a few thousand pages in a fully searchable PDF; to receive quarterly a link to the most recent version of that and to the author's seminars and webinars (including the SECURE Act), please complete *********.thompsoncoburn.com/forms/gorin-newsletter.

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## Drafting under the SECURE Act

### I. Explanation of Regulations' View of Trusts

ACTEC Comments on the SECURE Act – before the proposed regulations were promulgated - are linked here. ACTEC Comments on the proposed regulations under the SECURE Act are linked here (5/24/2022). ACTEC Comments of SECURE 2.0 – particularly spousal elections - are linked here (6/23/2023); and comments on July 19, 2024 proposed regulations are here (9/11/2024). This document assumes familiarity with the minimum distribution rules but a desire to explore drafting trusts to comply with those rules.

In "Determining Which See-Through Trust Beneficiaries Are Treated as Beneficiaries of the Employee," the preamble to the final regulations explains:

#### 1. See-Through Trust Beneficiaries Taken Into Account

Generally, the regulations provide that a beneficiary of a see-through trust is treated as a beneficiary of the employee if the beneficiary could receive amounts in the trust representing the employee's interest in the plan that are neither contingent upon nor delayed until the death of another trust beneficiary who does not predecease (and who is not treated as having predeceased)[9] the employee. A beneficiary described in the preceding sentence is referred to as a primary beneficiary in this Summary of Comments and Explanation of Revisions. One commenter requested that the final regulations provide a uniform simultaneous death provision for determining whether one beneficiary predeceases another beneficiary. The final regulations do not adopt this request because the disposition of property interests is governed by State law rather than by these regulations.

[9] For purposes of this rule, a beneficiary is treated as having predeceased the employee if the beneficiary is treated as predeceasing the employee pursuant to a simultaneous death provision under applicable State law or a qualified disclaimer satisfying section 2518 that applies to the entire interest to which the beneficiary is entitled.

Whether any other see-through trust beneficiary also is treated as a beneficiary of the employee depends upon whether the see-through trust is a conduit trust or an accumulation trust. A conduit trust is defined in the regulations as a see-through trust, the terms of which provide that all plan distributions will, upon receipt by the trustee, be paid directly to, or for the benefit of, primary beneficiaries during their lifetimes. For example, if an employee names a see-through trust as the beneficiary of the employee's interest in a plan and the trust terms provide that all distributions from the plan to the trust during the surviving spouse's life will, upon receipt by the trustee, be paid directly to that surviving spouse, then the trust is a conduit trust and the surviving spouse is treated as a beneficiary of the employee because the surviving spouse could receive amounts in the trust with respect to the deceased employee's interest in the plan that are neither contingent upon nor delayed until the death of another trust beneficiary. In this case, any beneficiary who could receive distributions from the trust with respect to the deceased employee's interest in the plan after the surviving spouse's death is not treated as a beneficiary of the employee.

An accumulation trust is any see-through trust that is not a conduit trust, and under an accumulation trust, there are potentially more beneficiaries. A beneficiary of an

accumulation trust is treated as a beneficiary of the employee if that beneficiary could receive amounts accumulated in the trust representing the employee's interest in the plan that were not distributed to other beneficiaries during their lifetimes (unless that beneficiary is disregarded pursuant to the rules described in section II.D.2.a.2 of this Summary of Comments and Explanation of Revisions). A beneficiary described in the preceding sentence is referred to as a residual beneficiary in this Summary of Comments and Explanation of Revisions.

As an illustration of the rule in the preceding paragraph, assume an employee designates a see-through trust as the sole beneficiary of the employee's interest in the plan. The terms of the see-through trust provide that the trustee is to pay specified amounts from the trust to the employee's surviving spouse, but do not provide that all plan distributions made to the trust will, upon receipt by the trustee, be paid directly to, or for the benefit of, the spouse. Upon the spouse's death, the see-through trust will terminate and the amounts remaining in the trust will be paid to the employee's brother. The surviving spouse is treated as a beneficiary of the employee (because the surviving spouse could receive amounts in the see-through trust representing the deceased employee's interest in the plan that are neither contingent upon nor delayed until the death of another trust beneficiary). Moreover, because not all distributions from the plan to the see-through trust are required, upon receipt by the trustee, to be paid directly to, or for the benefit of, a trust beneficiary, the trust is an accumulation trust. As a result, the employee's brother is treated as a beneficiary of the employee because he is the residual beneficiary of an accumulation trust (unless the employee's brother is disregarded pursuant to the rules described in section II.D.2.a.2 of this Summary of Comments and Explanation of Revisions).

One commenter requested that the final regulations provide that a see-through trust can still be a conduit trust if it includes certain trust terms. Specifically, the commenter requested that final regulations provide that a see-through trust will not fail to be treated as a conduit trust merely because that trust does not provide that, with respect to the deceased employee's interest in the plan, all distributions will, upon receipt by the trustee, be paid directly to a specified beneficiary provided that the beneficiary has a unilateral withdrawal right with respect to those amounts. The final regulations do not include this change because the Treasury Department and the IRS are concerned that if a trust merely provides a beneficiary with this type of unilateral withdrawal right (rather than providing that any distribution from the plan, upon receipt by the trustee, be paid directly to that beneficiary), then there could be an accumulation within the trust of amounts representing the employee's interest in the plan that could be paid to a different trust beneficiary. In those cases, the trust beneficiaries who could benefit from that accumulation should also be treated as beneficiaries of the employee for purposes of section 401(a)(9) (without regard to the taxability of the distribution).

Commenters requested that the regulations clarify the see-through trust rules in the case of payments that are not made directly to the trust beneficiary but are made indirectly for the benefit of the trust beneficiary (such as payments to a custodial account for the benefit of a minor child). In response to those comments, these regulations provide that a trust beneficiary will be treated as if that beneficiary could receive amounts in the trust representing the employee's interest in the plan regardless of whether those amounts could be paid directly to that beneficiary or indirectly for the benefit of that beneficiary.

**2. Disregarded Beneficiaries of See-Through Trusts**

The regulations provide for certain beneficiaries of a see-through trust to be disregarded as beneficiaries of the employee for purposes of section 401(a)(9). Specifically, a beneficiary of a see-through trust is not treated as a beneficiary of the employee if that trust beneficiary could receive payments from the trust that represent the employee's interest in the plan only after the death of another trust beneficiary who is a residual beneficiary (and is not also a primary beneficiary) who did not predecease (and is not treated as having predeceased) the employee.

One commenter requested that the disregard described in the preceding paragraph should not be affected by a trustee's ability to make sprinkling distributions to a residual beneficiary (that is, distributions for the health, support, or maintenance of that residual beneficiary) during the lifetime of a primary beneficiary. The Treasury Department and the IRS disagree with this request because of the potential for the primary beneficiary to be entitled to only a nominal amount (so that the residual beneficiary entitled to sprinkling distributions is effectively the primary beneficiary). In that case, the beneficiary who is entitled to amounts representing the employee's interest in the plan after the death of the residual beneficiary has a significant interest in amounts accumulated in the trust representing the employee's interest in the plan and should be treated as a beneficiary of the employee.

The regulations provide another exception under which a see-through trust beneficiary with a residual interest is disregarded as a beneficiary of the employee. Specifically, the regulations provide that if the see-through trust terms require a full distribution of amounts in the trust representing the employee's interest in the plan to a specified trust beneficiary by the later of: (1) the calendar year following the calendar year of the employee's death; and (2) the end of the calendar year that includes the tenth anniversary of the date the designated beneficiary reaches the age of majority, then any other beneficiary whose sole entitlement to distributions is conditioned on the specified trust beneficiary's death before the full distribution is required is disregarded as a beneficiary of the employee.

One commenter requested that the final regulations also disregard beneficiaries who have a contingent interest in the employee's benefit under the plan if the likelihood of that contingency occurring is remote (for example, the probability of that contingency occurring is less than 5 percent). The final regulations do not adopt this broad disregard because it is too difficult to determine the likelihood of a stated event occurring prior to a specified date in cases other than an individual reaching a particular age or a residual beneficiary predeceasing another designated beneficiary entitled to amounts in the trust.

Before we discuss trusts, let's look at some basics. Reg. § 1.401(a)(9)-3(c), "Distributions in the case of a defined contribution plan," provides:

(1) *In general*. The requirements of this paragraph (c) are satisfied if distributions are made in accordance with paragraph (c)(2), (3), or (4) of this section, whichever applies with respect to the employee. The determination of whether paragraph (c)(2), (3), or (4) of this section applies is made in accordance with paragraph (c)(5) of this section.

(2) *5-year rule*. Distributions satisfy this paragraph (c)(2) if the employee's entire interest is distributed by the end of the calendar year that includes the fifth anniversary of the date of the employee's death. For example, if an employee dies on any day in 2022,

the entire interest must be distributed by the end of 2027 in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii). For purposes of this paragraph (c)(2), if an employee died before January 1, 2020, then the 2020 calendar year is disregarded when determining the calendar year that includes the fifth anniversary of the date of the employee's death.

(3) *10-year rule*. Distributions satisfy this paragraph (c)(3) if the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the date of the employee's death. For example, if an employee died on any day in 2021, the entire interest must be distributed by the end of 2031 in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii), as extended to 10 years by section 401(a)(9)(H)(i).

(4) *Life expectancy payments*. Distributions satisfy this paragraph (c)(4) if annual distributions that satisfy the requirements of § 1.401(a)(9)-5 commence by the end of the calendar year following the calendar year in which the employee died, except as provided in paragraph (d) of this section (permitting a surviving spouse to delay the commencement of distributions). The requirement to take an annual distribution in accordance with the preceding sentence continues to apply for all subsequent calendar years until the employee's interest is fully distributed. Thus, a required minimum distribution is due for the calendar year of the eligible designated beneficiary's death, and that amount must be distributed during that calendar year to any beneficiary of the deceased eligible designated beneficiary to the extent it has not already been distributed to the eligible designated beneficiary.

(5) *Determination of which rule applies*.

(i) *No plan provision*. If a defined contribution plan does not include an optional provision described in paragraph (c)(5)(ii) or (c)(5)(iii) of this section specifying the method of distribution after the death of an employee, distributions must be made as follows -

(A) If the employee does not have a designated beneficiary, as determined under § 1.401(a)(9)-4, distributions must satisfy the 5-year rule described in paragraph (c)(2) of this section;

(B) If the employee dies on or after the effective date of section 401(a)(9)(H) (as determined in § 1.401(a)(9)-1(b)(2)(i) or (ii), whichever applies to the plan) and has a designated beneficiary who is not an eligible designated beneficiary (as determined under § 1.401(a)(9)-4(e)), distributions must satisfy the 10-year rule described in paragraph (c)(3) of this section; and

(C) If the employee has an eligible designated beneficiary, distributions must satisfy the life expectancy rule described in paragraph (c)(4) of this section.

(ii) *Optional plan provisions*. A defined contribution plan will not fail to satisfy section 401(a)(9) merely because it includes a provision specifying that the 10-year rule described in paragraph (c)(3) of this section (rather than the life expectancy rule described in paragraph (c)(4) of this section) will apply with respect to some or all of the employees who have an eligible designated beneficiary or will apply to some categories of eligible designated beneficiaries.

(iii) *Elections*. A defined contribution plan will not fail to satisfy section 401(a)(9) merely because it includes a provision that applies with respect to some or all of the employees who have an eligible designated beneficiary or to some categories of eligible designated beneficiaries, under which the employee (or eligible designated beneficiary) is permitted to elect whether the 10-year rule in paragraph (c)(3) of this section or the life expectancy rule in paragraph (c)(4) of this section applies. If a plan provides for this type of election, then -

(A) The plan must specify the method of distribution that applies if neither the employee nor the designated beneficiary makes the election unless that method is the method specified in paragraph (c)(5)(i) of this section;

(B) The election must be made no later than the end of the earlier of the calendar year by which distributions must be made in order to satisfy paragraph (c)(3) of this section and the calendar year in which distributions would be required to begin in order to satisfy the requirements of paragraph (c)(4) of this section (or, if applicable, paragraph (d) of this section); and

(C) As of the last date the election may be made, the election must be irrevocable with respect to the beneficiary (and all subsequent beneficiaries) and must apply to all subsequent calendar years.

Who is a minor child? Reg. § 1.401(a)(9)-4(e)(1)(ii) refers to "A child of the employee (within the meaning of section 152(f)(1)) who has not reached the age of majority within the meaning of paragraph (e)(3) of this section."[1] Code § 152(f)(1), "Child defined," provides:

(A) *In general*. The term "child" means an individual who is -

(i) a son, daughter, stepson, or stepdaughter of the taxpayer, or

(ii) an eligible foster child of the taxpayer.

(B) *Adopted child*. In determining whether any of the relationships specified in subparagraph (A)(i) or paragraph (4) exists, a legally adopted individual of the taxpayer, or an individual who is lawfully placed with the taxpayer for legal adoption by the taxpayer, shall be treated as a child of such individual by blood.

(C) *Eligible foster child*. For purposes of subparagraph (A)(ii), the term "eligible foster child" means an individual who is placed with the taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

Below is a brief discussion of selected excerpts from Reg. § 1.401(a)(9)-4.

Reg. § 1.401(a)(9)-4(f) provides rules for determining designated beneficiaries when benefits are payable to trusts. Before reviewing those rules, consider Reg. § 1.401(a)(9)-4(c)(2), "Circumstances under which a beneficiary is disregarded as a beneficiary of the employee," which provides:

[1] Who is a minor is in fn 28 in part VI Family Trust When At Least One Minor Child EDB.

> With respect to a beneficiary who was designated as a beneficiary under the plan as of the date of the employee's death (including a beneficiary who is treated as having been designated as a beneficiary pursuant to paragraph (f) of this section), if any of the following events occurs by September 30 of the calendar year following the calendar year of the employee's death, then that beneficiary is not treated as a beneficiary -
>
> (i) The beneficiary predeceases the employee;
>
> (ii) The beneficiary is treated as having predeceased the employee pursuant to a simultaneous death provision under applicable State law or pursuant to a qualified disclaimer satisfying section 2518 that applies to the entire interest to which the beneficiary is entitled; or
>
> (iii) The beneficiary receives the entire benefit to which the beneficiary is entitled.

When reviewing a trust agreement, keep in mind Reg. § 1.401(a)(9)-4(a)(3), "Specificity of beneficiary designation," which provides:

> A beneficiary need not be specified by name in the plan or by the employee to the plan in order for the beneficiary to be designated under the plan, provided that the person who is to be the beneficiary is identifiable pursuant to the designation. For example, a designation of the employee's children as beneficiaries of equal shares of the employee's interest in the plan is treated as a designation of beneficiaries under the plan even if the children are not specified by name. The fact that an employee's interest under the plan passes to a certain person under a will or otherwise under applicable State law does not make that person a beneficiary designated under the plan absent a designation under the plan.

The last sentence above continues the general rule that paying benefits to an estate precludes considering the beneficiaries of that estate, so that designating an estate is tantamount to not designating any beneficiary.

Reg. § 1.401(a)(9)-4(c), "Rules for determining beneficiaries," provides:

> (1) *Time period for determining the beneficiary*. Except as provided in paragraphs (d) and (f) of this section and § 1.401(a)(9)-6(b)(2)(i), a person is a beneficiary taken into account for purposes of section 401(a)(9) if, as of the date of the employee's death, that person is a beneficiary designated under the plan and none of the events described in paragraph (c)(2) of this section has occurred with respect to that person by September 30 of the calendar year following the calendar year of the employee's death.
>
> (2) *Circumstances under which a beneficiary is disregarded as a beneficiary of the employee*. With respect to a beneficiary who was designated as a beneficiary under the plan as of the date of the employee's death (including a beneficiary who is treated as having been designated as a beneficiary pursuant to paragraph (f) of this section), if any of the following events occurs by September 30 of the calendar year following the calendar year of the employee's death, then that beneficiary is not treated as a beneficiary -
>
> (i) The beneficiary predeceases the employee;

(ii) The beneficiary is treated as having predeceased the employee pursuant to a simultaneous death provision under applicable State law or pursuant to a qualified disclaimer satisfying section 2518 that applies to the entire interest to which the beneficiary is entitled; or

(iii) The beneficiary receives the entire benefit to which the beneficiary is entitled.

(3) *Examples*. The following examples illustrate the rules of this paragraph (c).

(i) *Example 1*. Employer M maintains a defined contribution plan, Plan X. Employee A dies in 2024 having designated A's three children - B, C, and D - as beneficiaries, each with a one-third share of A's interest in Plan X. B executes a disclaimer of B's entire share of A's interest in Plan X within 9 months of A's death and the disclaimer satisfies the other requirements of a qualified disclaimer under section 2518. Pursuant to the qualified disclaimer, B is disregarded as a beneficiary.

(ii) *Example 2*. The facts are the same as in paragraph (c)(3)(i) of this section (Example 1), except that B does not execute the disclaimer until 10 months after A's death. Even if the disclaimer is executed by September 30 of the calendar year following the calendar year of A's death, the disclaimer is not a qualified disclaimer (because B does not meet the 9-month requirement of section 2518) and B remains a designated beneficiary of A.

(iii) *Example 3*. The facts are the same as in paragraph (c)(3)(i) of this section (Example 1) except that, in exchange for B's disclaimer of the one-third share of A's interest in Plan X, C transfers C's interest in real property to B. Because B has received consideration for B's disclaimer of the one-third share, it is not a qualified disclaimer under section 2518 and B remains a designated beneficiary.

(iv) *Example 4*. The facts are the same as in paragraph (c)(3)(i) of this section (Example 1), except that Charity E (an organization exempt from taxation under section 501(c)(3)) also is a beneficiary designated under the plan as of the date of A's death, with B, C, D, and Charity E each having a one-fourth share of A's interest in Plan X. Plan X distributes Charity E's one-fourth share of A's interest in the plan by September 30 of the calendar year following the calendar year of A's death. Accordingly, Charity E is disregarded as A's beneficiary, and B, C, and D are treated as A's designated beneficiaries.

(v) *Example 5*. The facts are the same as in paragraph (c)(3)(i) of this section (Example 1), except that A's spouse, F, also is a beneficiary designated under the plan. A and F were residents of State Z so that State Z law applies. The laws of State Z include a simultaneous death provision under which two individuals who die within a 120-hour period of one another are treated as predeceasing each other. F dies four hours after A and under the laws of State Z, F is treated as predeceasing A. Because, under applicable State law, F is treated as predeceasing A, F is disregarded as a beneficiary of A.

(vi) *Example 6*. The facts are the same as in paragraph (c)(3)(i) of this section (Example 1), except that B, who was alive as of the date of A's death, dies before September 30 of the calendar year following the calendar year of A's death. Prior to B's death, none of the events described in paragraph (c)(2) of this section

> occurred with respect to B. Accordingly, B is still a beneficiary taken into account for purposes of section 401(a)(9) regardless of the identity of B's successor beneficiaries.

I refer to September 30 of the calendar year following the calendar year of the employee's death as the "beneficiary finalization deadline."

Reg. § 1.401(a)(9)-4(f)(1)(ii), "Types of trusts," includes:

> (A) The term *conduit trust* means a see-through trust, the terms of which provide that, with respect to the deceased employee's interest in the plan, all distributions will, upon receipt by the trustee, be paid directly to, or for the benefit of, specified trust beneficiaries; and
>
> (B) The term *accumulation trust* means any see-through trust that is not a conduit trust.

Note that a conduit trust may have multiple beneficiaries; however, Reg. § 1.401(a)(9)-4(f)(3)(iii), "Certain accumulations disregarded," requires the continuation of the conduit mandate until "the death of all of the beneficiaries described in paragraph (f)(3)(i)(A) of this section," so any downstream trust created for the benefit of any beneficiaries upon trust termination also needs to have conduit provisions:

> For purposes of this paragraph (f)(3), a trust will not fail to be treated as a conduit trust merely because the trust terms requiring that distributions from the plan, upon receipt by the trustee, are paid directly to, or for the benefit of, trust beneficiaries do not apply after the death of all of the beneficiaries described in paragraph (f)(3)(i)(A) of this section.

Reg. § 1.401(a)(9)-4(f)(3)(i) provides that, generally, what I refer to as "current beneficiaries" and "remaindermen" are "treated as having been designated as beneficiaries of the employee under the plan." Reg. § 1.401(a)(9)-4(f)(3)(i)(A) describes what I refer to as a "current beneficiary":

> Any beneficiary that could receive amounts in the trust representing the employee's interest in the plan that are neither contingent upon, nor delayed until, the death of another trust beneficiary who did not predecease (and who is not treated as having predeceased) the employee

Reg. § 1.401(a)(9)-4(f)(3)(i)(B) describes what I refer to as a "remainderman":

> Any beneficiary of an accumulation trust that could receive amounts in the trust representing the employee's interest in the plan that were not distributed to beneficiaries described in paragraph (f)(3)(i)(A) of this section.

However, not all remainderman count:

- Reg. § 1.401(a)(9)-4(f)(3)(ii)(A), "Entitlement conditioned on death of secondary beneficiary," disregards "any beneficiary of an accumulation trust who could receive amounts from the trust that represent the employee's interest in the plan solely because of the death of another" remainderman. However, that rule does not apply if that "other" remainderman "predeceased (or is treated as having predeceased) the employee" or is a current beneficiary.

- Reg. § 1.401(a)(9)-4(f)(3)(ii)(B), "Entitlement conditioned on death of young individual," provides, "If a beneficiary of a see-through trust is" a current beneficiary, "and the terms of the trust require full distribution of amounts in the trust representing the employee's interest in the plan to that individual by the later of the end of the calendar year following the calendar year of the employee's death or the end of the calendar year that includes the tenth anniversary of the date on which that individual reaches the age of majority (within the meaning of paragraph (e)(3) of this section), then any other beneficiary of the trust who could receive amounts in the trust representing the employee's interest in the plan if that individual dies before full distribution to that individual is made is not treated as having been designated as a beneficiary of the employee under the plan. The preceding sentence does not apply if the beneficiary who could receive amounts in the trust conditioned on the death of that individual" is a current beneficiary. Reg. § 1.401(a)(9)-4(e)(3), "Determination of age of majority," provides, "An individual reaches the age of majority on the individual's 21st birthday." In other words, if a trust terminates at the end of the calendar year in which a beneficiary reaches age 31, remaindermen are disregarded.

  Disregarding remaindermen means under this bullet point means that a trust for a minor-child EDB does not have to be a conduit trust to qualify for the life expectancy payout. It does not mean that a beneficiary who is not a minor-child EDB is converted to an EDB; rather, the 10-year rule applies to such a minor non-EDB. Natalie Choate pointed out to me than, for a non-EDB minor, it also means you can disregard the remaindermen when determining the applicable denominator for the trust, if such minor will receive distribution of the trust outright by age 31. In other words it does have a "deferral" benefit even for a non-EDB minor who otherwise could be stuck using the life expectancy of an older remainder beneficiary if participant died after RBD. Also, she emphasizes: the fact that the IRA must be distributed to the trust within 10 years does not mean that the trust must be distributed to the beneficiary within 10 years. The IRA distributions (after taxes are paid) can continue to be held in trust for the benefit of such beneficiary (up to age 31 if you want this disregard rule to apply).

  Also, note that disregarding a remainderman under Reg. § 1.401(a)(9)-4(f)(3)(ii)(B) does not carry over to Reg. § 1.401(a)(9)-4(f)(3)(ii)(A). Thus, if a trust is a Last One Standing Trust (see page 26), terminating in favor of an Age 31 Trust (see page 27) may not allow the remaindermen of the Age 31 Trust to be disregarded.

- If all of the current beneficiaries are disabled or chronically ill, their life expectancies may be used, without regard to the remaindermen, except that a last-one-standing clause appears to be required. Reg. §§ 1.401(a)(9)-4(g)(1)(i) (must be only designated beneficiaries), 1.401(a)(9)-4(g)(3). However, for any other trust for an EDB, all of the remaindermen who count must also be EDBs to be able to use the oldest EDB's life expectancy instead of the 10-year rule. Reg. § 1.401(a)(9)-4(f)(6), comparing Example (2) (use oldest EDB's life expectancy) with Example (3) (use 10-year rule, because first-line remainderman of accumulation trust is not an EDB).

Reg. § 1.401(a)(9)-4(f)(6), Example (2), is quite instructive:

> (A) *Facts related to plan and beneficiary*. Employer M maintains a defined contribution plan, Plan X. Employee A died in 2024 at the age of 55, survived by Spouse B, who was then 50 years old. A's account balance in Plan X is invested only in productive assets and was includible in A's gross estate under section 2039. A named a testamentary trust (Trust P) as the beneficiary of all amounts payable from A's account

in Plan X after A's death. Trust P satisfies the see-through trust requirements of paragraph (f)(2) of this section.

(B) *Facts related to trust*. Under the terms of Trust P, all trust income is payable annually to B, and no one has the power to appoint or distribute Trust P principal to any person other than B. A's sibling, C, who is less than 10 years younger than A (and thus is an eligible designated beneficiary) and is younger than B, is the sole residual beneficiary of Trust P. Also, under the terms of Trust P, if C predeceases B, then, upon B's death, all Trust P principal is distributed to Charity Z (an organization exempt from tax under section 501(c)(3)). No other person has a beneficial interest in Trust P. Under the terms of Trust P, B has the power, exercisable annually, to compel the trustee to withdraw from A's account balance in Plan X an amount equal to the income earned during the calendar year on the assets held in A's account in Plan X and to distribute that amount through Trust P to B. Plan X includes no prohibition on withdrawal from A's account of amounts in excess of the annual required minimum distributions under section 401(a)(9). In accordance with the terms of Plan X, the trustee of Trust P elects to take annual life expectancy payments pursuant to section 401(a)(9)(B)(iii). If B exercises the withdrawal power, the trustee must withdraw from A's account under Plan X the greater of the amount of income earned in the account during the calendar year or the required minimum distribution. However, under the terms of Trust P, and applicable State law, only the portion of the Plan X distribution received by the trustee equal to the income earned by A's account in Plan X is required to be distributed to B (along with any other trust income).

(C) *Analysis*. Because Trust P does not require that distributions from A's account in Plan X to Trust P, upon receipt by the trustee, be paid directly to (or for the benefit of) B, Trust P is not a conduit trust and accordingly is an accumulation trust (as described in paragraph (f)(1)(ii)(B) of this section). Pursuant to paragraph (f)(3)(i)(B) of this section, C, as the residual beneficiary of Trust P, is treated as a beneficiary designated under Plan X (even though access to those amounts is delayed until after B's death). Pursuant to paragraph (f)(2)(iii)(A) of this section, because Charity Z's entitlement to amounts in the trust is based on the death of a beneficiary described in paragraph (f)(3)(i)(B) of this section who is not also described in paragraph (f)(3)(i)(A) of this section, Charity Z is disregarded as a beneficiary of A. Under § 1.401(a)(9)-5(f)(1), the designated beneficiary used to determine the applicable denominator is the oldest of the designated beneficiaries of Trust P's interest in Plan X. B is the oldest of the beneficiaries of Trust P's interest in Plan X (including residual beneficiaries). Thus, the applicable denominator for purposes of section 401(a)(9)(B)(iii) is B's life expectancy. Because C is a beneficiary of A's account in Plan X in addition to B, B is not the sole beneficiary of A's account and the special rule in section 401(a)(9)(B)(iv) and § 1.401(a)(9)-3(d) is not available. Accordingly, the annual required minimum distributions from the account to Trust P must begin no later than the end of the calendar year following the calendar year of A's death.

Key takeaways include:

- The trust is a QTIPable accumulation trust, satisfying Rev. Rul. 2006-26.
- Both the surviving spouse, B, and the decedent’s close-in-age sibling, C, are EDBs.

- Because it was not a conduit trust, the Uniform Life Table is not available for the surviving spouse. The applicable life expectancy is that of the older of the two EDBs.

- The charity, which takes under the wipe-out clause, is disregarded because C would receive the Plan benefits outright.

- Although the sole remainderman is an eligible designated beneficiary, the trust being an accumulation trust prevents the surviving spouse from using the special rule for a surviving spouse to delay distributions until the employee would have reached the required beginning date.

- Not mentioned is that, if the sole individual remainderman had predeceased the employee, the trust may be reformed into a charitable remainder trust under Code § 2055(e)(3).

Looking further at Reg. § 1.401(a)(9)-4(f)(3)(ii)(A), if a trust for a child has only that child as a current beneficiary, then has a trust for only a grandchild as the remainderman, then Reg. § 1.401(a)(9)-4(f)(3)(ii)(A) may disregard those who take only on the death of the grandchild. On the other hand, if the trust for the child also had the child's descendants as beneficiaries, then Reg. § 1.401(a)(9)-4(f)(3)(ii)(A) may disregard only takers on the death of a descendant who was born after the child's death. I am unsure of the full implication of "could" and "solely" and therefore recommend using a Last One Standing clause as a precaution, especially given that this clause can be eliminated after about 10 years.[2]

If one uses a trust that distributes outright at age 31, consider whether to limit any facility of payment clause, such as Section 11.1, "Special Methods of Payment," on page 47 of the materials, so that the retirement plan benefits cannot be held in further trust after age 31. More far-reaching language is unlikely to be necessary, in that Reg. § 1.401(a)(9)-4(f)(1)(ii)(A) requires merely that a conduit trust pay all distributions "directly to, or for the benefit of" the conduit beneficiaries. This is consistent with Code § 401(a)(9)(B)(iii)(I), which refers to "payable to (or for the benefit of) a designated beneficiary." Fortunately, we have guidance on how to do this.[3]

Reg. § 1.401(a)(9)-4(f)(4), "Multiple trust arrangements," provides that, "if a beneficiary of a see-through trust is another trust, the beneficiaries of the second trust will be treated as beneficiaries of the first trust," if the documentation requirements of Reg. § 1.401(a)(9)-4(f)(2) are satisfied regarding that second trust; thus, "the beneficiaries of the second trust are treated as having been designated as beneficiaries of the employee under the plan." I am unsure what this means: If the second trust terminates in favor of another trust, then do the beneficiaries of the third and perhaps subsequent trusts need to be tested? I don't know the answer. To try to be safe, for now I am using the last-one-standing approach – when only one individual is left in the complete line of beneficiary succession, that person receives the benefits and any reinvested distributions outright.

Reg. § 1.401(a)(9)-4(f)(5) describes "Identifiability of trust beneficiaries." Reg. § 1.401(a)(9)-4(f)(5)(i) provides that current beneficiaries and remaindermen "are identifiable if it is possible to identify each person eligible to receive a portion of the employee's interest in the plan through the trust" and applies the Reg. § 1.401(a)(9)-4(a)(3) specificity requirements.

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[2] See paragraph of text accompanying fn 15 on page **Error! Bookmark not defined.**.

[3] See text accompanying fn 25 in part IV Revocable Trust, Per Stirpes Provision; Other Section 11.17 Additions.

Reg. § 1.401(a)(9)-5(e), (f)[4] explains the effect of multiple beneficiaries on which distribution periods are used.

Reg. § 1.401(a)(9)-4(f)(4)(ii), "Power of appointment," provides much needed relief relative to what we perceived the rules to be before the SECURE Act:

> (A) *Exercise or release of power of appointment by September 30*. A trust does not fail to satisfy the identifiability requirements of this paragraph (f)(5) merely because an individual (powerholder) has the power to appoint a portion of the employee's interest to one or more beneficiaries that are not identifiable within the meaning of paragraph (f)(5)(i) of this section. If the power of appointment is exercised in favor of one or more identifiable beneficiaries by September 30 of the calendar year following the calendar year of the employee's death, then those identifiable beneficiaries are treated as beneficiaries designated under the plan. The preceding sentence also applies if, by that September 30, in lieu of exercising the power of appointment, the powerholder restricts it so that the power can be exercised at a later time in favor of only two or more identifiable beneficiaries (in which case, those identified beneficiaries are treated as beneficiaries designated under the plan). However, if, by that September 30, the power of appointment is not exercised (or restricted) in favor of one or more beneficiaries that are identifiable within the meaning of paragraph (f)(5)(i) of this section, then each taker in default (that is, any person that is entitled to the portion that represents the employee's interest in the plan subject to the power of appointment in the absence of the powerholder's exercise of the power) is treated as a beneficiary designated under the plan.
>
> (B) *Exercise of power of appointment after September 30 of the calendar year following the calendar year of the employee's death*. If an individual has a power of appointment to appoint a portion of the employee's interest to one or more beneficiaries and the individual exercises the power of appointment after September 30 of the calendar year following the calendar year of the employee's death, then the rules of paragraph (f)(5)(iv) of this section apply with respect to any trust beneficiary that is added pursuant to the exercise of the power of appointment.

Ignoring an unexercised power of appointment greatly simplifies drafting – we no longer need to concern ourselves with the scope of a power of appointment![5] Instead, we have to be careful in drafting the exercise of a power of appointment so that we don't shorten the period in an inadvisable manner. Reg. § 1.401(a)(9)-4(f)(5)(iv), "Addition of beneficiary after September 30," provides the consequence:

> If, after September 30 of the calendar year following the calendar year of the employee's death, a trust beneficiary described in paragraph (f)(3) of this section is added as a trust beneficiary (whether through the exercise of a power of appointment, the modification of trust terms, or otherwise), then -

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[4] Above includes separate links for each of Reg. § 1.401(a)(9)-5, Reg. § 1.401(a)(9)-5(e), and Reg. § 1.401(a)(9)-5(f).

[5] How does one restrict a power of appointment? If the power if exercisable only by will, the trust agreement or applicable state law would need to provide a mechanism. My trust agreement, when defining the term "Appoint" (see page 53 of this document), allows the inter vivos exercise of powers of appointment, whether the power takes effect immediately or merely passes property at the death of the person holding the power.

(A) The addition of the beneficiary will not cause the trust to fail to satisfy the identifiability requirements of this paragraph (f)(5);

(B) Beginning in the calendar year following the calendar year in which the new trust beneficiary was added, the rules of § 1.401(a)(9)-5(f)(1) will apply taking into account the new beneficiary and all of the beneficiaries of the trust that were treated as beneficiaries of the employee before the addition of the new beneficiary; and

(C) Subject to paragraph (f)(5)(v) of this section, the rules of paragraphs (b) and (e)(2) of this section and § 1.401(a)(9)-5(f)(2) will apply taking into account the new beneficiary and all of the beneficiaries of the trust that were treated as beneficiaries of the employee before the addition of the new beneficiary.

Reg. § 1.401(a)(9)-4(f)(4)(iii), "Modification of trust terms," provides:

(A) *State law will not cause trust to fail to satisfy identifiability requirement*. A trust will not fail to satisfy the identifiability requirements of this paragraph (f)(5) merely because the trust is subject to State law that permits the trust terms to be modified after the death of the employee (such as through a court reformation or a permitted decanting) and thus, permits changing the beneficiaries of the trust.

(B) *Modification of trust to remove trust beneficiaries*. If a trust beneficiary described in paragraph (f)(3) of this section is removed pursuant to a modification of trust terms (such as through a court reformation or a permitted decanting) by September 30 of the calendar year following the calendar year of the employee's death, then that person is disregarded in determining the employee's designated beneficiary.

(C) *Modification of trust to add trust beneficiaries*. If a trust beneficiary described in paragraph (f)(3) of this section is added through a modification of trust terms (such as through a court reformation or a permitted decanting) on or before September 30 of the calendar year following the calendar year of the employee's death, then paragraph (c) of this section will apply taking into account the beneficiary that was added. If the beneficiary is added after that September 30, then the rules of paragraph (f)(5)(iv) of this section will apply with respect to the addition of that beneficiary.

For further relief when a beneficiary is added, Reg. § 1.401(a)(9)-4(f)(5)(v), "Delay in full distribution requirement," ameliorates the consequence:

This paragraph (f)(5)(v) provides a special rule that applies if a full distribution of the employee's entire interest in the plan is not required in a calendar year pursuant to § 1.401(a)(9)-5(e), but a beneficiary is added in that calendar year. In that case, if, taking into account the added beneficiary pursuant to paragraph (f)(5)(iv)(C) of this section, a full distribution of the employee's entire interest in the plan would have been required in that calendar year or an earlier calendar year, then a full distribution of the employee's entire interest in the plan will not be required until the end of the calendar year following the calendar year in which the beneficiary is added. For example, if life expectancy payments are being made to an eligible designated beneficiary and, more than 10 years after the employee's death, a beneficiary is added who is not an eligible designated beneficiary as described in paragraph (e) of this section, then the employee is treated as not having an eligible designated beneficiary for purposes of § 1.401(a)(9)-5(e)(2) (so that a full distribution of the employee's entire interest in the plan would have been required within

10 years of the employee's death). However, pursuant to this paragraph (f)(5)(v), the full distribution of the employee's entire interest in the plan is not required until the end of the calendar year following the calendar year in which the new trust beneficiary was added.

Note that, once the benefits have been fully distributed to the trust, we don't have to worry about how a later exercise might have affected the distribution period. So, the last-one-standing approach is not absolute – after the benefits have been fully distributed, a power of appointment can override it without any consequence.

Reg. § 1.401(a)(9)-4(f)(6)(iv), which is Example (4), provides:

(A) *Facts related to plan and beneficiary*. Employer N maintains a defined contribution plan, Plan Y. Employee F died in 2025 at the age of 60. F named a testamentary trust (Trust Q), which was established under F's will, as the beneficiary of all amounts payable from F's account in Plan X after F's death. Trust Q satisfies the see-through trust requirements of paragraph (f)(2) of this section.

(B) *Facts related to trust*. Under the terms of Trust Q, all trust income is payable to F's surviving spouse G for life, no person has the power to appoint or distribute Trust Q principal to any person other than G, and G has a testamentary power of appointment to name the beneficiaries of the remainder in Trust Q. The power of appointment provides that, if G does not exercise the power, then upon G's death, F's descendants, per stirpes, are entitled to the remainder interest in Trust Q. As of the date of F's death, F has two children, K and L, neither of whom is disabled, chronically ill, or under age 21. Before September 30 of the calendar year following the calendar year in which F died, G irrevocably restricts G's power of appointment so that G may exercise the power to appoint the remainder beneficiaries of Trust Q only in favor of G's siblings (who all are less than 10 years younger than F and thus, are eligible designated beneficiaries).

(C) *Analysis*. Pursuant to paragraph (f)(5)(ii)(A) of this section, because G timely restricted the power of appointment so that G may exercise the power to appoint the residual interest in Trust Q only in favor of G's siblings, the designated beneficiaries are G and G's siblings. Because all of the designated beneficiaries are eligible designated beneficiaries, annual life expectancy payments are permitted under section 401(a)(9)(B)(iii). Note, however, that because § 1.401(a)(9)-5(e)(3) applies, a distribution of the remaining interest is required by no later than 10 years after the calendar year in which the oldest of G and G's siblings dies.

The example is a little unclear, in that it says that G irrevocably restricted the exercise of the power of appointment but does not say that G actually exercised it. Initially I had assumed that the government assumed that the restriction was combined with a revocable exercise. Then I realized that the scope of a power of appointment would be irrelevant, when any power of appointment is disregarded except to the extent that the power is exercised. I have now concluded that irrevocably restricting a power of appointment counts as the equivalent of an exercise, even though it does not actually change the remaindermen expected to take under the trust agreement. The government is simply giving us a way to reduce who is counted without actually changing who is likely to take.

ACTEC Comments on the proposed regulations under the SECURE Act (5/24/2022) include:

**12. Treasury Should Clarify the Application of the Provisions in §§ 1.401(a)(9)-4(f)(5)(ii) and (iv) regarding Powers of Appointment.**

ACTEC observes that many individuals include "powers of appointment" in their trusts to provide flexibility in future planning for changes in circumstances. A power of appointment allows the powerholder to appoint the trust to one or more members of a stated class of potential beneficiaries in a certain manner as provided in the trust instrument. It is customary for the creator of the trust instrument to also name "takers in default" who will receive the trust interest if such power of appointment is not exercised.

Treasury has clarified in § 1.401(a)(9)-4(f)(5)(ii) that a see-through trust does not fail to satisfy the requirement that beneficiaries be identifiable merely because the trust includes a power of appointment, and has also clarified when certain actions taken with respect to a power of appointment impact the determination of the trust's beneficiaries as of the September 30 of the calendar year following the year of the Employee's death.

Treasury has also required in § 1.401(a)(9)-5(f)(iv) that if certain actions are taken after the September 30 determination date, including an exercise of a power of appointment, that result in additional beneficiaries being counted as beneficiaries of the trust, then the rules of § 1.401(a)(9)-5(f)(1) will be re-applied to take such additional beneficiary(ies) into account, effective the following calendar year. This redetermination requirement could be problematical for certain trustees, beneficiaries, and Plan administrators, as it is foreseeable that a power of appointment might be exercised after the September 30 determination date in a way that adds a new beneficiary, and those involved in the exercise of the power fail to recognize the need to redetermine RMDs. As a result, less than all of the RMDs for subsequent years may be timely distributed and the Plan administrator may be completely unaware that such a power has even been exercised.

ACTEC recognizes why the clarifications that are so helpful in the design and initial determination of trust beneficiaries must be accompanied by the requirement of a redetermination when a post-September 30 determination date exercise of a power of appointment or other actions result in new beneficiaries. On balance, ACTEC commends the approach Treasury has taken, because ACTEC anticipates that:

(i) The clarifications provided in § 1.401(a)(9)-4(f)(5)(ii) will be helpful in the vast number of situations where see-through trusts contain powers of appointment. These clarifications will help the Employee determine which terms to include in the see-through trust that will be designated as the beneficiary of the Employee's Plan, and will help in the determination of the designated beneficiaries of such a trust as of the September 30 determination date after an Employee's death; and

(ii) There will be relatively few situations in which an exercise of a power of appointment will occur before the Employee's Plan interest is fully distributed that adds one or more beneficiaries in a way that would increase RMDs, but a redetermination of RMDs is inadvertently not made.

ACTEC recommends that Treasury consider adding clarification in the Proposed Regulations that any such failure to redetermine RMDs does not result in exposure to the Plan administrator, and does not disqualify the Plan. ACTEC also recommends adding

clarification in the Proposed Regulations that any such failure constitutes "reasonable error" for purposes of § 54.4974-1(g)(1).

Finally, ACTEC also requests that Treasury add examples such as the following to these Regulations to clarify further the application of these proposed rules.

> *Example 12A*. Employee A named her Trust Z as sole beneficiary of Employee A's plan interest upon A's death. Trust Z provides that, after A's death, B is entitled to receive all of the income for B's life. Trust Z grants B a power of appointment, exercisable by B's Last Will and Testament or other written instrument, to appoint the trust assets remaining at B's death to any one or more recipients consisting of B's descendants or Code section 501(c)(3) organizations. Trust Z provides that, if B does not exercise the power of appointment, then B's three children C, D and E will receive the trust assets. B survives A and is still living on September 30 of the year following the year of A's death. Additionally, on or before September 30 of the calendar year following the calendar year of A's death, B executes a new Will that exercises B's power of appointment in favor of B's child C only. On or before October 31 of the calendar year following the calendar year of A's death, B provides a copy of Trust Z and a copy of B's new Will to the Plan administrator together with a written statement to the effect that if B revises B's Will at any future date, B will promptly provide a copy of the revised Will to the Plan administrator.
>
> *Analysis*. Pursuant to § 1.401(a)(9)-4(f)(5)(ii)(A), only B and C are treated as beneficiaries designated under the Plan.
>
> *Example 12B*. The same facts as Example 12A, except there is no exercise of the power of appointment by B on or before September 30 of the calendar year following the calendar year of A's death. However, on or before the September 30 date, B signs a document that irrevocably restricts the power of appointment so that it can be exercised at a later time but only in favor of B's children C and E. On or before October 31 of the calendar year following the calendar year of A's death, B provides a copy of the irrevocable restriction of the power of appointment to the Plan administrator.
>
> *Analysis*. Pursuant to § 1.401(a)(9)-4(f)(5)(ii)(A), only B, C and E are treated as beneficiaries designated under the Plan.
>
> *Example 12C*. The same facts as Example 12A, except there is no exercise of the power of appointment by B on or before September 30 of the calendar year following the calendar year of A's death. On January 10 of the second year following the year of A's death, B executes a new Will revoking all prior Wills. The Will executed on January 10 exercises B's power of appointment in favor of X charitable organization and the children of child C (B's grandchildren). On or before the end of the second calendar year following the year of A's death, B provides a copy of the new Will to the Plan administrator together with a statement to the effect that if B revises B's Will at any future date, B will promptly provide a copy of the revised Will to the Plan administrator.
>
> *Analysis*. Pursuant to § 1.401(a)(9)-4(f)(5)(ii)(B), only B and the takers in default, C, D, and E are initially treated as beneficiaries designated under the Plan. However, B's

execution of a new Will on January 10 requires a prospective redetermination of the trust's required minimum distributions pursuant to the rules of § 1.401(a)(9)-4(f)(5)(iv).

These Examples illustrate how the rules set forth in § 1.401(a)(9)-4(f)(5)(ii) apply to (i) an exercise of a power of appointment on or before September 30 of the calendar year following the calendar year of the Employee's death, (ii) a restriction of a power of appointment on or before such September 30 date, and (iii) an exercise of a power of appointment after such September 30 date. In addition, the Examples set forth reasonable examples of the documentation that should be provided to the Plan administrator regarding the exercise or restriction of powers of appointment as set forth in § 1.401(a)(9)-4(f)(5)(ii).

The final regulations did not respond to the above Comment about powers of appointment in any way whatsoever, except that it eased the notification requirement, as the preamble explains:

Section 1.401(a)(9)-4(h) permits an employee who wants to name a trust as a beneficiary to treat the underlying beneficiaries of the trust as designated beneficiaries of the employee's benefit under a retirement plan if the employee (or the trustee of the trust) either: (1) provides a copy of the trust instrument to the plan administrator or (2) provides a list of all the beneficiaries of the trust, certifies that, to the best of the employee's (or trustee's) knowledge, this list is correct and complete, and agrees to provide a copy of the trust instrument upon demand. If the trust instrument is amended at any time in the future, the employee (or trustee) must, within a reasonable time, provide a copy of each such amendment, or provide corrected certifications to the extent that the amendment changes the information previously certified. This requirement must generally be satisfied no later than October 31 of the calendar year following the calendar year of the employee's death.

It also eliminated the notification requirement for IRAs:

… as described in section IV of this Summary of Comments and Explanation of Revisions, the regulations provide that a trustee of a see-through trust is not required to provide the trust documentation to an IRA custodian, trustee, or issuer.

If the trust agreement does not sufficiently restrict the current beneficiaries and the remaindermen who count, we can fall back on Reg. § 1.401(a)(9)-4(f)(5)(iii), "Modification of trust terms," which provides:

(A) *State law will not cause trust to fail to satisfy identifiability requirement*. A trust will not fail to satisfy the identifiability requirements of this paragraph (f)(5) merely because the trust is subject to State law that permits the trust terms to be modified after the death of the employee (such as through a court reformation or a permitted decanting) and thus, permits changing the beneficiaries of the trust.

(B) *Modification of trust to remove trust beneficiaries*. If a trust beneficiary described in paragraph (f)(3) of this section is removed pursuant to a modification of trust terms (such as through a court reformation or a permitted decanting) by September 30 of the calendar year following the calendar year of the employee's death, then that person is disregarded in determining the employee's designated beneficiary.

(C) *Modification of trust to add trust beneficiaries*. If a trust beneficiary described in paragraph (f)(3) of this section is added through a modification of trust terms (such as

through a court reformation or a permitted decanting) on or before September 30 of the calendar year following the calendar year of the employee's death, then paragraph (c) of this section will apply taking into account the beneficiary that was added. If the beneficiary is added after that September 30, then the rules of paragraph (f)(5)(iv) of this section will apply with respect to the addition of that beneficiary.

Suppose a trust is divided and beneficial interests are rearranged, and all of that happens before the September 30 beneficiary finalization date. The IRA is then divided into a separate inherited IRA for each resulting separate trust. Do the unique characteristics of each separate trust apply to separately determine payouts, or does Reg. § 1.401(a)(9)-8(a)(1)(iii), "Separate application of section 401(a)(9) for trust beneficiaries," put the kibosh on that, subject to a particular exception:

(A) *General prohibition*. Except as provided in paragraph (a)(1)(iii)(B) of this section, section 401(a)(9) may not be applied separately to the separate interests of each of the beneficiaries of a see-through trust described in § 1.401(a)(9)-4(f)(1)(i). For purposes of the excise tax under section 4974, unless the exception in paragraph (a)(1)(iii)(B) of this section applies, the trust is the payee with respect to the required distribution of the employee's interest in the plan.

(B) *Exception for certain trusts divided upon the death of the employee*. Section 401(a)(9) is applied separately with respect to the separate interests of the beneficiaries of a see-through trust if the terms of the trust provide that it is to be divided immediately upon the death of the employee, provided that the requirements in paragraph (a)(1)(iii)(C) of this section are satisfied. The preceding sentence applies only if the separate interests are held in separate see-through trusts (in which case the rules of §§ 1.401(a)(9)-4(f) and 1.401(a)(9)-5 will apply separately to each separate trust).

(C) *Immediately divided defined*. For purposes of paragraph (a)(1)(iii)(B) of this section, a trust is immediately divided upon the death of the employee only if, as of the date of death, the trust is terminated and there is no discretion as to the extent to which of the separate trusts post-death distributions attributable to the employee's interest in the plan are allocated. A trust does not fail to be immediately divided upon the death of the employee merely because there are administrative delays between the date of the employee's death and the date on which the trust is divided and terminated, provided that any amounts received by the trust during this period are allocated as if the trust had been divided on the date of the employee's death.

The preamble elaborates:

The proposed regulations generally retained the separate account rules applicable to beneficiaries after the death of the employee that were adopted in the 2002 final regulations, including the rule that prohibits separate application of section 401(a)(9) to separate interests in a trust. However, in light of the enactment of special rules that apply to an applicable multi-beneficiary trust described in section 401(a)(9)(H)(iv)(I) (a trust with at least one disabled or chronically ill beneficiary that provides that it is to be immediately divided upon the death of the employee into separate trusts for each beneficiary), the proposed regulations provided an exception to that prohibition that would permit separate application of section 401(a)(9) to those separate trusts.

Consistent with requests made by commenters, the final regulations expand the exception in the proposed regulations to permit separate application of section 401(a)(9) to the

> separate interests of beneficiaries of a see-through trust if certain requirements are met. This exception applies to the separate interests of beneficiaries of a see-through trust if the terms of that trust provide that it is to be divided immediately upon the death of the employee into separate shares for one or more trust beneficiaries (without regard to whether any of the beneficiaries are disabled or chronically ill).
>
> For this purpose, the final regulations provide that a trust is divided immediately upon the death of the employee into separate shares for one or more trust beneficiaries only if the trust is terminated, the separate interests of the trust beneficiaries are held in separate trusts, and there is no discretion as to the extent to which the separate trusts will be entitled to receive post-death distributions attributable to the employee's interest in the plan. In addition, the final regulations clarify that a trust does not fail to be divided immediately upon the death of the employee merely because there are administrative delays between the date of the employee's death and the date on which the trust actually is divided and terminated provided that any amounts received by the trust during this period are allocated as if the trust had been divided on the date of the employee's death.

For most beneficiaries, this is a welcome expansion of separate trust treatment. Now, separate account treatment can apply to an IRA payable to a revocable trust. However, the language I highlighted above in the regulation, which is repeated in the preamble, imposes unwelcome contraints – the trust agreement must require the IRA's allocation to the various trusts, rather than allowing the trustee to decide whether the IRA or another asset is allocated to each beneficiary. On the other hand, the required language comports with my sample beneficiary designation form[6] and allows the revocable trust to be named directly as a beneficiary, which will make completing beneficiary designation forms much easier and avoid needing to use my customized form. Any AMBT should be amended to include this provision, and any revocable trust that would like to take advantage of this rule should also be amended.

For sample language effectuating the above, see part IV Revocable Trust, Per Stirpes Provision.

How about when the decedent died before the SECURE Act's effective date, and the designated beneficiary needs to do estate planning? P.L. 116-94, § 402(b)(5)(A), "In General," provides:

> If an employee dies before the effective date, then, in applying the amendments made by this section to such employee's designated beneficiary who dies after such date -
>
> (i) such amendments shall apply to any beneficiary of such designated beneficiary; and
>
> (ii) the designated beneficiary shall be treated as an eligible designated beneficiary for purposes of applying section 401(a)(9)(H)(ii) of the Internal Revenue Code of 1986 (as in effect after such amendments).

Reg. § 1.401(a)(9)-1(b)(2)(iii)(A), "In general," includes:

> Except as otherwise provided in this paragraph (b)(2)(iii), if an employee who died before the effective date described in paragraph (b)(2)(i) or (ii) of this section (whichever applies to the plan) has only one designated beneficiary and that beneficiary dies on or after that effective date, then, upon the death of the designated beneficiary, section 401(a)(9)(H) applies with respect to any beneficiary of the employee's designated beneficiary.

[6] In part VIII Beneficiary Designation Form, see the text accompanying fn 31.

> Section 401(b)(5) of Division O of the Further Consolidated Appropriations Act, 2020 (known as the SECURE Act) provides that, if an employee dies before the effective date, then a designated beneficiary of an employee is treated as an eligible designated beneficiary. Accordingly, once the rules of section 401(a)(9)(H) apply with respect to the employee's designated beneficiary, the rules of section 401(a)(9)(H)(iii) (requiring full distribution of the employee's interest within 10 years after the death of an eligible designated beneficiary) apply upon the designated beneficiary's death.

Reg. § 1.401(a)(9)-1(b)(3)(i) provides:

> *Example (1)*. Employer M maintains a defined contribution plan, Plan X. Employee A died in 2017, at the age of 68, and designated A's 40-year-old child, B, who was not disabled or chronically ill at the time of A's death, as the sole beneficiary of A's interest in Plan X. Pursuant to a plan provision in Plan X, B elected to take distributions over B's life expectancy under section 401(a)(9)(B)(iii). B dies in 2024, after the effective date of section 401(a)(9)(H). Because section 401(b)(5) of the SECURE Act treats B as an eligible designated beneficiary, the rules of section 401(a)(9)(H)(iii) apply to B's beneficiaries. Therefore, A's remaining interest in Plan X must be distributed by the end of 2034 (the calendar year that includes the tenth anniversary of B's death).

Reg. § 1.401(a)(9)-1(b)(3)(ii) provides:

> *Example (2)*. The facts are the same as in paragraph (b)(3)(i) of this section (Example 1), except that B died in 2019. Because A's designated beneficiary died before the effective date of section 401 of the SECURE Act, the rules of section 401(a)(9)(H) do not apply to B's beneficiaries.

Reg. § 1.401(a)(9)-1(b)(3)(iii)-(vi) provide additional examples relating to payouts after such a beneficiary's death.

Code § 401(a)(9)(H)(iii), "Rules upon death of eligible designated beneficiary," provides:

> Rules upon death of eligible designated beneficiary. If an eligible designated beneficiary dies before the portion of the employee's interest to which this subparagraph applies is entirely distributed, the exception under clause (ii) shall not apply to any beneficiary of such eligible designated beneficiary and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary.

Reg. § 1.401(a)(9)-5(e)(3), "10-year limit following death of eligible designated beneficiary," provides:

> If the employee's designated beneficiary is an eligible designated beneficiary (as determined in accordance with § 1.401(a)(9)-4(e)), then the calendar year described in this paragraph (e)(3) is the calendar year that includes the tenth anniversary of the date of the designated beneficiary's death.

Nothing above suggests that, when the decedent died before the SECURE Act's effective date, the designated beneficiary's estate plan affects the 10-year payout. Rather, the beneficiary's life expectancy continues to be used, as was the case before the SECURE Act, except that the 10-year outer limit begins based on the beneficiary's death.

The preamble describes relief with respect to certain required minimum distributions that were not made in 2024 or prior years:

> While the final regulations do not eliminate the annual distribution requirement in cases in which annual life expectancy payments have begun, the Treasury Department and the IRS issued Notice 2022-53, 2022-45 IRB 437, Notice 2023-54, 2023-31 IRB 382, and Notice 2024-35, 2024-19 IRB 1051, in response to comments requesting transition relief for this requirement. Under those notices, if a distribution would have been required to be made to certain beneficiaries under these regulations had they applied before January 1, 2025, then: (1) a plan will not fail to be qualified for failing to make that distribution in 2021, 2022, 2023, or 2024; and (2) the taxpayer who failed to take the distribution will not be assessed an excise tax for failing to do so.[11] This relief applies with respect to a beneficiary who is a designated beneficiary of an employee who died in 2020, 2021, 2022, or 2023, and after the employee's required beginning date, provided that the beneficiary was not an eligible designated beneficiary who used the lifetime or life expectancy payments exception under section 401(a)(9)(B)(iii). Those notices also provided comparable relief for the case in which an eligible designated beneficiary who was taking annual life expectancy payments died in 2020, 2021, 2022, or 2023, and that beneficiary's successor beneficiary failed to take a distribution in 2021, 2022, 2023, or 2024.
>
> [11] This relief does not require taxpayers to make up missed required minimum distributions nor does it permit taxpayers to extend the 10-year deadline by which a full distribution is required to be made. For example, if an employee died in 2020, then in 2025, there are six years remaining in the 10-year period without regard to whether the designated beneficiary took distributions in 2021, 2022, 2023, or 2024. In 2030, the designated beneficiary must take a distribution of the remaining account balance.

## II. Explanation of Retirement Planning Default Provisions for Life Trusts for Descendants

This memo is intended as a practice aid - the reader is expected to exercise his or her independent legal judgment, and any reader who is not a lawyer is expected to use a lawyer who will exercise his or her independent legal judgment. This form reflects a variety of assumptions and preferences; and what terms should be in a trust may vary significantly from this, depending on the lawyer, the client, and whether those expected to serve as trustee may be comfortable with them. I may not necessarily use all of the provisions described below. Furthermore, I expect my thoughts to change over time as I discuss this with my law partners and with others outside my firm, so I don't view these forms as static.[7] With these caveats, we need to at least have some starting point, so here goes!

First, below I advocate significant flexibility. Some may be uncomfortable regarding whether the flexibility might cause the trust to lose its qualification as a see-through trust that allows identification of only qualified beneficiaries. In some cases, my view or our view may become irrelevant. Qualified plans generally decline to maintain a deceased participant's account and require it be paid out. In those cases, to the extent that the tax laws permit stretch, that stretch will exist only in inherited IRAs receiving a direct trustee-to-trustee transfer under

[7] I thank my colleagues at Thompson Coburn LLP, members of ACTEC's Employee Benefits Committee, Natalie Choate, and various readers for their input into this document. I am solely responsible for the contents of this document.

Code § 402(c)(11). However, for a nonspousal beneficiary, Code § 402(c)(11) requires a designated beneficiary under Code § 401(a)(9)(E) or a see-through trust for a designated beneficiary. Therefore, if the client has material retirement plan assets in a qualified plan (instead of an IRA), consider being much more conservative than one might otherwise be.

Article 7, "Life Trusts," is the centerpiece. It is primarily a trust for a child or other descendant, but the beneficiary could exercise a power of appointment in favor of anyone, and the wipe-out clause could also pass assets to anyone. First, we'll do a brief overview of how the Life Trust is organized, then we'll go back and examine each provision.

Section 7.1 names the trust. Section 7.2 provides for distributions, with subsection (a) being for the beneficiary, subsection (b) being for the beneficiary's descendants, and subsection (c) providing rules for IRAs (IRA is my shorthand in this memo for any plan subject to the required minimum distribution rules) that generally constrict subsections (a) and (b) and Sections 7.3 and 7.4. Section 7.3 is an inter vivos power of appointment. Section 7.4 is distributions on termination. Section 12.1 explains how to exercise a power of appointment and provides that any exercise may be revocable or irrevocable; one can limit the scope of remaindermen by irrevocably exercising the power to Appoint in Section 7.4, which may help when doing nonjudicial settlement agreements or if the beneficiary needs to limit the scope of the power for other reasons.

Section 7.2(a) authorizes distributions for the beneficiary's support (Section 12.18) and welfare (Section 12.21).

"Support" is shorthand for ascertainable standards, and welfare is shorthand for any other reason or no reason at all and contemplates making distributions to or for the benefit of (in other words, perhaps in trust) the beneficiary. Interpret "support" in light of Section 11.4, "Consideration of Other Resources," which allows the trustee to consider or ignore other resources and therefore introduces considerable flexibility. In defining "welfare," Section 12.21 authorizes distributions "to or for the benefit of" the beneficiary, which is intended to authorize decanting. Although I do not purport to have my standard Life Trust qualify as a supplemental needs trust, one court has authorized decanting into such a trust;[8] whether other courts would agree is unclear.

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[8] *Simonsen v. Bremby*, 2015 WL 9451031, Med & Med GD (CCH) P 305,504 [not reported in F.Supp.] (D. Conn. 2015), *aff'd* 679 Fed.Appx. 57, Med & Med GD (CCH) P 305,866 (2nd Cir. 2017) (designated as not precedential), held that consenting to decanting from a spendthrift trust to a clearly supplemental needs trust did not constitute a transfer of an available asset. Citing POMS SI § 01110.100(B)(1), the Second Circuit reasoned:

> … as DSS argues, Simonsen remains "legally restricted from using" the trust funds except as disbursed to her in the discretion of the trustee. *Id*. § 01110.100(B)(1).
>
> … The POMS recognizes that a beneficiary's authority thus to control trust principal may be evident from "either specific trust provisions allowing the beneficiary to act on his or her own or by permitting the beneficiary to order actions by the trustee." *Id.* § 01120.200(D)(1)(b). The trust documents here provide no such authority or permission. The trustee alone has authority to direct the use of trust principal for Simonsen's support and welfare. Furthermore, the trust documents do not authorize Simonsen to "revoke or terminate" the trusts, and DSS does not contend that Simonsen can "sell ... her beneficial interest" in the trusts, since they contain a valid spendthrift clause. *Id.* § 01120.200(D)(1)(a).
>
> To the extent the trustee is authorized to direct use of principal only for Simonsen's support and welfare, Simonsen might well be able to sue were the trustee to do otherwise. *See generally* Restatement (Second) of Trusts § 187 (stating that trustee's exercise of discretion "is not subject to control by the court, except to prevent an abuse by the trustee of his discretion"). But the POMS states that an individual is "not require[d] ... to undertake litigation in order to accomplish ...access"

Because "welfare" is not "ascertainable," it is quite tax-sensitive, and who holds the power is of great importance. Most states have statutes prohibiting a beneficiary who is trustee from exercising such a power. Section 11.5, "No Discharge of Support Obligations and Other Limitations," opts out of such a statute and provides alternative rules. It addresses what I'll refer to here as "sensitive powers" – authority to make distributions for a beneficiary that are made under nonascertainable standards or payments that discharge that beneficiary's legal obligations. Generally, neither the beneficiary nor a trustee appointed by the beneficiary may exercise sensitive powers; however, a trustee the beneficiary appointed may exercise sensitive powers if the trustee is an "independent trustee" – a person who is not a Code § 672(c) related or subordinate party, given that private letter rulings in the general power of appointment area defer to Rev. Rul. 95-58. If the beneficiary is the sole trustee, the beneficiary has two choices. Under subsection (c), the beneficiary may appoint an independent trustee. Alternatively, the beneficiary may resign as trustee, let the beneficiary's successor named under Section 9.1 exercise sensitive powers, then the beneficiary may exercise his or her authority under Section 9.2(b)(3) to appoint himself or herself as trustee again. The highlighted language in Section 11.5 is of limited use – it is a Missouri equivalent of giving the beneficiary what is effectively an unlimited withdrawal right while providing protection from creditors under RSMo § 456.5-501.1.

Section 7.2(b) authorizes distributions for the beneficiary's descendants:

- "Reasonable support and comfort" is an ascertainable standard used in gift tax regulations. Suppose a child is serving as trustee of trust for the child and wants to make distributions to her descendants. If she does so not using an ascertainable standard, she may make a gift. If she does so discharging a support obligation, that would be like holding a general power, and Section 11.5 prohibits that. The language we used is intended to communicate authorizing more than support obligation but still being within an ascertainable standard. Our definition of support in Section 12.18 is broader than a support obligation, so perhaps this is not necessary, but it just seems to be a nice way to communicate what we wanted to. Other than this concern, using support, welfare, or both would be fine.

- Section 7.2(b) is great from the viewpoint of being able to sprinkle income among beneficiaries and get income taxed at lower rates. However, it brings with it much more accountability to the beneficiary's descendants, which is very unattractive to many, so consider omitting it.

Now we get into drafting for IRAs and other plans subject to the requirement minimum distribution rules. These assets are referred to as "Benefits." As an aside, most employers have no desire to keep track of their dead employees' beneficiaries, so generally retirement plans are paid to deceased employees' IRAs.

The first sentence of the introduction to subsection (c) refers to the Life Trust being a beneficiary of a Benefit Plan directly or indirectly. Examples of the latter:

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to a resource. POMS SI § 01120.010(C)(2). "The property is not a resource under such circumstances...." *Id.*

These POMS interpretations are not inconsistent with 20 C.F.R. § 416.1201's definition of resources and, thus, we defer to them here, see *Lopes v. Dep't of Soc. Servs.*, 696 F.3d at 186, and conclude that the district court did not abuse its discretion in determining that Simonsen had established likely success on the merits of her claim that the Predecessor Trusts are not available resources under the federal SSI program.

- The Revocable Trust might be named as the direct beneficiary. Generally, I do not recommend naming the Revocable Trust as beneficiary, because any change to one Life Trust affects all Life Trusts;[9] however, naming the Revocable Trust as beneficiary works if one complies with the rules in part IV Revocable Trust, Per Stirpes Provision.

- Each Life Trust (the "Main Beneficiary") terminates in favor of other Life Trusts (the remaindermen). Thus, a remainderman Life Trust is not directly a designated beneficiary; rather, the Main Beneficiary is a designated beneficiary. Thus, any remainderman Life Trust is indirectly a beneficiary.

Subsection (c)(1) requires withdrawals from a Benefit Plan to the extent required by the minimum distribution rules and authorizes additional withdrawals. Section 7.2(c) does not restrict distributions to the beneficiary and the beneficiary's descendants. One needs to go back to Section 7.2(a) and (b) for that. One law firm has suggested having one trust for all of the grantor's children and their descendants, distributing to beneficiaries whose tax would be the least, with equalizing distributions to other beneficiaries in the current year from a side-by-side trust,[10] in future years, or upon trust termination; however, one needs to consider the multiple trust rule under Code § 643(f),[11] which may collapse side-by-side trusts.

Subsection (c)(2) provides the paradigm that will apply unless another paradigm is more appropriate. (Of course, if a predecessor trust was a conduit trust, no special provisions are required, because downstream beneficiaries are ignored.) I view predicting whether any beneficiary will qualify for an exception to the 10-year rule and how much will be in the Benefit Plan when the grantor dies to be an impossible task, so whatever default rules I put in subsection (c)(2) based on the client's circumstances have a very high chance of becoming inappropriate for any changes that may occur between date of signing and whenever the client dies or otherwise is unable to change the provisions. Thus, each paradigm is not only defined by Section 11.17 but also contemplates that it can be changed by Section 11.17.

Before addressing the paradigms under Section 11.17 that contemplate using a period relating to the existence of one or more individual beneficiaries, note that, if the IRA owner dies after the required beginning date, the decedent's life expectancy is used (the "ghost life expectancy"), unless the oldest counted beneficiary has a longer life expectancy.[12] In the latter case, the oldest counted beneficiary's life expectancy is used, but the entire IRA must be distributed no later than

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[9] See text accompanying and preceding fn 6 on page 19. If Benefits are payable to the Revocable Trust, the Benefits Trustee may want to restrict the exercise of a power to Appoint or any other trust modification until all Benefits are distributed, so that actions taken with respect to one trust do not affect the other trusts created after the Revocable Trust terminates.

[10] Gassman, Crotty & Denicolo's "Tea Pot Trust System."

[11] See Gorin, part II.J.9.c. Multiple Trusts Created for Tax Avoidance, "Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications," available by emailing the author at sgorin@thompsoncoburn.com. The author encourages you to subscribe to his free quarterly newsletter, which provides a link to the most recent version of this few thousand page PDF, by completing the form at **********.thompsoncoburn.com/forms/gorin-newsletter.

[12] Reg. § 1.401(a)(9)-5(d)(1). Reg. § 1.401(a)(9)-5(d)(3)(ii), "Employee's life expectancy," provides:

> The employee's remaining life expectancy is determined initially using the employee's age as of the employee's birthday in the calendar year of the employee's death. In subsequent calendar years, the remaining life expectancy is determined by reducing that initial life expectancy by one for each calendar year that has elapsed after that first calendar year.

the 10th calendar year following the calendar year of the employee's death if the designated beneficiary is not an eligible designated beneficiary (EDB):[13]

- Thus, distributions with respect to a decedent with a life expectancy less than the beneficiary's, that would have been distributed over a period exceeding 10 years, are cut short if there was a designated beneficiary who is not an EDB. Thus, consider taking actions post-mortem to be able to use only the decedent's life expectancy, to get a longer period if the decedent's ghost life expectancy exceeded 10 years.[14]

- If it turns out that having no designated beneficiary would generate a better result, under my forms a beneficiary who has reached the age of maturity set by the decedent could exercise an inter vivos power of appointment to add a charitable beneficiary.

- Post-mortem actions might be taken to eliminate beneficiaries so that the oldest countable beneficiary has a favorable life expectancy.

For non-Roth IRAs, the preamble to the final regulations explains:

> Specifically, these regulations generally provide that the required beginning date is April 1 of the calendar year following the later of (1) the calendar year in which the employee reaches the applicable age, and (2) the calendar year in which the employee retires from employment with the employer maintaining the plan. These regulations provide that the applicable age is determined based on an employee's date of birth, as follows: (1) for employees born before July 1, 1949, the applicable age is 70½; (2) for employees born on or after July 1, 1949, but before January 1, 1951, the applicable age is 72; (3) for employees born on or after January 1, 1951, but before January 1, 1959, the applicable age is 73; and (4) for employees born on or after January 1, 1960, the applicable age is 75.[7] The final regulations make conforming changes by replacing references to age 72 in the proposed regulations (when referring to the age for determining the required beginning date) with references to the applicable age….
>
> [7] Section 107 of the SECURE 2.0 Act includes an ambiguity relating to the definition of applicable age for employees born in 1959 (section 401(a)(9)(C)(v) provides that the applicable age for those employees is both 73 and 75). Accordingly, these regulations reserve a paragraph that defines the applicable age for employees born in 1959, and that issue is addressed in a notice of proposed rulemaking (REG-103529-23) in the Proposed Rules section of this issue of the Federal Register.

Because Roth IRAs never have a required beginning date (RBD), the ghost life expectancy never applies to them, and often we merely need concern ourselves whether any individual is the last one standing, often without being concerned about the beneficiaries' ages. However, for a Roth IRA or if the IRA owner dies before the RBD, the beneficiaries' ages do matter if any beneficiary is an eligible designated beneficiary (EDB), given that exceptions relating to EBDs to escape the general 10-year outer limit rule tend to involve taking immediate distributions based on the oldest countable beneficiary's age.

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[13] Reg. § 1.401(a)(9)-5(e)(1), (2).

[14] Reg. § 1.401(a)(9)-5(d)(1)(iii), "Employee with no designated beneficiary," provides:

> If the employee does not have a designated beneficiary as of the date determined under § 1.401(a)(9)-4(c), the applicable denominator is the employee's remaining life expectancy.

Section 11.17, "Special Rules for Benefits," is the heart of my SECURE Act provisions. Subsection (a) defines the paradigms that Section 7.2(c)(2) references. Subsection (b) authorizes modifying the trust to fit the post-mortem facts (as contrasted with assumptions made while drafting the estate plan). Subsection (c) defines terms.

Within subsection (a):

- Paragraph (1), "Last One Standing Trust," imposes a last-person-standing rule. Unless the trust is a conduit trust, this provision may be required to make the trust a qualified see-through trust.[15] In most cases, I view an accumulation trust as desirable, and the Last One Standing Trust may be required for an accumulation trust to get stretch if the ghost life expectancy is not a better paradigm. Benefits, withdrawals of Benefits, and any reinvested withdrawals of Benefits together constitute Fruits of Benefits, which must ultimately be payable to one or more individuals. To track this limitation, as a practical matter the trustee may need to place the Fruits of Benefits into a separate trust. However, after all Benefits have been distributed, violating this segregation would have no practical tax impact, so in many cases this limitation will turn out to be a paper tiger. So, in many cases, after around 10 years have passed and Benefits have been fully withdrawn from the IRA, the Benefits Trustee or primary beneficiary can eliminate the Last One Standing feature without causing any harm.

  When the remaindermen's life expectancy is important in determining annual required minimum distributions, the primary beneficiary might revocably exercise a power of appointment to make the Last One Standing Trust terminate at the death of the last surviving of a class of beneficiaries whose life expectancies are tolerable. Then, in the final year of the 10-year outer limit, the primary beneficiary can restore whatever class of beneficiaries is most consistent with the primary beneficiary's estate plan.

- Paragraph (2), "Conduit Trust," tracks the regulations for conduit trusts. Here are some examples when a conduit approach may be desirable:

  - The Benefit Plan is relatively modest, so conduit distributions won't disturb the overall estate plan very much.

  - The trust would have made the distributions anyway, and the trust has significant other income that is taxed at lower rates (for example, dividends taxed as capital gains, or capital gains that are actually distributed. Treas. Reg. § 1.661(b)-1 provides that all of the trust's items of income is pro-rated according to how much DNI is distributed or retained; the trustee can't select which income is distributed and which is retained. However, if a particular class of income is directed to be distributed, those distributions will carry out that class of income. If IRA income is taxed at more favorable rates in the beneficiary's hands than in the trust's hands – and that is the case more so than other classes of income – then a conduit trust would facilitate that treatment.

  - If the client prefers to leave Benefits outright because the beneficiaries are responsible individuals, consider what happens if a beneficiary becomes incapacitated due to illness or accident after the grantor becomes incapacitated or dies, so the grantor cannot adjust the plan to take into that incapacity. Such a situation may require a conservatorship for the beneficiary or may make outright distributions inappropriate. A conduit trust (combined

[15] See text preceding and accompanying fn 2 on page **Error! Bookmark not defined.** for when the Last One Standing clause might not be necessary.

with appropriate drafting in Article 7 and Section 11.5) lets the beneficiary take outright if that remains appropriate and lets a trustee intervene if the beneficiary is incapacitated, with such intervention perhaps being limited to management outside of a conservatorship setting or being substantial enough that distribution provisions are modified.

- Any trust for an EDB other than a disabled or chronically ill beneficiary gets to use the life expectancy of one or more EDBs only if all beneficiaries, including remaindermen, are EDBs. A conduit trust would eliminate the need to consider remaindermen. If you use a conduit trust as a client's default rule for these other EDBs, consider which conditions should trigger it instead of making it apply to all such EDBs in all situations. For example, you might cap (by dollar amount or formula) the amount that is automatically held in a conduit trust, understanding that subsection (b) may be used to adjust that amount up or down.

- Paragraph (3), "Age 31 Trust," tracks the proposed regulations' allowing one to disregard remaindermen if the primary beneficiary gets the benefits outright at age 31. This provision is helpful only of the beneficiary is not yet 21 when the grantor dies, so if the beneficiary is older than 21 then the trust is instead a conduit trust (given that the age 31 trust paradigm assumes that the grantor wants the beneficiary to take outright anyway). Because an Age 31 trust required this outright distribution at 31, it cannot be subject to contingencies that defer payment past that age, so any modification that makes it not qualify must be made by the September 30 beneficiary finalization date.

- Paragraph (4), "Trust for Disabled or Chronically Ill Beneficiaries," provides an accumulation trust for the life of one or more of such individuals, merely tracking the statute's language. Reg. § 1.401(a)(9)-4(g)(1), "Certain see-through trusts with disabled or chronically ill beneficiaries," provides:

  > An applicable multi-beneficiary trust is a see-through trust with more than one beneficiary and with respect to which -
  >
  > (i) All of the trust beneficiaries are designated beneficiaries;
  >
  > (ii) The trust terms identify one or more individuals, each of whom is disabled (as defined in paragraph (e)(1)(iii) of this section) or chronically ill (as defined in paragraph (e)(1)(iv) of this section), who are described in paragraph (f)(3)(i)(A) of this section; and
  >
  > (iii) The terms of the trust provide that no beneficiary (other than an individual described in paragraph (g)(1)(ii) of this section) has any right to the employee's interest in the plan until the death of all of the eligible designated beneficiaries described in paragraph (g)(1)(ii) of this section.

It has been suggested that one should consider whether to include in the trust agreement the settlor's intent that the trust is intended to be treated as an applicable multi-beneficiary trust ("AMBT"): to help if the trust has to be modified to meet the AMBT rules, to signal to the trustee that the beneficiary should be receiving RMDs, and to cause the trustee to pursue legal assistance to understand how to administer the trust as an AMBT.

Subsection (b) authorizes the Benefits Trustee to modify the trust. Because the proposed regulations disregard unexercised powers of appointment, this subsection is couched in that term.

Section 12.1 sets forth the procedure for exercising a power of appointment. Section 11.17(b) is extremely broad to provide maximum flexibility.

As to subsection (c)(2), there is nothing special about the term "Benefits Trustee," other than making sure the person who holds those powers can hold such tax-sensitive powers. Depending on the proposed exercise of power, the Benefits Trustee may be concerned that the exercise may violate the Benefits Trustee's duty to promote beneficial interests impartially. Accordingly, the Benefits Trustee may ask the trustee to appoint a Trust Protector.

Note that Section 7.3 also authorizes a beneficiary who is old enough to modify the trust.

Part V Conduit Marital Trust, is designed for a long-term second (or subsequent) marriage.[16] Here, the grantor cares more about supporting the surviving spouse than ensuring the IRA goes to the children from the first marriage. However, if the surviving spouse doesn't spend the whole IRA, the children from the first marriage get whatever remains. If the grantor left the IRA outright to the surviving spouse and the surviving spouse died prematurely, the surviving spouse's children would get the IRA instead of the children from the first marriage, which would have frustrated the parties' intent. The reference in part V to a Modification Declaration is to give the Benefits Trustee leverage in negotiating regarding the following:

- Reg. § 1.401(a)(9)-3(c)(5)(iii) allows the surviving spouse to elect not to apply the 10-year rule if the plan so permits, even though the trustee has plenary control over the Benefits. If available, this election can be made by December 31 of the year following the year of the decedent's death, which deadline makes these issues tricky. It has been suggested that this regulation permits the retirement plan to allow the owner to forbid the election of the 10-year rule and that, if the applicable plan permits this, the participant should take advantage of that to prohibit use of the 10-year rule for the account payable to the conduit trust if it is unclear whether the election is made by the beneficiary or the trustee.

- Starting in 2024, Code § 401(a)(9)(B)(iv) allows the surviving spouse to elect to use the Uniform Lifetime Table (on or after January 1, 2022) instead of the recalculated Single Life

[16] This footnote is merely for convenience in cross-referencing part V Conduit Marital Trust to this discussion.

Table (on or after January 1, 2022).[17] Code § 408A(c)(4)[18] provides that Code § 401(a)(9)(A) required minimum distribution (RMD) rules[19] do not apply to Roth IRAs. Because nothing in Code § 401(a)(9)(B)(iv) refers to either of Code § 408A(c)(4) or § 401(a)(9)(A), its election does not prevent the RMD rules from applying.

- The surviving spouse may need inducements to (or consequences not to) take steps to lock in a longer (or not shorter) life expectancy. My documents generally authorize the trustee to distribute principal for support and welfare. Those distributions can ignore the surviving spouse's other assets or require the surviving spouse to use such assets. Whether those provisions and the reference in part V to a Modification Declaration suffice is up to the lawyer and client.

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[17] Code § 401(a)(9)(B)(iv), "Special rule for surviving spouse of employee," provides:

If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee and the surviving spouse elects the treatment in this clause -

(I) the regulations referred to in clause (iii)(II) shall treat the surviving spouse as if the surviving spouse were the employee,

(II) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained the applicable age, and

(III) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse is the employee.

An election described in this clause shall be made at such time and in such manner as prescribed by the Secretary, shall include a timely notice to the plan administrator, and once made may not be revoked except with the consent of the Secretary.

Code § 401(a)(9)(B)(iii), "Exception to 5-year rule for certain amounts payable over life of beneficiary," provides:

If -

(I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

(II) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

(III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,

for purposes of clause (ii) , the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

[18] Code § 408A(c)(4), "Mandatory Distribution Rules Not To Apply Before Death," provides:

Notwithstanding subsections (a)(6) and (b)(3) of section 408 (relating to required distributions), the following provisions shall not apply to any Roth IRA:

(A) Section 401(a)(9)(A).

(B) The incidental death benefit requirements of section 401(a).

[19] Code § 401(a)(9)(A), "In General," provides:

A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee -

(i) will be distributed to such employee not later than the required beginning date, or

(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

The preamble to proposed regulations issued July 19, 2024 provides:

**F. Spousal Election Under Section 327 of the SECURE 2.0 Act**

The 2024 final regulations permit a defined contribution plan to provide that, if an employee participating in the plan dies before the required beginning date, then an eligible designated beneficiary of the employee (including the employee's surviving spouse) may elect to receive the beneficiary's interest under the plan under the 10-year rule or as annual payments over a period not extending beyond the beneficiary's life expectancy.[2] Section 401(a)(9)(B)(iv)(I) through (III) of the Code, as amended by section 327(a) of the SECURE 2.0 Act, provides that, if the designated beneficiary of an employee who dies before the employee's required beginning date is the employee's surviving spouse, then the spouse may elect to: (1) be treated as if the surviving spouse were the employee for purposes of the regulations referred to in section 401(a)(9)(B)(iii)(II) of the Code (providing for annual payments over the beneficiary's life or life expectancy), (2) delay commencement of required minimum distributions until the year the employee would have attained the applicable age (as defined in section 401(a)(9)(C)(v)), and (3) be treated as the employee in the event the surviving spouse dies before distributions to the spouse begin.[3]

[2] If the employee is a participant in a defined benefit plan, the election is between receiving the beneficiary's interest under a 5-year rule or as annuity payments over the beneficiary's lifetime.

[3] Section 401(a)(9)(B)(iv)(II) and (III) correspond to section 401(a)(9)(B)(iv)(I) and (II) before the changes made by section 327(a) of the SECURE 2.0 Act.

Under the 2024 final regulations, if: (1) the employee dies before the employee's required beginning date; (2) the employee's surviving spouse is the sole beneficiary of the employee; and (3) that spouse is subject to the life expectancy rule, then the treatment described in section 401(a)(9)(B)(iv)(II) and (III) will apply automatically (that is, a separate election is not required). See § 1.401(a)(9)-3(d) and (e) of the 2024 final regulations.

Section 327(b) of the SECURE 2.0 Act instructs the Secretary to modify the regulations applicable to defined contribution plans under section 401(a)(9) of the Code so that an election under section 401(a)(9)(B)(iv) by the surviving spouse will extend the distribution period in the case of an employee's death after the required beginning date. In accordance with this instruction, § 1.401(a)(9)-5(g)(3)(i) of the 2024 final regulations provides that a defined contribution plan may permit a surviving spouse who is the sole beneficiary of the employee to elect to be treated as the employee for purposes of determining the required minimum distribution for a calendar year. The 2024 final regulations reserve § 1.401(a)(9)-5(g)(3)(ii) for rules relating to this election, and these proposed regulations would fill in that reserved paragraph.

Proposed § 1.401(a)(9)-5(g)(3)(ii) provides a series of rules that would apply with respect to the spousal election described in § 1.401(a)(9)-5(g)(3)(i) of the 2024 final regulations. Under the proposed regulations, if the employee dies before the required beginning date and the sole beneficiary of the employee is the surviving spouse who is subject to the life expectancy rule, then the spouse would automatically be treated as making the election described in section 401(a)(9)(B)(iv). As a result, the proposed regulations provide that section 401(a)(9)(B)(iv)(I) (under which the spouse is treated as the employee for

purposes of section 401(a)(9)(B)(iii)(II)) would apply automatically in this case (in addition to the automatic application of sections 401(a)(9)(B)(iv)(II) and (III)). If the employee dies on or after the required beginning date, then the corresponding election under section 327(b) of the SECURE 2.0 Act does not apply automatically. However, these proposed regulations would provide that this corresponding election may be the default election under the terms of a plan (so that the surviving spouse need not take any action to have this election apply).

If the election under § 1.401(a)(9)-5(g)(3)(i) is in effect for a surviving spouse, then, regardless of whether the employee died before, on, or after the required beginning date, the proposed regulations provide that the applicable denominator used for determining the required minimum distribution for each distribution calendar year up to and including the calendar year that includes the surviving spouse's date of death would be determined using the Uniform Lifetime Table (rather than the Single Life Table) for the surviving spouse's age as of the surviving spouse's birthday in the distribution calendar year.[4]

[4] However, if the employee dies on or after the employee's required beginning date and the employee's remaining life expectancy is greater than the applicable denominator determined under the Uniform Lifetime Table for the surviving spouse's age (which would occur only if the surviving spouse was more than ten years older than the employee), then that greater life expectancy is used as the applicable denominator.

In accordance with § 1.401(a)(9)-5(d)(1)(i) of the 2024 final regulations, the required minimum distribution for the calendar year of the surviving spouse's death must be made to a beneficiary of the surviving spouse to the extent it has not already been distributed to the surviving spouse.

These proposed regulations provide that, if the election described in § 1.401(a)(9)-5(g)(3)(i) is in effect for the surviving spouse and the spouse dies on or after the date on which distributions are considered to have begun to the spouse under the rules of § 1.401(a)(9)-3(e)(3) of the 2024 final regulations (that is, the end of the calendar year in which the employee would have reached the applicable age), then annual distributions to the spouse's beneficiary would have to continue. Those distributions would be determined using the spouse's remaining life expectancy for the spouse's age as of the spouse's birthday in the calendar year of the spouse's death from the Single Life Table, reduced by one for each subsequent calendar year. In addition, the proposed regulations add a conforming sentence to § 1.401(a)(9)-4(e)(8), providing that the spouse's beneficiary would not be an eligible designated beneficiary in this situation. As a result, a final distribution of the employee's interest would have to be made by the end of the calendar year that includes the tenth anniversary of the spouse's death.

Under the proposed regulations, the spousal election described in § 1.401(a)(9)-5(g)(3)(i) would be available only if the first year for which annual required minimum distributions to the surviving spouse must be made is 2024 or later. For example, if an employee who died in 2017 and before the employee's required beginning date would have reached the applicable age in 2024 or later, then the first year for which an annual required minimum distribution is due would be 2024 or later, and the spousal election could apply. However, if the employee would have reached the applicable age in 2022, then the first year for which an annual required minimum distribution is due to the spouse was 2022, and the spousal election would not be available. Similarly, if the employee died in 2021 and after the employee's required beginning date, then the spouse must begin receiving annual

required minimum distributions (based on the spouse's remaining life expectancy) in 2022, and the spousal election would not be available.

Although an election under section 401(a)(9)(B)(iv) of the Code results in the spouse being treated as the employee for purposes of the regulations referred to in section 401(a)(9)(B)(iii)(II) (that is, § 1.401(a)(9)-5), that treatment does not extend to other purposes.[5]

[5] However, if the spouse dies before distributions have begun, then in accordance with section 401(a)(9)(B)(iv)(III), the spouse is treated as the employee for purposes of determining the beneficiary designated under the plan. In addition, if the spouse executes a spousal rollover to the spouse's own IRA in accordance with section 402(c)(9) after having made the election described in section 401(a)(9)(B)(iv), then the spouse will not be treated as a beneficiary with respect to any amounts in that IRA.

For example, the spouse would not be subject to the 10 percent additional tax under section 72(t)(2)(A)(ii) even if the spouse takes a distribution before attaining age 59½. Similarly, the date by which the surviving spouse must commence distributions is determined by reference to the employee's attainment of the applicable age (rather than by reference to the spouse's attainment of the applicable age [6]). In addition, for purposes of determining the account balance under a plan while the surviving spouse is taking distributions, § 1.401(a)(9)-5(b)(3) of the 2024 final regulations (which excludes amounts held in a designated Roth account from the employee's account balance during the employee's lifetime) does not apply. Thus, all amounts held in a designated Roth account and any other account under the plan are included for purposes of determining the required minimum distribution due under the plan for the calendar year.

[6] The election under section 401(a)(9)(B)(iv) does not affect the ability of the employee's surviving spouse to make a rollover to the spouse's own IRA or to treat an IRA as the surviving spouse's own IRA. In either of these cases, the date by which distributions from that IRA must commence would be determined by reference to the surviving spouse's attainment of the applicable age.

These proposed regulations also provide an updated Uniform Lifetime Table that provides the applicable denominator for individuals ages 10 through 120+. This table was originally published in Notice 2022-6, 2022-5 IRB 460, relating to the determination of whether a series of payments is considered a series of substantially equal periodic payments.

Section 1.402(c)-2(j)(4) of the 2024 final regulations sets forth a special rule under which a portion of a distribution to certain surviving spouses (that is, the portion of the distribution that represents a catch-up of missed hypothetical required minimum distributions) is treated as a required minimum distribution that is not eligible for rollover. Section 1.402(c)-2(j)(4)(iii), which provides rules for the calculation of the hypothetical required minimum distributions, includes the assumption that the election in § 1.401(a)(9)-5(g)(3)(i) was in effect for the spouse. The 2024 final regulations reserve § 1.402(c)-2(j)(4)(vii) for an example of the calculation of the hypothetical required minimum distributions, and proposed § 1.402(c)-2(j)(4)(vii) would fill in the reserved paragraph with an example of the calculation of the hypothetical required minimum distributions over multiple years, which reflects the use of the Uniform Lifetime Table.

The proposed regulations do not include any changes to the defined benefit rules of § 1.401(a)(9)-6 to reflect the amendment to section 401(a)(9)(B)(iv) made by section 327 of the SECURE 2.0 Act. Comments are requested on whether there are circumstances under which that provision would affect the required minimum distribution rules applicable to defined benefit plans.

Reg. § 1.401(a)(9)-3(d), "Permitted delay for surviving spouse beneficiaries," provides:

If the employee's surviving spouse is the employee's sole beneficiary, then the commencement of distributions under paragraph (b)(3) or (c)(4) of this section may be delayed until the end of the calendar year in which the employee would have attained the applicable age.

Reg. § 1.401(a)(9)-3(e), "Distributions that commence after surviving spouse's death," provides:

(1) *In general*. If the employee's surviving spouse is the employee's sole beneficiary and dies before distributions have commenced under paragraph (d) of this section, then the 5-year rule in paragraph (b)(2) or (c)(2) of this section, the 10-year rule in paragraph (c)(3) of this section, the annuity payment rules in paragraph (b)(3) of this section, or the life expectancy rules in paragraph (c)(4) of this section, are to be applied as if the surviving spouse were the employee. For this purpose, the date of death of the surviving spouse is substituted for the date of death of the employee.

(2) *Remarriage of surviving spouse*. If the delayed commencement in paragraph (d) of this section applies to the surviving spouse of the employee, and the surviving spouse remarries but dies before distributions have begun, then the rules in paragraph (d) of this section are not available to the surviving spouse of the deceased employee's surviving spouse.

(3) *When distributions are treated as having begun to surviving spouse*. For purposes of section 401(a)(9)(B)(iv)(III), distributions are considered to have begun to the surviving spouse of an employee on the date, determined in accordance with paragraph (d) of this section, on which distributions are required to commence to the surviving spouse without regard to whether payments have actually been made before that date. However, see §1.401(a)(9)-6(l) for an exception to this rule in the case of an annuity that commences early.

Reg. § 1.401(a)(9)-5(g)(3), "Surviving spouse election under section 401(a)(9)(B)(iv)," provides:

(i) *In general*. A defined contribution plan may include a provision, applicable to an employee whose sole beneficiary is that employee's surviving spouse, under which the surviving spouse may elect to be treated as the employee for purposes of determining the required minimum distribution for a calendar year under this section.

(ii) [Reserved]

Proposed regulations would flesh out Reg. § 1.401(a)(9)-5(g)(3)(ii), "Rules relating to election":

(A) *Employee dies before required beginning date*. If the employee dies before the employee's required beginning date, § 1.401(a)(9)-3(c)(4) applies to the designated beneficiary (under which life expectancy payments will be made to the employee's

designated beneficiary), and the designated beneficiary is the employee's surviving spouse who is eligible to make the election described in paragraph (g)(3)(i) of this section, then the spouse is treated as having made that election.

(B) *Employee dies on or after required beginning date*. If the employee dies on or after the employee's required beginning date, the spouse is not automatically treated as having made the election described in paragraph (g)(3)(i) of this section. However, that election may be a default election under the terms of the plan.

(C) *Use of Uniform Lifetime Table*. If the election described in paragraph (g)(3)(i) of this section applies with respect to a surviving spouse, then the applicable denominator for each distribution calendar year beginning with the calendar year following the year of the employee's death and up to and including the calendar year that includes the surviving spouse's date of death is determined using the Uniform Lifetime Table in § 1.401(a)(9)-9(c) for the surviving spouse's age as of the surviving spouse's birthday in the distribution calendar year. However, if the employee died on or after the required beginning date, then the applicable denominator for a distribution calendar year is the greater of the applicable denominator determined under the preceding sentence and the employee's remaining life expectancy.

(D) *Distribution after spouse's death*. If the election described in paragraph (g)(3)(i) of this section applies with respect to an employee who dies on or after the required beginning date (or whose surviving spouse dies after distributions are considered to have begun to the spouse as determined under § 1.401(a)(9)-3(e)(3)), then -

(1) For calendar years following the calendar year that includes the surviving spouse's date of death, the applicable denominator used for determining the required minimum distribution for each distribution calendar year is determined under the rules of paragraph (d)(3)(iv) of this section, and

(2) A final distribution of the employee's entire interest must be made by the end of the calendar year that includes the tenth anniversary of the surviving spouse's death.

(E) *Applicability dates for spousal election*. The spousal election described in paragraph (g)(3)(i) of this section applies only if the first year for which annual required minimum distributions to the surviving spouse must be made is 2024 or later. Thus, the election described in paragraph (g)(3)(ii)(A) of this section (relating to employees who die before the required beginning date) applies only if the calendar year in which life expectancy payments must begin under § 1.401(a)(9)-3(d) is 2024 or later. Similarly, the election described in paragraph (g)(3)(ii)(B) of this section (relating to an employee who dies on or after the required beginning date) applies only if the first year for which the surviving spouse must take annual required minimum distributions under paragraph (d) of this section is 2024 or later (that is, if the employee died in 2023 or later).

I am unlikely to want to draft a trust for an IRA for a surviving spouse's that is not a conduit trust, because the IRA deferral period will be shortened significantly.

Part VI Family Trust When At Least One Minor Child EDB is a specialized trust when at least one child has not reached 21, which lasts until all children have either died or reached age 31.

Normally I terminate a family trust when the youngest reaches age 25, so that the trust can put all children through college, so this lasts a little longer.

Part VII Clauses to Shift Income Taxation is designed to shift income taxation to the beneficiary. Paragraph (1) is intended to address the concern that any Benefits distributed to the trust and not also distributed to the beneficiary will trigger income tax at high fiduciary income tax rates:

- Before using it, look at the discussion in my business structuring materials in part III.B.2.i.viii. Creditor and Gift/Estate Tax Issues Regarding Withdrawal Rights, Whether Currently Exercisable or Lapsed;[20] Ed Morrow has a more comprehensive list.[21] Giving the beneficiary a withdrawal right generates concerns similar to those in creating a conduit trust. However, given that the Benefits Trustee may wait for quite some time before exercising this authority and may tailor the withdrawal right granted to the beneficiary, in some ways the clause may be a little less concerning. Note also that these provisions make the beneficiary a deemed owner of the trust for income tax purposes, in whole or in part, under Code § 678(a), so that the beneficiary - not the trust - will be taxed on Fruits of Benefits.

- To the extent that this withdrawal right lapses within the 5&5 power described in Code § 2514(e), the assets will not be included in the beneficiary's estate and may also be protected from creditors, the latter depending on state law (California and New York being among the states that unfortunately do not provide such protection). *Fish v. U.S.*, 432 F.2d 1278 (9th Cir. 1970), held that Code § 2514(e) measures the lapse of a right to income by multiplying the income, rather than the trust's value, by 5%. So, I adapted language developed by Ellen Harrison and Carlyn McCaffrey addressing *Fish* in a different context into my own clause addressing Benefits.[22] The example in paragraph (1) converts the right to withdraw Benefits in the year of Benefits are distributed to a right to withdraw from the entire trust in a subsequent year. I can't promise that this fully addresses *Fish* and leave it to you to decide. Also, when the power converts to a power over principal, consider also requiring the consent of a nonadverse party to exercise it, which keeps it alive as a general power of appointment but may offer protection from creditors.[23] In this document, see part X Withdrawal Right Provisions from Uniform Trust Code.

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[20] "Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications," available by emailing the author at sgorin@thompsoncoburn.com or, if you are an ACTEC Fellow and don't want to wait for my response, by going to **********.actec.org/resources/gorins-business-succession-news and downloading the PDF from the most recent newsletter posted there.

[21] Morrow, Edwin P., "IRC Section 678 and the Beneficiary Deemed Owner Trust (BDOT)" (4/19/2018 posted 5/6/2018 and last revised 4/22/2021). Available at SSRN: ********ssrn.com/abstract=3165592 or *******dx.doi.org/10.2139/ssrn.3165592, it includes a chart, "Creditor Protection for Assets Subject to Presently Exercisable General Powers of Appointment (Including *Crummey*, "Five and Five" or Other Withdrawal Powers) Pre and Post Lapse in Trust Level of Protection."

[22] In addition to minor differences in wording, Carlyn would replace the sentence regarding lapses with: "On January 31 of the succeeding year and on January 31 of each subsequent year, any withdrawal right not exercised by the Primary Beneficiary shall lapse to the extent of 5% of the value of the trust on January 31 (or such larger amount that can lapse under section 2514(e) without being considered to be a transfer to the trust by the holder of the withdrawal right)." She points out that, unless the trust receiving the Benefits has substantial assets other than the retirement benefits, the risk of using this technique is that the beneficiary for a number of years is likely to have large un-lapsed withdrawal rights. If he or she dies during those years, there could be substantial estate tax inclusion.

[23] For example, RSMo § 456.1-103(17) defines:

> "Power of withdrawal", a presently exercisable power of a beneficiary to withdraw assets from the trust without the consent of the trustee or any other person.

Paragraph (2) is designed to make IRA distributions the first type of income that passes to the beneficiary on the trust's K-1. See the reference to Treas. Reg. § 1.661(b)-1 on page 26.

Part IX Charitable Planning Opportunities includes the opportunity to convert a Life Trust into a charitable remainder trust.

I hope you find the provisions below to be helpful thoughts as you independently decide which ideas and language may be helpful and appropriate in various situations. I cannot emphasize strongly enough not to view them as boilerplate to be used whole-cloth for all of your trusts for descendants (or trusts for anyone else). Also, as one financially engineers a plan, consider whether an IRA should be divided and paid into different trusts with different payouts, which may require special provisions in a beneficiary designation form.[24]

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RSMo § 456.5-504 prevents a creditor from requiring a trustee to exercise discretion.

[24] In part VIII Beneficiary Designation Form, see the text accompanying fn 31, which is suggested by the discussion in the text accompanying and preceding fn 6 on page 19 of this memo.

## III. All Clauses

### ARTICLE 7

### LIFE TRUSTS

**SECTION 7.1** **DESIGNATION.** Assets to be held as a separate Life Trust for the primary benefit of an individual (referred to in this Article as the "beneficiary") pursuant to the provisions of this Article shall be held as a separate trust estate with income and principal distributed as provided in this Article and shall be designated in substantially the following form: the beneficiary's name followed by "Life Trust U/A/D ___/___/____."

**SECTION 7.2** **DISTRIBUTION OF INCOME AND PRINCIPAL.**

(a) To the Beneficiary. The trustee is authorized to distribute to the beneficiary any part or all of the income, principal or both from the trust to provide for the beneficiary's support, welfare, or both (subject to Section 11.5). In addition to the distributions authorized by the preceding sentence, subject to the following sentence the trustee shall distribute to the beneficiary so much of the principal of the trust as the beneficiary, while at least <AGE 1> (___) years of age, may request once during the last two weeks of every calendar year, on a noncumulative basis, up to five percent (5%) of the aggregate value, as of the time of such request by the beneficiary, of the principal of the trust. The trustee may, by instrument placed in the trust's records, provide that the preceding sentence shall not apply during any period (including the beneficiary's remaining life), which period shall begin no earlier than the January 1 following the date of the instrument.

(b) To Others. To the extent that any part or all of the income, principal or both of the trust are not distributed pursuant to subsection (a), the trustee may make the distributions described in this subsection. The trustee is authorized to distribute to the beneficiary's descendants all or any part of the income, principal or both of the trust to provide for the reasonable support and comfort of one or more of any such descendants. Notwithstanding the foregoing, the trustee should consider the generation–skipping transfer tax consequences of making any distributions for a descendant of the beneficiary from a nonexempt trust other than distributions made on behalf of such descendant in direct payment to the service provider of such descendant's tuition or medical care (as defined in Code section 213(d)). Any distributions made pursuant to this subsection need not be equal, and the trustee is authorized, within the limits of the foregoing standards, to pay all of such income, principal or both to any one or more of such persons to the

complete exclusion of any other. Any such distribution(s) shall be charged against the trust as a whole and not against the ultimate distributive share of any person.

(c) Benefit Plans. If and to extent that the trust is the beneficiary of (or is directly or indirectly a beneficiary of another trust that is a beneficiary of) any Benefit Plan (for definitions, see Section 11.17 (Special Rules for Benefits)):

(1) Required Minimum Distributions and Other Distributions. The trustee shall withdraw from the Life Trust's direct or indirect portion of the Benefit Plan the amount required under the Minimum Distribution Rules and may make additional withdrawals. Subsections (a) and (b) shall determine distributions to one or more beneficiaries under this subsection except to the extent this subsection or Section 11.17 overrides this sentence. I encourage but do not require the Benefits Trustee, within a few months after my death, to consult a tax advisor with a working knowledge of the Minimum Distribution Rules regarding any actions that may be taken under Section 11.17 to ameliorate the impact of those rules.

***[select only one of the following paragraphs or customize as appropriate; use (2) if unsure:]***

(2) Application of Section 11.17. This paragraph applies except if and to the extent that any predecessor trust that was a beneficiary of that Benefit Plan was a Conduit Trust that provided current distributions only to the primary beneficiary. The trust shall be a Last One Standing Trust under Section 11.17 if and to the extent not otherwise changed pursuant to Section 11.17.

[(3) Application of Section 11.17. This paragraph applies except if and to the extent that any predecessor trust that was a beneficiary of that Benefit Plan was a Conduit Trust that provided current distributions only to the primary beneficiary. The trust shall be a Conduit Trust under Section 11.17 if and to the extent not otherwise changed pursuant to Section 11.17.]

[(4) Application of Section 11.17. This paragraph applies except if and to the extent that any predecessor trust that was a beneficiary of that Benefit Plan was a Conduit Trust that provided current distributions only to the primary beneficiary. The trust shall be an Age 31 Trust under Section 11.17 if and to the extent not otherwise changed pursuant to Section 11.17.]

[(5) Application of Section 11.17. I have made no special provisions in this Agreement for any Benefit Plan, and I realize that not doing so may cause Benefit Plans to be distributed to the Life Trust within as few as five (5) years.]

**SECTION 7.3** **SPECIAL POWER OF APPOINTMENT WHILE LIVING.** The beneficiary, while at least <AGE 3> (___) years of age, in the beneficiary's individual capacity, shall have the continuing discretionary power to Appoint all or any part of the income, principal, or both of the trust to or for the benefit of any person, but may not increase the authority, if any, to make distributions to or for the benefit of the beneficiary, the beneficiary's estate, the beneficiary's creditors, or the creditors of the beneficiary's estate; however: (a) if the trust is an electing small business trust under Code section 1361(e)(1), the beneficiary may not exercise the power to Appoint in a manner that might cause the corporation to violate Code section 1361(b)(1), and (b) subject to subsection (a), a beneficiary, who is not incapacitated and has not attained the age stated above, may with the trustee's consent Appoint the trust's gross income to one or more Charities. Any Appointment under the preceding sentence may be exercised either to effect immediate distribution to the appointee or to take effect upon the occurrence of a future event, such as the beneficiary's death.

**SECTION 7.4** **TERMINATION AND DISTRIBUTION.** The trust shall terminate upon the death of the beneficiary; and the trustee shall distribute the remaining assets as the beneficiary Appoints among a class or classes as follows:

(a) Such class shall consist of all persons, including the creditors of the beneficiary's estate, with respect to :

(1) all assets that the beneficiary could have distributed for his or her own welfare under Section 7.2(a) if the beneficiary is serving as trustee (or has the power to appoint himself or herself as trustee) or could have withdrawn immediately before the beneficiary's death, and

(2) that portion of the remaining assets not described in paragraph (1) that would be subject to tax under Chapter 13 of the Code, but for the general

power granted under this subsection (a) and without regard to any exercise of the special power described in subsection (b).

[Delete highlighted language unless we are certain we want to force estate tax inclusion]

(b) If and to the extent subsection (a) does not apply, then such class shall consist of all persons, specifically excluding, however, the beneficiary, the beneficiary's estate, the beneficiary's creditors, and the creditors of the beneficiary's estate.

To the extent the beneficiary fails to Appoint, the trustee shall allocate the unappointed assets to the beneficiary's then living descendants, per stirpes, or, if no such descendant is then living, to the then living descendants, per stirpes, of the beneficiary's most closely–related ancestor who is either me or my descendant and who has one or more descendants then living. The trustee shall add any such share so created for any person for whose primary benefit a separate trust is then held pursuant to the provisions of this Article to such trust. The trustee shall hold any such share so created for any other person as a separate trust, pursuant to the provisions of this Article.

## ARTICLE 8

## FINAL CONTINGENT DISPOSITION

**SECTION 8.1** **APPLICATION.** This Article shall apply to a trust created in this Agreement if all persons named or designated as remaindermen of such trust predecease the termination of the trust and, as a consequence, there is no person described in this Agreement other than in this Article who is entitled to take such trust remainder.

**SECTION 8.2** **DIVISION.** This Section is subject to Section 7.2(c) if and to the extent that any Fruits of Benefits pass under this Section. Upon termination of any trust to which this Article applies, the trustee shall allocate the remaining assets one-half (1/2) to those persons then living who then would be my heirs-at-law, and one-half (1/2) to those persons then living who then would be my spouse's heirs-at-law, had each of us died at that time intestate and not married, under then existing laws of descent and distribution of the State of Missouri. The trustee shall hold each such share so created for a person in a separate Life Trust for such person (Article 7).

## ARTICLE 9

## THE TRUSTEES

**SECTION 9.1** **DESIGNATION OF TRUSTEES.** This Section is subject to the immediately following Section.

(a) Initial Trustees. My spouse and I shall be the initial co-trustees of the trusts created in this Agreement. If either of us shall cease to serve as trustee for any reason, the other of us shall continue to serve as sole trustee.

(b) Successor Trustees. If both my spouse and I shall cease to serve as trustee for any reason, the following shall serve, one at a time in the order named: first <TEE1>; then <TEE2>; then <TEE3>. If all of the individuals named above shall fail or cease to serve, then <CORP TEE> shall serve as sole trustee.

**SECTION 9.2 POWERS TO CHANGE TRUSTEES.** This Section describes powers to change the trustee and designates the persons to exercise those powers.

(a) Definition of All Powers. Each reference in subsection (b) to "all powers" means all of the following powers: (1) to remove any trustee or co–trustee then serving, with or without cause; (2) to appoint any person(s) (including the person(s) exercising the power) to serve as sole trustee or as co–trustees; (3) to change the designation of the prospective trustee(s), whether such then existing designation is pursuant to the immediately preceding Section or the exercise of a power under this Section, by appointing any succession of persons to serve as prospective trustee(s); (4) to bifurcate (or otherwise separate) authority and duties; (5) to designate any person(s) to exercise, upon any conditions, any of the powers stated in this Section; and (6) to limit or cancel any and all of the powers stated in this Section or existing pursuant to the exercise of a power stated in this Section.

(b) Persons To Exercise All Powers. Subject to the limitations provided in this subsection (b), and subject to the limitation or cancellation of a power stated in this subsection pursuant to subsection (a)(6), the following persons, in the order named, may exercise all powers:

(1) I, while living and not incapacitated, may exercise all powers with respect to any trust created or to be created in this Agreement, and if I am deceased or incapacitated, my spouse, while living and not incapacitated, may exercise all powers with respect to any trust created or to be created in this Agreement;

**[NOTE FOR (2), (3) AND (4): <AGE 3> IS THE AGE AT WHICH THE BENEFICIARY MAY EXERCISE ALL POWERS. IF THE AGES ARE**

**STAGGERED, AGE 1 IS THE FIRST THRESHOLD AGE AND AGE 2 IS THE SECOND THRESHOLD AGE.]**

(2) At any time when I am deceased or incapacitated and my spouse is deceased or incapacitated and all my then living children have attained <AGE 3> years of age, my children who are not incapacitated, acting unanimously, may exercise all powers with respect to all trusts created or to be created under this Agreement, subject to the rights reserved to the primary beneficiary of a Life Trust pursuant to paragraph (3); and

(3) The primary beneficiary of each Life Trust, provided the primary beneficiary has attained <AGE 3> years of age and is not incapacitated, may exercise all powers with respect to such Life Trust and any other trust that may come into existence upon termination of such Life Trust. **USE 3 OR 4 BUT NOT BOTH**

(4) The primary beneficiary of each Life Trust, if the primary beneficiary has attained <AGE 3> years of age and is not incapacitated, may exercise all powers with respect to such Life Trust. If the primary beneficiary has attained <AGE 1> years of age and is not incapacitated, but not <AGE 3> years of age, the primary beneficiary may exercise all powers with respect to "Share A" of such Life Trust as set forth below:

(A) If the primary beneficiary has attained <AGE 1> years of age but not <AGE 2> years of age when first exercising such powers, then the trustee shall set aside as "Share A" one-third (1/3) of such primary beneficiary's trust estate, as then constituted, to be held as described in such exercise, and the trustee shall hold the other two-thirds (2/3) of such primary beneficiary's trust estate, as then constituted, as a segregated share, hereinafter referred to as "Share B." When such primary beneficiary attains <AGE 2> years of age, one-half (1/2) of such primary beneficiary's Share B, as then constituted, shall be added to, and become an integral part of, such primary beneficiary's Share A. When such primary beneficiary attains <AGE 3> years of age, such primary beneficiary's entire Share B, as then constituted, shall be added to, and shall become an integral part of, such primary beneficiary's Share A, and from and after such time the primary beneficiary shall have all powers over all of such Life Trust.

(B) If the primary beneficiary has attained <AGE 2> years of age but not <AGE 3> years of age when first exercising such powers, then the trustee shall set aside as "Share A" two-thirds (2/3) of such primary beneficiary's trust estate, as then constituted, to be held as described in such exercise, and the trustee shall hold the other one-third (1/3) of such primary beneficiary's trust estate, as then constituted, as a segregated share, hereinafter referred to as "Share B." When such primary beneficiary attains <AGE 3> years of age, such primary beneficiary's entire Share B, as then constituted, shall be added to, and shall become an integral part of, such primary beneficiary's Share A, and from and after such time the primary beneficiary shall have all powers over all of such Life Trust.

Whether or not the primary beneficiary has attained <AGE 3> years of age, the primary beneficiary, if not incapacitated, may exercise all powers with respect to all of any trust that may come into existence upon termination of such Life Trust.

(c) Trustee Then Serving. While none of the powers stated in subsection (b) is then exercisable with respect to a particular trust, the individual(s) then serving as sole trustee or co-trustees of such trust, by unanimous agreement if more than one, shall have the continuing discretionary power, to the extent not limited or canceled pursuant to the exercise of a power stated in this Section, with respect to the trust of which such individual(s) are serving and any trust that may come into existence upon termination of such trust: (1) if a corporate trustee is then serving as a co-trustee, to remove the corporate co-trustee then serving, with or without cause, but such individual(s) shall be required to appoint another corporate trustee to serve as co-trustee; and (2) whether or not a corporate trustee is then serving as co-trustee, to change the designation of the prospective corporate trustee(s), whether such then existing designation is pursuant to the immediately preceding Section or the exercise of a power under this Section.

**USE ABOVE SUBSECTION OR BELOW SUBSECTION BUT NOT BOTH**

(d) Trustee Then Serving. While none of the powers stated in subsection (b) is then exercisable with respect to a particular trust, the individual(s) then serving as sole trustee or co-trustees of such trust, by unanimous agreement if more than one, shall have the continuing discretionary power, to the extent not limited or canceled pursuant to the exercise of a power stated in this Section, with respect to the trust of which such individual(s) are serving and any trust that may come into existence upon termination of

such trust: (1) if a corporate trustee is then serving as a co-trustee, to remove the corporate co-trustee then serving, with or without cause, but such individual(s) shall be required to appoint another corporate trustee to serve as co-trustee; and (2) whether or not a corporate trustee is then serving as co-trustee, to change the designation of the prospective trustee(s), by appointing any succession of persons to serve as prospective trustee(s) after the individuals named in Section 9.1 (or treated as named in Section 9.1 by reason of the exercise of a power in subsection (b)).

(e) Beneficiary's Power to Change Corporate Trustee. While none of the powers stated in subsections (b) and (c) is then exercisable with respect to a particular trust, the primary beneficiary (or such beneficiary's representative under the last sentence of Section 11.13), by unanimous agreement if more than one, shall have the continuing discretionary power, to the extent not limited or canceled pursuant to the exercise of a power stated in this Section, exercisable with respect to such particular trust and any other trust that may come into existence upon termination of such particular trust: (1) for any trust for which a corporate trustee is then serving as sole trustee, to remove the corporate trustee then serving, with or without cause, but the person(s) exercising the power shall be required to appoint another corporate trustee to serve as sole trustee; and (2) for any trust for which a corporate trustee is not then serving, to change the designation of the prospective corporate trustee, whether such then existing designation is pursuant to the immediately preceding Section or the exercise of a power under this Section, by designating another corporate trustee.

**SECTION 9.13** **TRUST PROTECTOR.** For all purposes of this Agreement:

(a) Definition and Requirements. "Trust Protector" means a person who has been appointed in writing by the then acting trustee, and such appointment has been accepted in writing by the person appointed to serve as Trust Protector. The trustee then acting shall designate the initial Trust Protector at such time as the trustee deems appropriate, in the trustee's sole and absolute discretion. However, in no event may any beneficiary of a trust or any related or subordinate party (as defined by Code section 672(c)) with respect to any such beneficiary be appointed as Trust Protector of that trust.

(b) Designation of Successor Trust Protector. Subject to the preceding provisions of this Section, the trustee then acting may appoint a successor Trust Protector.

(c) Majority Rule. During such time when two or more persons are serving as Trust Protectors, any decision of the Trust Protectors shall require the affirmative consent of a majority of them.

(d) Powers of Trust Protector. The Trust Protector may, from time to time, notwithstanding any other provision of this Agreement, modify this Agreement, including the dispositive, management, administrative and other provisions of all kinds with respect to any or all trusts created under this Agreement. Without limiting the generality of the foregoing, the Trust Protector shall have the following powers which may be exercised in the sole and absolute discretion of the Trust Protector:

(1) To modify the distributive provisions with respect to any one or more beneficiaries or to terminate a trust, in either case to address changes in tax or other laws or circumstantial changes that may affect the trust and/or trust beneficiaries, including any changes a court may approve under RSMo sections 456.4-415 (reformation to correct mistakes), 456.4-416 (modification to achieve settlor's tax objectives), or both;

(2) To exercise the powers described in Section 10.34 to the extent described therein;

(3) To amend this Agreement to correct errors or ambiguities that might otherwise defeat my intent;

(4) To modify the management or administrative provisions of a trust;

(5) To modify any power of appointment by increasing or decreasing the class of appointees and by converting any limited power of appointment to a general power of appointment, the exercise of which takes effect at the death of the person holding the power, or to similarly change such a general power of appointment to a limited power of appointment;

(6) To distribute the principal of any trust created under this Agreement in further trust under RSMo section 456.4-419 or any successor statute; and

(7) To exercise any authority that any other provision of this Agreement so provides.

(e) Exercise of Powers. All powers granted herein: (1) shall be exercised only by an instrument that is signed by the Trust Protector and delivered to the trustee; (2) may be exercised any number of times without exhausting the power; (3) are personal to the Trust Protector, and no person is authorized to execute the power on behalf of an individual Trust Protector; and (4) may not be exercised in a manner that directly or indirectly authorizes distributions to the Trust Protector, the Trust Protector's estate or the creditors of either or to the natural objects of the Trust Protector's bounty who are not descendants of mine.

(f) Limitation. The Trust Protector may not exercise any power under this Section that would (1) cause the assets of any trust to be included in my gross estate for federal estate tax purposes; (2) disqualify any trust from being an qualified subchapter S trust from and after an election is made to treat such trust as an qualified subchapter S trust; (3) disqualify any trust from being a electing small business trust from and after an election is made to treat such trust as an electing small business trust; (4) change a trust's inclusion ratio for federal generation-skipping transfer tax purposes, except for a change under subsection (d)(5); (5) exercise a power in a manner that would cause the trust assets to no longer be exempt from generation-skipping transfer tax, except for a change under subsection (d)(5); (6) violate Section 11.12(a) [marital deduction savings clause limitation on trustee's actions], applied as if the Trust Protector were the trustee, or (7) change this subsection.

(g) Release of Powers. The Trust Protector, acting on the Trust Protector's own behalf and on behalf of all successor Trust Protectors, may at any time irrevocably release, renounce, suspend, reduce or modify to a lesser extent any or all powers and discretions conferred under this Section.

(h) No Requirement to Act. The Trust Protector need not consider the advisability of exercising a power under this Section until the trustee requests by written

instrument delivered to the Trust Protector that the Trust Protector consider exercising the powers under this Section.

(i) Liability. A Trust Protector exercising the powers under this Section is not a trustee or any other fiduciary with respect to those powers and shall not have the same legal responsibilities as a trustee or any other fiduciary in the exercise of the powers under this Section. The Trust Protector shall not be liable to any person for any action taken or omitted under this Section unless and except to the extent that the person asserting liability proves, by clear and convincing evidence, that the Trust Protector acted in bad faith. The trust estate shall indemnify and hold harmless the Trust Protector from any and all claims, demands, causes of action, costs, and expenses, including attorney fees, in connection with the Trust Protector's actions or omissions, unless the Trust Protector is proven liable under the preceding sentence.

(j) Miscellaneous. Sections 9.5, 9.6, 9.7, 9.8, 9.10, 9.11 and 9.12 shall apply to the Trust Protector by substituting the words "Trust Protector" for the word "trustee."

**SECTION 11.1 SPECIAL METHODS OF PAYMENT.** Whenever the trustee is authorized or directed by other provisions of this Agreement to distribute principal or income to a beneficiary, or to encroach upon the principal for the benefit of a beneficiary, and the trustee determines that the beneficiary, because of mental or physical infirmity or other reason, is unable to use such distribution in the beneficiary's own best interests, the trustee, in the trustee's discretion, may make such distribution in any one or more of the following ways:

(a) To the beneficiary directly;

(b) To a legal or natural guardian, conservator, personal custodian, legal representative or other similar representative of the beneficiary;

(c) As to any minor beneficiary, to a custodian designated by the trustee under the uniform transfers to minors law or other similar statute of any state; or

(d) By expending the same directly for the benefit of the beneficiary for a purpose for which the distribution is authorized.

This Section may affect the method of a distribution authorized or directed by other provisions of this Agreement, but the propriety, amount and purpose of the distribution shall be determined without regard to this Section. The trustee shall not be responsible for the application of any

distribution made pursuant to this Section. Nothing in this Section shall be deemed to be for the benefit of any third party.

**SECTION 11.4 CONSIDERATION OF OTHER RESOURCES.** In the exercise of the trustee's discretionary power to distribute income or principal of a trust for the support or welfare of any beneficiary, the trustee may consider the other income and financial resources known by the trustee to be reasonably available to such beneficiary, including the legal obligation of any other person to provide for such beneficiary's support. If the beneficiary fails to provide the information requested by the trustee, the trustee shall make such assumptions as the trustee deems appropriate. Except as specifically provided in this Agreement to the contrary, the trustee may either ignore the existence of such other income and financial resources in making the distribution or require the beneficiary to use all or any portion of such other income and financial resources as a condition to the distribution.

**SECTION 11.5 NO DISCHARGE OF SUPPORT OBLIGATIONS AND OTHER LIMITATIONS.** Subsections 2 through 4, inclusive, of RSMo section 456.8-814 shall not apply to any trust created in this Agreement. Notwithstanding that other provisions of this Agreement empower the trustee, in the trustee's discretion, to make distributions of income, principal or both from a trust, except as provided in the last sentence of this Section, the following provisions are limitations of the powers of the trustee (other than me) and shall not be construed as granting the trustee additional powers:

[Delete highlighted language here and at the end unless we are certain we want to force estate tax inclusion]

(a) No individual trustee shall have any voice or vote in considering whether to make any discretionary distribution of income or principal for such trustee's own benefit unless such distribution pertains to such trustee's support. No trustee who is appointed by a beneficiary may make any discretionary distribution of income or principal for such beneficiary unless either such distribution pertains to such beneficiary's support or the trustee is not a related or subordinate party (as defined in Code section 672(c)) with respect to such beneficiary.

(b) No such discretionary power, whether or not subject to standards, ascertainable or otherwise, may be exercised to effect a distribution that would discharge (in whole or in part) any legal obligation (including a support obligation) of any of the following described persons in their individual capacity, specifically excluding me: (1) any person who is then a trustee of the trust that would make the distribution; and (2) any

person who is deemed to have the power of a trustee of the trust that would make the distribution (and without limiting the generality of the foregoing, an example of such a person would be a person who holds a power, then exercisable with respect to the trust that would make the distribution, to remove the trustee then serving and appoint the holder of such power as the trustee).

(c) A power the exercise of which is limited or prohibited by subsection (a) or subsection (b) may be exercised by a majority of the remaining trustee(s) whose exercise of the power is not so limited or prohibited. If the power of all trustees is so limited or prohibited, the trustees(s) may appoint a special trustee (who is otherwise not limited or prohibited from exercising the power under subsection (a) or subsection (b)) to exercise the power.

This Section shall not apply to limit distributions that any trustee of a nonexempt Life Trust (even if the beneficiary) makes for the beneficiary's welfare.

**SECTION 11.17 SPECIAL RULES FOR BENEFITS.** This Section applies if and to the extent that Benefits are or remain payable to a trust; subsection (d) applies if and to the extent that Benefits are or remain payable to the Revocable Trust. If and to the extent the Benefits Trustee so provides in a trust record, this Section may apply separately with respect to any separate Benefit Plan.

(a) Types of Trusts.

(1) Last One Standing Trust. If a trust is a "Last One Standing Trust," then, subject to any power to Appoint that applies to that trust or any trust to which that trust passes directly or indirectly, the following provisions of this paragraph shall apply. If at any time only one individual is living who is or would be a beneficiary of any trust (including any remaindermen described in Article 8 (Final Contingent Disposition)) that would hold any Fruits of Benefits, any Fruits of Benefits must be distributed to that individual. If no individual is described in Article 8, then, if at any time only one descendant of mine is living, any Fruits of Benefits must be distributed to that descendant, or, if no descendant of mine is living, to my heirs-at-law determined as if I had died at that time intestate and not

married, under then existing laws of descent and distribution of the State of Missouri.

(2) Conduit Trust. If a trust is a "Conduit Trust," then, subject to any power to Appoint that applies to that trust or any trust to which that trust passes directly or indirectly, the following provisions of this paragraph shall apply. Each withdrawal from a Benefit Plan will, upon receipt by the trustee, be paid directly to, or for the benefit of, one or more Specified Beneficiaries. A "Specified Beneficiary" is any individual to whom a trustee may make any distribution while the primary beneficiary is then living. Payments required under this paragraph shall be made first according to the distribution provisions of the relevant Article, then any excess to or for the benefit of the primary beneficiary. If more than one individual is a Specified Beneficiary, the first sentence of Section 7.2(c)(1) shall not apply.

(3) Age 31 Trust. If a trust is an "Age 31 Trust," then:

(A) If the primary beneficiary has attained twenty-one (21) years of age no later than the end of the calendar year of my death, the trust shall be subject to the terms of a Conduit Trust and subparagraph (B) shall not apply.

(B) Otherwise, all Fruits of Benefits shall be distributed to the primary beneficiary no later than the end of the tenth ($10^{th}$) calendar year following the calendar year in which the primary beneficiary attains twenty-one (21) years of age, and Section 11.1 shall not apply in any manner that delays payment to the beneficiary any later than that deadline. The Benefits Trustee may modify this subparagraph or otherwise cause this subparagraph not to apply if and to the extent that, before September 30 of the calendar year following the calendar year of my death, the Benefits Trustee so provides.

(4) Trust for Disabled or Chronically Ill Beneficiaries (Special EDBs). If a trust is a "Special EDB Trust," then, subject to any power to Appoint that applies

to that trust or any trust to which that trust passes directly or indirectly, the following provisions of this paragraph shall apply. In a Special EDB Trust, the primary beneficiary must be an eligible designated beneficiary described in Code section 401(a)(9)(E)(ii)(III) or (IV) (a "special EDB"). During the beneficiary's life Fruits of Benefits may be distributed only to one or more special EDBs, and the limitations of a Last One Standing Trust shall apply when the trust terminates.

(b) Modification Declaration. The Benefits Trustee may Appoint Fruits of Benefits (a "Modification Declaration") to:

(1) convert a trust from one type of trust described in subsection (a) to another type of trust described in subsection (a),

(2) modify the application of the rules described in subsection (a), or

(3) provide that different rules or no rules apply to Benefits.

Except to the extent that an Age 31 Trust or the exercise of a power to Appoint expressly restricts the timing of a Modification Declaration, the Benefits Trustee may effectuate a Modification Declaration at any time. I understand that the Modification Declaration may cause there not to be a designated beneficiary under the Minimum Distribution Rules and may reduce the period over which distributions are required to be made under the Minimum Distribution Rules to as few as five (5) or fewer years. The exercise of the power to Appoint shall be among a class consisting of the beneficiaries of the relevant trust and may not increase the authority, if any, to make distributions to or for the benefit of the Donee, the Donee's estate, the Donee's creditors, or the creditors of the Donee's estate.

(c) Definitions Used in This Section. As used in this Section:

(1) Benefits. "Benefits" and "Benefit Plan" are defined in Section 12.2.

(2) Benefits Trustee. The "Benefits Trustee" is the trustee who is authorized to make distributions for welfare under the relevant Article, if and to the extent not prohibited by Section 11.5 (No Discharge Of Support Obligations And Other Limitations). If no trustee qualifies as a Benefits Trustee such that one would

need to be appointed under Section 11.5 or otherwise so that a Benefits Trustee is serving under this Section, the trustee may appoint a Trust Protector (Section 9.13) who is hereby authorized to exercise the powers described in this subsection instead of the Benefits Trustee. The Benefits Trustee may release authority under any portion of this Section and shall not be liable for so doing. If and to the extent the preceding sentence applies, any remaining trustee (or successor trustee who would serve if the Benefits Trust failed to serve) shall appoint a Trust Protector who is hereby authorized to exercise the powers described in this subsection instead of the Benefits Trustee; and if no co-trustee or successor trustee is designated, the person(s) who under Section 9.2 would have the authority to fill a vacancy in the trustee shall appoint such a Trust Protector.

(3) Fruits of Benefits. "Fruits of Benefits" means Benefits and any reinvestments of Benefits, to the extent not distributed to the beneficiary. Any distributions to a beneficiary to whom Fruits of Benefits may or must be distributed shall be treated as coming first from Fruits of Benefits except if and to the extent that the trustee indicates otherwise in a record created on or before the due date (including any extensions) for the federal income tax return reporting the distribution or, if no such return applies, on or before October 15 of the calendar year following the calendar year in which the distribution occurs.

(4) Minimum Distribution Rules. "Minimum Distribution Rules" means Code section 401(a)(9), 408(a)(6), 457(d)(2) or comparable provisions that apply to a Benefit Plan.

(d) Benefits Payable to Revocable Trust. If and to the extent that Benefits are or remain payable to the Revocable Trust, Articles 3 and 4 shall not apply to Fruits of Benefits. However, the Benefits Trustee may provide in a Modification Declaration that items in Article 3 apply to Fruits of Benefits to the extent that they are properly allocable to Fruits of Benefits.

[Article 3 applies to debts and expenses, and Article 4 is specific bequests; see part IV Revocable Trust, Per Stirpes Provision for why this being added]

(e) Payments for the Benefit of a Trust Beneficiary. With respect to Fruits of Benefits, Section 11.1 shall apply in a manner consistent with U.S. Treas. Reg. section 1.401(a)(9)-4(f)(3)(iv). However, the Benefits Trustee may provide in a Modification Declaration that the preceding sentence shall not apply.

[Section 11.1 is the facility of payment clause, allowing payments to or for the benefit of a beneficiary]

**SECTION 12.1** **APPOINT.** The exercise by any person (the "Donee" in this Section) of any power to "Appoint" in this Agreement shall be subject to this Section. Subject to the restrictions stated in this Section and any other provisions of this Agreement specifically to the contrary, in the exercise of such power of appointment the Donee may appoint outright or in trust (including continuing the existing trust but with modified terms), may appoint to or for the benefit of one or more persons (whether born or unborn on the date of this Agreement) in the restricted group who are objects of such power to the complete exclusion of any one or more other persons in such group, may create additional powers of appointment that may be exercised in favor of persons within or without the restricted group, and generally may appoint in any lawful manner. Notwithstanding the foregoing, if a power to Appoint that is not a general power of appointment (within the meaning of Code section 2041) is exercised by creating another power of appointment which under the applicable local law could be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, then any trust created by such exercise shall terminate no later than the period provided under Section 11.3, determined as if that period had not been extended by the exercise of a power to Appoint; however, the limitations of this sentence shall not apply if the exercise specifically states an intent to create a general power of appointment or specifically refers to Code section 2041(a)(3) in a manner which demonstrates such an intent (this clause is referred to below as the "Delaware Tax Trap"). Except where specifically provided in this Agreement to the contrary, any exercise shall affect only the assets remaining in the trust at its termination, if any. Except with respect to triggering the Delaware Tax Trap, the power is personal to the Donee, and no person is authorized to exercise the power on behalf of the Donee. Any exercise must specifically refer to the power and shall be effected only by a will duly admitted to probate or other written instrument. Any exercise by an instrument other than a will shall be revocable by a

subsequent instrument or by will, unless the Donee specifically provides otherwise in the instrument. Each exercise or revocation by an instrument other than a will shall be accomplished upon the delivery to the trustee during the Donee's life of a written instrument of exercise or revocation that is dated and signed by the Donee. So far as possible, the laws of the State of Missouri shall govern the validity of any interest created by the exercise of such power of appointment.

**SECTION 12.2** **BENEFIT PLAN AND BENEFITS.** The term "Benefit Plan" means any qualified retirement plan (including a pension, profit sharing, stock bonus or other retirement plan) under Code sections 401(a) or 403(b), an individual retirement account or annuity under Code section 408 (including 408A), or an eligible deferred compensation plan under Code section 457(b). The term "Benefits" includes any interest in a Benefit Plan and any distributions made from a Benefit Plan.

**SECTION 12.12** **PRIMARY BENEFICIARY.** The term "primary beneficiary" means: me, with respect to the Revocable Trust while I am living; those persons and the trustees of those trusts who or which are entitled to the residuary trust assets, with respect to the Revocable Trust after my death; my spouse, with respect to the Marital Trust; and the person referred to as the "beneficiary," with respect to a separate Life Trust.

**SECTION 12.18** **SUPPORT.** Distributions for a person's "support" means distributions for a person's support and maintenance in reasonable comfort, medical care and education (including a course of instruction at an elementary school, secondary school, vocational school, art school, college, university, and graduate school, as well as private tutoring, internships and apprentice work). Distributions for the support of a beneficiary shall be based upon the standard of living to which such beneficiary shall have become accustomed. If and to the extent the power to distribute for support can be exercised to distribute assets to a new trust, the person holding this power may exercise it by modifying the existing trust rather than being required to distribute assets to a new trust.

**SECTION 12.21** **WELFARE.** Distributions for a person's "welfare" means distributions for such person's comfort, welfare and best interests, all as determined in the trustee's absolute discretion. Pursuant to this standard, the trustee is authorized, in the trustee's absolute discretion, to determine that such person's welfare is enhanced by making a distribution to or for the benefit of such person of none, part or all of the trust. If and to the extent the power to distribute for welfare can be exercised to distribute assets to a new trust, the person holding this power may exercise it by modifying the existing trust rather than being required to distribute assets to a new trust.

**SECTION 12.22** **WORD USAGE.** Except where otherwise clearly required by the context, these rules of construction shall apply.

(a) Individual and Person. Each reference to "individual" means a natural person. Except as provided in the preceding sentence, each reference to "person" includes an individual, corporation, limited liability company, general partnership, limited partnership, limited liability partnership (whether general or limited, and whether registered or not), trust, estate, unincorporated organization, government or any agency or political subdivision thereof, custodian, trustee, executor, administrator, personal representative, nominee or other entity in its own or a representative capacity. For example, each reference to "person" in the Article of this Agreement entitled "The Trustees" includes individual trustees and corporate trustees.

(b) Other. The singular or plural number of any word includes the other number. The masculine, feminine or neuter gender of any word includes the other genders. Any form of the word "include" is deemed to be followed by "without limitation." The present tense of any verb includes the future tense.

**SECTION 12.23** **HEADINGS AND TABLE OF CONTENTS.** The headings and table of contents in this Agreement have been inserted for administrative convenience only and do not constitute matter to be construed in interpreting this Agreement.

**SECTION 12.24** **REFERENCES.** Each reference in this Agreement to an Article, Section, subsection, paragraph, subparagraph, part or sentence refers to such in this Agreement, except where specifically designated otherwise. For example, a reference to Section 1.1(a)(1)(A)(i) would mean part (i) of subparagraph (A) of paragraph (1) of subsection (a) of Section 1.1 of Article 1 of this Agreement. Similarly, a reference to "subparagraph (A)" would mean that subparagraph (A) found in the paragraph that contains the reference.

## IV. Revocable Trust, Per Stirpes Provision; Other Section 11.17 Additions

This is based on Reg. § 1.401(a)(9)-8(a)(1)(iii)(C), which allows separate account treatment only if "there is no discretion as to the extent to which of the separate trusts post-death distributions attributable to the employee's interest in the plan are allocated."

After each allocation, per stirpes, upon the owner's death add the following language:

> Notwithstanding any other provision in this Agreement, neither Section 10.25 nor RSMo section 456.8-816(22) shall apply to any Benefits; thus, all Benefits shall be allocated per stirpes without regarding to the allocation of any other property.

In the form referenced in this paper, Section 10.25, "Make Distributions in Cash or in Kind," provides:

> The trustee is authorized to make all distributions of income and principal, including distributions to satisfy any pecuniary or fractional gift made in any Article of this Agreement, in cash or in kind, or partly in each, without any requirement to allocate equitably the basis of property for income tax purposes, and without any requirement to make pro rata distributions of specific assets; provided, however, that any in-kind distribution to satisfy a pecuniary gift and any non-pro-rata distribution to satisfy a fractional gift shall be valued by the trustee at its fair market value as of the date of distribution. The values placed on such assets and the particular assets selected by the trustee for distribution to any particular distributee shall be binding upon all persons having an interest in the trust estate.

If the trust agreement does not have such a clause, cross-reference applicable state law. For example, Section 816(22) of the Uniform Trust Code (last updated 9/15/2023, but probably unchanged since inception) authorizes a trustee to:

> on distribution of trust property or the division or termination of a trust, make distributions in divided or undivided interests, allocate particular assets in proportionate or disproportionate shares, value the trust property for those purposes, and adjust for resulting differences in valuation

Section 11.17(d) is added to prevent Fruits of Benefits from being used to pay debts and expenses, although the Benefits Trustee may charge Fruits of Benefits with any expenses properly allocable to Fruits of Benefits. Furthermore, the language from Reg. § 1.401(a)(9)-8(a)(1)(iii)(C) found at the top of this Part IV Revocable Trust, Per Stirpes Provision requires Benefits to be distributed per stirpes without any trustee discretion, so Section 11.17(d) prevents the trustee from using Fruits of Benefits to satisfy any specific bequests.

Section 11.17(e) is added to make the facility of payments clause, Section 11.1, consistent with Reg. § 1.401(a)(9)-4(f)(3)(iv), "Treatment of payments for the benefit of a trust beneficiary," which provides:[25]

> For purposes of this paragraph (f)(3), a trust beneficiary will be treated as if the beneficiary could receive amounts in the trust representing the employee's interest in the

[25] This discussion may also be important for Age 31 trusts. See fn 3 in part I Explanation of Regulations' View of Trusts.

plan regardless of whether those amounts could be paid to that beneficiary or for the benefit of that beneficiary. Thus, for example, if a trust beneficiary is a minor child of the employee, payments that could be made to a custodial account for the benefit of that child are treated as amounts that could be received by the child.

Of course, for some clients using the full 10-year period or other stretch is not as important as fractional pick-and-choose authority, so this should not be used in those situations. Further language would be needed for *Clayton* QTIP plans, but this would be fine for disclaimer plans.

Suppose a revocable trust agreement provides for a QTIPable trust and a sprinkle credit shelter trust. To preserve estate tax flexibility, the trust agreement does not have the recommended no-discretion language. If the trustee decides to allocate the IRA to the Marital Trust with conduit language for Benefits, the credit shelter trust's terms must be considered. If the credit shelter trust lacks conduit language, the Marital Trust would not be able to use the Uniform Life Table. To remedy this situation, the Benefits Trustee could add conduit language to the credit shelter trust; that way, each trust to which the IRA could be allocated has the same Benefits language. However, if and to the extent the IRA is not payable to the credit shelter trust, the conduit language would not affect the credit shelter trust's accumulation purpose.

Suppose revocable trust provides that child A has Trust A and child B has Trust B, and the trust does not have the recommended no-discretion language. If child A modifies Trust A in a way that ruins the 10-year payout, then it also ruins Trust B's payout. Child A might not have had any malice – child A just spent down the IRA sooner and modified the trust because child A did not need to preserve the 10-year payout anymore and did not know about the impact on child B. However, if that situation occurs, the Benefits Trustee might make a Modification Declaration to preclude such changes.

## V. Conduit Marital Trust

For an explanation, see text accompanying fn 16 in part II Explanation of Retirement Planning Default Provisions for Life Trusts for Descendants.

**SECTION 6.4 RECEIPT AND ALLOCATION OF DISTRIBUTION FROM BENEFIT PLAN.** See Section 11.17 for terms used in this Section.

(a) If and to extent that the Marital Trust is the beneficiary of any Benefit Plan, the trustee:

(1) shall withdraw from the Marital Trust's direct or indirect portion of the Benefit Plan the amount required under the Minimum Distribution Rules,

(2) may make additional withdrawals, and

(3) shall administer the Marital Trust as a Conduit Trust, except if and to the extent that, no later than before September 30 of the calendar year following the calendar year of my death, a Modification Declaration is executed providing that the Marital Trust may not or shall not be administered as a Conduit Trust, taking into account my desire to use the longest distribution period allowable.

(b) If the Marital Trust's portion of the income earned by a Benefit Plan for a calendar year exceeds the distributions from such Benefit Plan to the Marital Trust, the trustee shall, upon the demand of my spouse, withdraw such excess income from the Benefit Plan and distribute such excess income directly to my spouse; however, the trustee may satisfy that demand, in whole or in part, by distributing principal from assets other than the Benefit Plan rather than distributing from the Benefit Plan itself. This subsection is intended to comply with the minimum requirements of Revenue Ruling 2006-26 to qualify for a marital deduction.

## VI. Family Trust When At Least One Minor Child EDB

Reg. § 1.401(a)(9)-5(f)(2)(i), "General rule," provides:

> Except as otherwise provided in paragraphs (f)(2)(ii) and (iii) of this section and § 1.401(a)(9)-8(a), if an employee has more than one designated beneficiary, then paragraph (e)(1) of this section is applied with respect to the oldest of the employee's designated beneficiaries.

Reg. § 1.401(a)(9)-5(f)(2)(ii) is discussed below and is the main topic of this part VI Family Trust When At Least One Minor Child EDB. Reg. § 1.401(a)(9)-5(f)(2)(iii), "Applicable multi-beneficiary trust," provides:

> If an employee's beneficiary is an applicable multi-beneficiary trust described in § 1.401(a)(9)-4(g)(1), then paragraph (e)(3) of this section applies as if the death of the employee's eligible designated beneficiary does not occur until the death of the last to survive of the trust beneficiaries who are described in § .401(a)(9)-4(g)(1)(ii).

Reg. § 1.401(a)(9)-5(e)(1), "In general," provides:

> Except as provided in paragraph (f) of this section, if an employee's accrued benefit is in the form of an individual account under a defined contribution plan, then the entire interest of the employee must be distributed by the end of the earliest of the calendar years described in paragraph (e)(2), (3), or (4) of this section. However, the preceding sentence does not apply if section 401(a)(9)(H) does not apply with respect to the employee (for example, if both the employee and the employee's designated beneficiary died before January 1, 2020). See §1.401(a)(9)-1(b) for rules relating to the section 401(a)(9)(H) effective date.

Reg. § 1.401(a)(9)-5(e)(2), (3), and (4) are referred to below. Let's get into the special rule for a trust for at least one minor child:

Reg. § 1.401(a)(9)-5(f)(2)(ii), "Special rule for employee's minor child," provides:

> If any of the employee's designated beneficiaries is an eligible designated beneficiary because that designated beneficiary is described in § 1.401(a)(9)-4(e)(1)(ii) (relating to the child of the employee who has not reached the age of majority at the time of the employee's death), then -
>
> (A) Paragraph (e)(2) of this section does not apply;
>
> (B) Paragraph (e)(3) of this section applies as if the death of the employee's eligible designated beneficiary does not occur until the death of all of the designated beneficiaries who are described in § 1.401(a)(9)-4(e)(1)(ii); and
>
> (C) Paragraph (e)(4) of this section applies as if the attainment of the age of majority of the employee's eligible designated beneficiary described in § 1.401(a)(9)-4(e)(1)(ii) does not occur until the youngest of those eligible designated beneficiaries reaches the age of majority.

Reg. § 1.401(a)(9)-5(e)(2) is the 10-year outer limit.[26] Thus, (A) provides that the 10-year outer limit does not apply. However, the life expectancy of the oldest beneficiary applies under the general rule of Reg. § 1.401(a)(9)-5(f)(2)(i).

Reg. § 1.401(a)(9)-5(e)(3) is the 10-year outer limit following the death of an EDB.[27]
Reg. § 1.401(a)(9)-4(e)(1)(ii) refers to the owner's minor child and cross-references the definition of "age of majority" as the individual's 21st birthday.[28] Thus, (B) provides that the 10-year outer limit is triggered by death only when all minor children who are beneficiaries have died.

Reg. § 1.401(a)(9)-4(e)(4) provides that the 10-year outer limit applies to the owner's minor child after that minor child attains 21.[29] Thus, the modification in (C) above means that the 10-year outer limit applies after the youngest minor child of the owner attains 21

The IRA distribution period will be 10 years after the youngest minor child-EDB reaches age 21 or when all minor child-EDBs have died before then. The oldest countable designated beneficiary's life expectancy still applies to determine how quickly distributions need to be made before that point. The preamble comments:

> … these regulations retain this requirement for continued annual distributions for up to 10 years after: (1) the death of an eligible designated beneficiary who was taking life expectancy payments; or (2) the attainment of the age of majority (in the case of an eligible designated beneficiary who was a minor child of the employee taking life expectancy payments).

The first Family Trust is only for descendants.

---

[26] Reg. § 1.401(a)(9)-5(e)(2), "10-year limit for designated beneficiary who is not an eligible designated beneficiary," provides:

> If the employee's designated beneficiary is not an eligible designated beneficiary (as determined in accordance with § 1.401(a)(9)-4(e)), then the calendar year described in this paragraph (e)(2) is the calendar year that includes the tenth anniversary of the date of the employee's death.

[27] Reg. § 1.401(a)(9)-5(e)(3), "10-year limit following death of eligible designated beneficiary," provides:

> If the employee's designated beneficiary is an eligible designated beneficiary (as determined in accordance with § 1.401(a)(9)-4(e)), then the calendar year described in this paragraph (e)(3) is the calendar year that includes the tenth anniversary of the date of the designated beneficiary's death.

[28] Reg. § 1.401(a)(9)-4(e)(1)(ii) refers to:

> A child of the employee (within the meaning of section 152(f)(1)) who has not reached the age of majority within the meaning of paragraph (e)(3) of this section.

Code § 152(f)(1) is reproduced in the text accompanying fn 1 in part I Explanation of Regulations' View of Trusts.
Reg. § 1.401(a)(9)-4(e)(3), "Determination of age of majority," provides, "An individual reaches the age of majority on the individual's 21st birthday."

[29] Reg. § 1.401(a)(9)-5(e)(4), "10-year limit after minor child of the employee reaches age of majority," provides:

> If the employee's designated beneficiary is an eligible designated beneficiary only because the beneficiary is the child of the employee who has not reached the age of majority at the time of the employee's death, then the calendar year described in this paragraph (e)(4) is the calendar year that includes the tenth anniversary of the date the designated beneficiary reaches the age of majority.

The second Family Trust is when the grantor wants to have a separate trust for each minor child and also wants to allow another family member to benefit, but if the owner dies after the required beginning date then that other family member should have a life expectancy that exceeds 10 years to get any advantage from this situation.

In either case, the beneficiary form must pour into this trust only if a beneficiary qualifies as a "minor child."

## ARTICLE 9

## FAMILY TRUST FOR DESCENDANTS

**SECTION 9.1** **DESIGNATION.** Assets to be held as a separate Family Trust pursuant to the provisions of this Article shall be held as a separate trust estate with income and principal distributed as provided in this Article and shall be designated in substantially the following form: my name followed by "Family Trust U/A/D ___/___/____."

**SECTION 9.2** **DISTRIBUTION OF INCOME AND PRINCIPAL.** The trustee may distribute so much of the income and principal of the Family Trust as the trustee shall deem appropriate for the support and welfare of any one or more of my descendants, taking into account the following:

(a) Any distribution to my descendants may be unequal and shall be charged against the trust as a whole and not against the ultimate distributive share of any person; and

(b) I intend that the trustee be liberal in providing for the support of any of my minor children; for example, the trustee might determine that under such circumstances it is appropriate for the trust to do one or more of the following:

(1) Purchase and own a home and allow to live in that home the individual ("guardian" in this Section) who is then the guardian of the person for my children, along with my children and the rest of the guardian's family;

(2) Pay all or part of those expenses that will allow the guardian to improve or expand the guardian's existing home or purchase a larger or more appropriate home; and

(3) Pay all or part of those expenses that will allow the guardian, my children, and the rest of the guardian's family who are living in the guardian's home to take vacations (including trips overseas).

[Note that subsection (b) would cause the life expectancy of the guardian or of other members of the guardian's household to be used. Consider editing or deleting if the oldest member of the guardian's household has a short life expectancy.]

(c) Benefit Plans. If and to extent that the trust is the beneficiary of (or is directly or indirectly a beneficiary of another trust that is a beneficiary of) any Benefit Plan (for definitions, see Section 11.17 (Special Rules for Benefits)):

(1) Required Minimum Distributions and Other Distributions. The trustee shall withdraw from the Family Trust's direct or indirect portion of the Benefit Plan the amount required under the Minimum Distribution Rules and may make additional withdrawals. Subsections (a) and (b) shall determine distributions to one or more beneficiaries under this subsection except to the extent this subsection or Section 11.17 overrides this sentence. I encourage but do not require the Benefits Trustee, within a few months after my death, to consult a tax advisor with a working knowledge of the Minimum Distribution Rules regarding any actions that may be taken under Section 11.17 to ameliorate the impact of those rules.

(2) Application of Section 11.17. This paragraph applies except if and to the extent that any predecessor trust that was a beneficiary of that Benefit Plan was a Conduit Trust. The trust shall be a Last One Standing Trust under Section 11.17 if and to the extent not otherwise changed pursuant to Section 11.17.

**SECTION 9.3** **TERMINATION AND DISTRIBUTION.** The Family Trust shall terminate on December 31 of the tenth (10th) calendar year following the first calendar year in which all of my children, who had not attained twenty-one (21) years of age upon my death, have either attained that age or died. Upon termination the trustee shall allocate the remaining assets to my then living descendants, per stirpes. The trustee shall hold any such share so created for a descendant in a separate Life Trust for such descendant (Article 7).

***[Alternative]***

***[Note that the life expectancy of the oldest beneficiary must be used. Consider editing or deleting if the oldest member of the guardian's household has a short life expectancy.]***

## ARTICLE 9

## FAMILY TRUST FOR CHILD AND GRANTOR'S PARENTS

**SECTION 9.1** **DESIGNATION.** Assets to be held as a separate Family Trust pursuant to the provisions of this Article shall be held as a separate trust estate with income and principal distributed as provided in this Article and shall be designated in substantially the following form: the beneficiary's name followed by "Family Trust U/A/D ___/___/____."

**SECTION 9.2** **DISTRIBUTION OF INCOME AND PRINCIPAL.** The trustee may distribute so much of the income and principal of the Family Trust as the trustee shall deem appropriate for the support and welfare of the beneficiary and my those of my parents who are then living. If and to extent that the trust is the beneficiary of (or is directly or indirectly a beneficiary of another trust that is a beneficiary of) any Benefit Plan (for definitions, see Section 11.17 (Special Rules for Benefits)):

(a) Required Minimum Distributions and Other Distributions. The trustee shall withdraw from the Family Trust's direct or indirect portion of the Benefit Plan the amount required under the Minimum Distribution Rules and may make additional withdrawals. Subsections (a) and (b) shall determine distributions to one or more beneficiaries under this subsection except to the extent this subsection or Section 11.17 overrides this sentence. I encourage but do not require the Benefits Trustee, within a few months after my death, to consult a tax advisor with a working knowledge of the Minimum Distribution Rules regarding any actions that may be taken under Section 11.17 to ameliorate the impact of those rules.

(b) Application of Section 11.17. This paragraph applies except if and to the extent that any predecessor trust that was a beneficiary of that Benefit Plan was a Conduit Trust. The trust shall be a Last One Standing Trust under Section 11.17 if and to the extent not otherwise changed pursuant to Section 11.17.

**SECTION 9.3** **TERMINATION AND DISTRIBUTION.** The Family Trust shall terminate on December 31 of the tenth (10th) calendar year following the first calendar year in which the beneficiary either attains twenty-one (21) years of age or died. Upon termination due to age, the trustee shall hold the remaining assets in a Life Trust (Article 7) for the beneficiary. Upon termination due to death, the trustee shall distribute the remaining assets as the beneficiary Appoints among a class or classes as follows:

(a) Such class shall consist of all persons, including the creditors of the beneficiary's estate, with respect to that portion of the remaining assets not described in paragraph (1) that would be subject to tax under Chapter 13 of the Code, but for the general power granted under this subsection (a) and without regard to any exercise of the special power described in subsection (b).

[Delete highlighted language unless we are certain we want to force estate tax inclusion]

(b) If and to the extent subsection (a) does not apply, then such class shall consist of all persons, specifically excluding, however, the beneficiary, the beneficiary's estate, the beneficiary's creditors, and the creditors of the beneficiary's estate.

To the extent the beneficiary fails to Appoint, the trustee shall allocate the unappointed assets to the beneficiary's then living descendants, per stirpes, or, if no such descendant is then living, to the then living descendants, per stirpes, of the beneficiary's most closely–related ancestor who is either me or my descendant and who has one or more descendants then living. The trustee shall add any such share so created for any person for whose primary benefit a separate trust is then held pursuant to the provisions of Article 7 to such trust. The trustee shall hold any such share so created for any other person as a separate trust, pursuant to the provisions of Article 7.

## VII. Clauses to Shift Income Taxation

One might move Section 11.17(c) to Section 11.17(d) (and otherwise renumber Section 11.17) and insert a new subsection (c) with one or more of the following:

(a) Without limiting the generality of the Benefits Trustee's authority under this Section, the Benefits Trustee may exercise the Benefits Trustee's authority under by doing any one or more of the following:

(1) Grant of Limited Withdrawal Right. With respect to one or more taxable years, the Benefits Trustee may grant the beneficiary the absolute right to withdraw any Benefits (other than Benefits that are nontaxable under Code § 408A or comparable provisions) distributed to the trust. An example of such a withdrawal right follows: The beneficiary shall have the right to withdraw all Benefits distributed to the trust in each calendar year. Any Benefits not withdrawn by the beneficiary by the end of the calendar year shall be added to principal, if and to the extent they do not already constitute principal. An amount equal to any Benefits distributed to the trust but not withdrawn by the beneficiary shall remain subject to withdrawal by the beneficiary, and this withdrawal right may be satisfied from the trust's entire principal. Any distribution to the beneficiary shall come first from (reduce) withdrawable assets, and the trustee may not distribute withdrawable assets to anyone except the beneficiary. On January 31 of the succeeding year and on January 31 of each subsequent year, any withdrawal right not exercised by the beneficiary shall be reduced by the maximum amount that the beneficiary could fail to withdraw on such date without such failure constituting a release of a general power of appointment under Code section 2514; and, except to the extent that the beneficiary's income tax liability on such Benefits exceeds the Benefits the beneficiary withdrew, any withdrawal right remaining after that lapse may be exercised only with the corporate trustee's consent (and the beneficiary may appoint a corporate trustee solely for this purpose if no corporate trustee is then serving). The Benefits Trustee may by written instrument delivered to the trustee

terminate this withdrawal right, but any termination shall affect only the right to withdraw Benefits distributed to the trust after the effective date of the termination.

(2) Conduit Declaration. If a trust is not a Conduit Trust, the Benefits Trustee may nevertheless require that a fixed amount (or amount set by formula) of Benefits shall be paid to the primary beneficiary for such taxable years as the Benefits Trustee may determine before the trustee exercises any discretion regarding distributions under the relevant Article.

## A. BDOT – Hanging Power with Creditor Protection

**DRAFTING NOTE**: Trustees are the primary beneficiary's sister [D] and uncle [E]. Beneficiary [A]is schizophrenic but follows her lawyer's advice and is able to understand the long-term benefits to not exercising her withdrawal right. Traditional and Roth IRAs are significant but less than a majority of the assets of the Exempt Life Trust.

**Creation of BDOT for**
**[A] Exempt Life Trust**
**U/A [B] dated [C]**

TO: [A]

This Instrument is executed as of the first date signed by either of by us, [D] ("[D first name]"), and [E] ("[E first name]"), as trustees of the [A] Exempt Life Trust U/A [B] dated [C] (the "Exempt Life Trust") established under that certain trust agreement created by [B] ("[B first name]"), as grantor and trustee, on [C], as restated in its entirety on [F], and known as the [B] Revocable Trust dated [C] (as restated, "[B first name]'s Trust Agreement").

WHEREAS, pursuant to Section ____ of [B first name]'s Trust Agreement, we as trustees may distribute all or any part of the assets in the Exempt Life Trust for your support, welfare, or both (the "Distribution Power");

WHEREAS, we have determined that it is in your best interest to exercise the Distribution Power to allow you to withdraw certain amounts, giving you the right to withdraw those amounts for at least one year (the "Crediting Document," a sample of which is Exhibit A to this Instrument) and, under certain conditions, for longer than that;

WHEREAS, the effect of this process is to include in your personal taxable income at least the amount provided in the Crediting Document and in the BDOT described below, so that these amounts are taxed at your income tax rates instead of the trust's income tax rate;

WHEREAS, our financial advisor, in projections provided to you over the course of the past year, has estimated that this process would provide significant tax benefits to you and your family; and

WHEREAS, by this Instrument, we desire to exercise the Distribution Power under the conditions hereinafter set forth.

NOW, THEREFORE, we exercise the Distribution Power to create one or more separate accounts within the Exempt Life Trust, which will be referred to as the [A] BDOT U/A/D [C] (collectively, the "BDOT"), which will be funded by contributions provided for in the Crediting Document(s) and administered in the same manner as the Exempt Life Trust, but in addition to any distributions you may receive under the Distribution Power, you shall also have the right to withdraw all assets in the BDOT ("withdrawable assets," subject to lapse or reduction below), except that:

1. Starting on January 1, 202__ [second January 1 after the document was signed], you may exercise your withdrawal right only with the consent of the nonadverse trustee(s) of the Exempt Life Trust, with respect to any portion of the BDOT that has been in the BDOT for more than one taxable year (the "Trustee Consent Portion"); and

2. With respect to the Trustee Consent Portion, your withdrawal right may be satisfied from any part of the Exempt Life Trust, and every December 31 (starting December 31, 202__) [same year] your withdrawal right over the Trustee Consent Portion shall lapse (no longer be exercisable) to the extent of five percent (5%) of the fair market value of the Exempt Life Trust as of such date.

A "nonadverse" trustee is any person who is not an adverse party under U.S. Treas. Reg. § 20.2041-3(c)(2), and [D first name] is not a nonadverse trustee, so initially only [E first name]'s consent is required when [D first name] is serving as co-trustee with [E first name]. If [E first name] ceases serving as a trustee and no other trustee who serves as [his/her] successor qualifies as a nonadverse trustee, then the person who can change the trustee under Section _____ of [B first name]'s Trust Agreement (currently [D first name]) shall promptly upon your request appoint a nonadverse trustee with respect to the BDOT for the purpose of giving or withholding consent over the Trustee Consent Portion.

Furthermore, any distribution to you from the BDOT shall come first from (in other words, reduce) withdrawable assets, and the trustee(s) may not distribute withdrawable assets to anyone except you.

Dated: [G]

_ [D], Trustee

Dated: [G]

_ [E], Trustee

COUNTY OF _____ )
) ss.
STATE OF MISSOURI )

On this date of [G], before me appeared [D], to me known to be the person described in and who executed the foregoing instrument, and acknowledged that [s]he executed the same as [his/her] free act and deed in the capacity stated above for the purposes therein stated.

_____
Notary Public

My Commission Expires:

COUNTY OF _____ )
) ss.
STATE OF _____ )

On this date of [G], before me appeared [E], to me known to be the person described in and who executed the foregoing instrument, and acknowledged that [s]he executed the same as [his/her] free act and deed in the capacity stated above for the purposes therein stated.

_____
Notary Public

My Commission Expires:

**ACKNOWLEDGEMENT OF RECEIPT**

I acknowledge having received this Creation of BDOT for [A] Exempt Life Trust U/A [B] dated [C].

Dated: _____ _____, 202__

_____

_

[A]

**EXHIBIT A**

**Crediting Document**

TO: [A]

As of the Effective Date (defined below), we, [D] and [E], as trustees of the [A] Exempt Life Trust U/A [B] dated [C] (the "Exempt Life Trust") established under that certain trust agreement created by [B], as grantor and trustee on [C], as restated in its entirety on [F], and known as the [B] Revocable Trust dated [C] (as restated, "[B first name]'s Trust Agreement"), are executing this Instrument.

WHEREAS, pursuant to a certain Creation of BDOT for [A] Exempt Life Trust U/A/D [C] executed as of [G] (the "Creation of BDOT"), we may fund the [A] BDOT U/A/D [C] (the "BDOT") from assets of the Exempt Life Trust in accordance with our distribution powers;

WHEREAS, the amount funded to the BDOT will be deposited by us into one or more separate accounts within the Exempt Life Trust; and

WHEREAS, you may withdraw all or a portion of the BDOT in accordance with the provisions of the Creation of BDOT;

NOW, THEREFORE, pursuant to the Creation of BDOT and our distribution powers under the Exempt Life Trust, we are depositing certain assets into the BDOT, which assets have a fair market value estimated to be $_____, and we hereby notify you that this deposit was made on _____ ___, 20___ (the "Effective Date").

Dated: _____, 20____

_____

[D], Trustee

Dated: _____, 20____

_____

[E], Trustee

**B. BDOT – Hanging Power with No Creditor Protection**

**DRAFTING NOTE**: Trustee is the primary beneficiary [A]. Traditional and Roth IRAs are significant but less than a majority of the assets of the Exempt Life Trust.

**Creation of BDOT for**
**[A] Exempt Life Trust**
**U/A [B] dated [C]**

TO: [A]

This Instrument is executed on this day of [E], by [A] ("[A first name]"), as trustee of the [A] Exempt Life Trust U/A [B] dated [C] (the "Exempt Life Trust") established under that certain trust agreement created by [B] ("[B first name]"), as grantor and trustee, on [C], as restated in its entirety on [D], and known as the [B] Revocable Trust dated [C] (as restated, "[B first name]'s Trust Agreement").

WHEREAS, pursuant to Section _____ of [B first name]'s Trust Agreement, I as trustee may distribute all or any part of the assets in the Exempt Life Trust for your support (the "Distribution Power");

WHEREAS, I have determined that it is in your best interest to exercise the Distribution Power to allow you to withdraw certain amounts, giving you the right to withdraw those amounts for at least one year (the "Crediting Document," a sample of which is Exhibit A to this Instrument) and, under certain conditions, for longer than that;

WHEREAS, the effect of this process is to include in your personal taxable income at least the amount provided in the Crediting Document and in the BDOT described below, so that these amounts are taxed at your income tax rates instead of the trust's income tax rate;

WHEREAS, the financial advisor for the Exempt Life Trust, in projections provided to you over the course of the past year, has estimated that this process would provide significant tax benefits to you and your family; and

WHEREAS, by this Instrument, I desire to exercise the Distribution Power under the conditions hereinafter set forth.

NOW, THEREFORE, I exercise the Distribution Power to create one or more separate accounts within the Exempt Life Trust, which will be referred to as the [A] BDOT U/A/D [C] (collectively, the "BDOT"), which will be funded by contributions provided for in the Crediting Document(s) and administered in the same manner as the Exempt Life Trust, but in addition to any distributions you may receive under the Distribution Power, you shall also have the right to withdraw all assets in the BDOT, except that, starting on January 1, 202__ [second January 1

after this document was signed], with respect to any portion of the BDOT that has been in the BDOT for more than one taxable year, your withdrawal right over that portion may be satisfied from any part of the Exempt Life Trust, and every December 31 (starting December 31, 202__) [same year] your withdrawal right over that portion shall lapse (no longer be exercisable) to the extent of five percent (5%) of the fair market value of the Exempt Life Trust as of such date.

Furthermore, any distribution to you from the BDOT shall come first from (in other words, reduce) withdrawable assets, and the trustee may not distribute withdrawable assets to anyone except you.

Dated: [E]

_ _____

[A], Trustee

I acknowledge having received this Creation of BDOT for [A] Exempt Life Trust U/A [B] dated [C].

Dated: [E]

_ _____

[A], Beneficiary

STATE OF MISSOURI )
) ss.
COUNTY OF _____ )

On this date of [E], before me appeared [A], to me known to be the person described in and who executed the foregoing instrument, and acknowledged that [s]he executed the same as [his/her] free act and deed in the capacities stated above for the purposes therein stated.

_____
Notary Public

My Commission Expires:

**EXHIBIT A**

**Crediting Document**

TO: [A]

As of the Effective Date (defined below), I, [A], as trustee of the [A] Exempt Life Trust U/A [B] dated [C] (the "Exempt Life Trust") established under that certain trust agreement created by [B], as grantor and trustee on [C], as restated in its entirety on [D], and known as the [B] Revocable Trust dated [C] (as restated, "[B first name]'s Trust Agreement"), am executing this Instrument.

WHEREAS, pursuant to a certain Creation of BDOT for [A] Exempt Life Trust U/A/D [C] executed as of [E] (the "Creation of BDOT"), I as trustee may fund the [A] BDOT U/A/D [C] (the "BDOT") from assets of the Exempt Life Trust in accordance with my distribution powers;

WHEREAS, the amount funded to the BDOT will be deposited by me into one or more separate accounts within the Exempt Life Trust; and

WHEREAS, you may withdraw all or a portion of the BDOT in accordance with the provisions of the Creation of BDOT;

NOW, THEREFORE, pursuant to the Creation of BDOT and my distribution powers under the Exempt Life Trust, I am depositing certain assets into the BDOT, which assets have a fair market value estimated to be $_____, and I hereby notify you that this deposit was made on _____ ___, 20___ (the "Effective Date").

Dated: _____, 20____

_____

[A], Trustee

## VIII. Beneficiary Designation Form

RETIREMENT ACCOUNT OF JOHN A. DOE
ATTACHMENT TO BENEFICIARY DESIGNATION

Primary Beneficiary.

If I am survived by my spouse, Jane B. Doe, then my entire account shall be paid to my spouse. However, if and to the extent my spouse (or the personal representative of my spouse's estate) disclaims an interest in the account, then the disclaimed portion of the account shall be paid to the trustee of the John A. Doe Marital Trust created upon my death under the provisions of the John A. Doe Revocable Trust Agreement dated _____, [as amended _____, and] as may be further amended from time to time (the "Revocable Trust Agreement"). If and to the extent that my spouse further disclaims an interest in the account in said Marital Trust, the disclaimed portion of the account shall pass to the Contingent Beneficiary (see below).

Contingent Beneficiary.

If (a) I am not survived by my spouse, or (b) my spouse survives me and dies without designating one or more beneficiaries to receive the full amount of my account, then upon the second to die of my spouse and me, my account, or any portion thereof with respect to which a beneficiary has not been designated, shall be divided into the following shares:[30]

1. One (1) equal share for each of my children who is then living. For purposes of this instrument, my children shall mean [children's names], [and any other child of mine born or legally adopted by me after the date of this instrument.]

2. One (1) equal share for each of my said children who is not then living but has one or more descendants who is then living.

3. A share established under (2), above, shall be further subdivided among the then living descendants of my deceased child, per stirpes.

The share of each living child, and the subshare of each descendant of a deceased child of mine, shall be paid to the trustee of the Life Trust for such child or descendant under the Revocable Trust Agreement.[31]

---

[30] IRA custodians often reject this introductory paragraph due to system limitations. In that case, one might instead use:

If I am not survived by my spouse, then my account shall be divided into the following shares:

[31] If you want to plan for separate Life Trusts with different payout periods (see text accompanying and preceding fn 6 on page 19 of this memo), consider substituting for that sentence:

The share of each living child, and the subshare of each descendant of a deceased child of mine, shall be subdivided further into ___ equal subshares, with each further subshare paid to the trustee of a separate Life Trust for such child or descendant under the Revocable Trust Agreement. Nothing in the preceding sentence shall be construed as limiting the trustee's authority to combine trusts, before, during, or after those trusts are funded.

Miscellaneous.

1. If my spouse and I shall die simultaneously or under such circumstances that it cannot be determined with reasonable certainty who died first, then it shall be presumed for purposes of this designation that I survived my spouse.

2. The Custodian may conclusively rely upon the certification of the trustee(s) under the Revocable Trust Agreement as to proper payees under the Contingent Beneficiary portion hereof and shall be fully released and discharged from any and all liability for payments in reliance upon such certification.

3. Regardless of who is named as beneficiary above, the trustee(s) under the Revocable Trust Agreement and the personal representative, administrator, or other duly appointed representative of my estate shall be provided with such information regarding my account or the beneficiary(ies) of my account as such person(s) may request.

Date: _____ _____

John A. Doe

## IX. Charitable Planning Opportunities

The portion of the primary beneficiary's Life Trust that holds part or all of the IRAs can be converted into a charitable remainder trust (CRT),[32] but the financial advisor would need to confirm that the IRA custodian would not balk at that. Here are some key features, using the example of a donor advised fund (DAF) being the remainderman:

1. No tax when the IRA is distributed to the CRT

2. All of the CRT's investment income (including capital gain) is reinvested tax-free

3. The CRT distributes to the primary beneficiary 5% (or perhaps a higher fixed percentage) every year

4. The CRT's distributions to the primary beneficiary are taxed the same as an IRA distribution[33]

5. On the primary beneficiary's death, the CRT passes to charity. The primary beneficiary can make a DAF be the charity, and the primary beneficiary can advise the DAF to change the charities from time to time.

The CRT's main disadvantages are:

(a) the primary beneficiary can't take out any more or any less than the 5% (or perhaps a higher fixed percentage) every year

(b) The assets must pass to charity

(c) Increased annual tax preparation fee

the primary beneficiary can direct the CRT to distribute to the DAF, but that would require certain documentation that makes this best done infrequently rather than routinely.[34]

Charities facing obstacles collecting on beneficiary designations should check out the resources at ********charitablegiftplanners.org/ira-distribution-resource-center.

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[32] Mechanically, the Life Trust would be divided, and the primary beneficiary would exercise her power to Appoint under Section 7.3 to name the DAF as the irrevocable beneficiary on her death. The Benefits Trustee would then modify the trust using the welfare distribution authority and the resulting decanting power to turn it into a CRT. I practice primarily in states where decanting can be effectuated merely by modifying the trust; the responsible attorney needs to see whether applicable state law includes such a provision (which is in the Uniform Decanting Act.)

[33] This statement is not a complete description of how Code § 664 works, but it's close enough from the viewpoint of explaining it to a client.

[34] The CRT would not include a spendthrift clause, so the primary beneficiary can assign to the DAF part of her right to receive distributions during her life. That assignment would cause that portion of the CRT to merge into the DAF's right to receive assets on her death, causing an outright distribution of that portion to be made. the primary beneficiary would obtain a charitable deduction based on the value of her right to receive distributions during her life, but that deduction would require an appraisal of that right.

## X. Withdrawal Right Provisions from Uniform Trust Code

**SECTION 103. DEFINITIONS.** In this [Code]:

(11) “Power of withdrawal” means a presently exercisable general power of appointment other than a power: (A) exercisable by a trustee and limited by an ascertainable standard; or (B) exercisable by another person only upon consent of the trustee or a person holding an adverse interest.

**Comment**

A “power of withdrawal” (paragraph (11)) is defined as a presently exercisable general power of appointment other than a power exercisable by a trustee and limited by an ascertainable standard, or a power which is exercisable by another person only upon consent of the trustee or a person holding an adverse interest. The exception for a power exercisable by a trustee that is limited by an ascertainable standard was added in 2004. For a discussion of this amendment, see the comment on the 2004 Amendment to Section 504, which made a related change.

**Comment to 2004 Amendment to Section 504**

In addition, the definition of "power of withdrawal" in Section 103 is amended to clarify that a power of withdrawal does not include a power exercisable by the trustee that is limited by an ascertainable standard. The purpose of this amendment is to preclude a claim that the power of a trustee-beneficiary to make discretionary distributions for the trustee-beneficiary's own benefit results in an enforceable claim of the trustee-beneficiary's creditors to reach the trustee-beneficiary's interest as provided in Section 505(b). Similar to the amendment to Section 504, the amendment to "power of withdrawal" is being made because of concerns that Restatement (Third) of Trusts Section 60, comment g, otherwise might allow a beneficiary-trustee's creditors to reach the trustee's beneficial interest.

The Code does not specifically address the extent to which a creditor of a trustee/beneficiary may reach a beneficial interest of a beneficiary/trustee that is not limited by an ascertainable standard.

**SECTION 505. CREDITOR’S CLAIM AGAINST SETTLOR.**

(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor’s creditors.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor’s benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor’s interest in the portion of the trust attributable to that settlor’s contribution.

(3) After the death of a settlor, and subject to the settlor’s right to direct the source from which

liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and [statutory allowances] to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and [allowances].

(b) For purposes of this section:

(1) during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; and

(2) upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in Section 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986, in each case as in effect on [the effective date of this [Code]] [, or as later amended].

**Comment**

Subsection (a)(1) states what is now a well accepted conclusion, that a revocable trust is subject to the claims of the settlor's creditors while the settlor is living. See Restatement (Third) of Trusts Section 25 cmt. e (Tentative Draft No. 1, approved 1996). Such claims were not allowed at common law, however. See Restatement (Second) of Trusts Section 330 cmt. O (1959). Because a settlor usually also retains a beneficial interest that a creditor may reach under subsection (a)(2), the common law rule, were it retained in this Code, would be of little significance. See Restatement (Second) of Trusts Section 156(2) (1959).

Subsection (a)(2), which is based on Restatement (Third) of Trusts Section 58(2) and cmt. e (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts Section 156 (1959), follows traditional doctrine in providing that a settlor who is also a beneficiary may not use the trust as a shield against the settlor's creditors. The drafters of the Uniform Trust Code concluded that traditional doctrine reflects sound policy. Consequently, the drafters rejected the approach taken in States like Alaska and Delaware, both of which allow a settlor to retain a beneficial interest immune from creditor claims. See Henry J. Lischer, Jr., Domestic Asset Protection Trusts: Pallbearers to Liability, 35 Real Prop. Prob. & Tr. J. 479 (2000); John E. Sullivan, III, Gutting the Rule Against Self-Settled Trusts: How the Delaware Trust Law Competes with Offshore Trusts, 23 Del. J. Corp. L. 423 (1998). Under the Code, whether the trust contains a spendthrift provision or not, a creditor of the settlor may reach the maximum amount that the trustee could have paid to the settlor-beneficiary. If the trustee has discretion to distribute the entire income and principal to the settlor, the effect of this subsection is to place the settlor's creditors in the same position as if the trust had not been created. For the definition of "settlor," see Section 103(15).

This section does not address possible rights against a settlor who was insolvent at the time of the trust's creation or was rendered insolvent by the transfer of property to the trust. This subject

is instead left to the State's law on fraudulent transfers. A transfer to the trust by an insolvent settlor might also constitute a voidable preference under federal bankruptcy law.

Subsection (a)(3) recognizes that a revocable trust is usually employed as a will substitute. As such, the trust assets, following the death of the settlor, should be subject to the settlor's debts and other charges. However, in accordance with traditional doctrine, the assets of the settlor's probate estate must normally first be exhausted before the assets of the revocable trust can be reached. This section does not attempt to address the procedural issues raised by the need first to exhaust the decedent's probate estate before reaching the assets of the revocable trust. Nor does this section address the priority of creditor claims or liability of the decedent's other nonprobate assets for the decedent's debts and other charges. Subsection (a)(3), however, does ratify the typical pourover will, revocable trust plan. As long as the rights of the creditor or family member claiming a statutory allowance are not impaired, the settlor is free to shift liability from the probate estate to the revocable trust. Regarding other issues associated with potential liability of nonprobate assets for unpaid claims, see Section 6-102 of the Uniform Probate Code, which was added to that Code in 1998.

Subsection (b)(1) treats a power of withdrawal as the equivalent of a power of revocation because the two powers are functionally identical. This is also the approach taken in Restatement (Third) of Trusts Section 56 cmt. b (Tentative Draft No. 2, approved 1999). If the power is unlimited, the property subject to the power will be fully subject to the claims of the power holder's creditors, the same as the power holder's other assets. If the power holder retains the power until death, the property subject to the power may be liable for claims and statutory allowances to the extent the power holder's probate estate is insufficient to satisfy those claims and allowances. For powers limited either in time or amount, such as a right to withdraw a $10,000 annual exclusion contribution within 30 days, this subsection would limit the creditor to the $10,000 contribution and require the creditor to take action prior to the expiration of the 30-day period.

Upon the lapse, release, or waiver of a power of withdrawal, the property formerly subject to the power will normally be subject to the claims of the power holder's creditors and assignees the same as if the power holder were the settlor of a now irrevocable trust. Pursuant to subsection (a)(2), a creditor or assignee of the power holder generally may reach the power holder's entire beneficial interest in the trust, whether or not distribution is subject to the trustee's discretion. However, following the lead of Arizona Revised Statutes Section 14-7705(g) and Texas Property Code Section 112.035(e), subsection (b)(2) creates an exception for trust property which was subject to a *Crummey* or five and five power. Upon the lapse, release, or waiver of a power of withdrawal, the holder is treated as the settlor of the trust only to the extent the value of the property subject to the power at the time of the lapse, release, or waiver exceeded the greater of the amounts specified in IRC Sections 2041(b)(2) or 2514(e) [greater of 5% or $5,000], or IRC Section 2503(b) [$10,000 in 2001].

The Uniform Trust Code does not address creditor issues with respect to property subject to a special power of appointment or a testamentary general power of appointment. For creditor rights against such interests, see Restatement (Property) Second: Donative Transfers Sections 13.1-13.7 (1986).

## XI. SECURE Act – Code § 401(a)(9)

Checkpoint

§401 Qualified pension, profit-sharing, and stock bonus plans.

§ 401 Qualified pension, profit-sharing, and stock bonus plans.

[401(a)](a) Requirements for qualification.

A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section -

[401(a)(9)](9) Required distributions.

[401(a)(9)(A)](A) In general. A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee-

[401(a)(9)(A)(i)](i) will be distributed to such employee not later than the required beginning date, or

[401(a)(9)(A)(ii)](ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

[401(a)(9)(B)](B) Required distribution where employee dies before entire interest is distributed.

[401(a)(9)(B)(i)](i) Where distributions have begun under subparagraph (A)(ii). A trust shall not constitute a qualified trust under this section unless the plan provides that if-

[401(a)(9)(B)(i)(I)](I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

[401(a)(9)(B)(i)(II)](II) the employee dies before his entire interest has been distributed to him,

the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

[401(a)(9)(B)(ii)](ii) 5-year rule for other cases. A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

[401(a)(9)(B)(iii)](iii) Exception to 5-year rule for certain amounts payable over life of beneficiary. If-

[401(a)(9)(B)(iii)(I)](I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

[401(a)(9)(B)(iii)(II)](II) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

[401(a)(9)(B)(iii)(III)](III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,

for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

[401(a)(9)(B)(iv)](iv) Special rule for surviving spouse of employee. If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee-

[401(a)(9)(B)(iv)(I)](I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 72, and

[401(a)(9)(B)(iv)(II)](II) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

[401(a)(9)(C)](C) Required beginning date. For purposes of this paragraph-

[401(a)(9)(C)(i)](i) In general. The term "required beginning date" means April 1 of the calendar year following the later of-

[401(a)(9)(C)(i)(I)](I) the calendar year in which the employee attains age 72, or

[401(a)(9)(C)(i)(II)](II) the calendar year in which the employee retires.

[401(a)(9)(C)(ii)](ii) Exception. Subclause (II) of clause (i) shall not apply-

[401(a)(9)(C)(ii)(I)](I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 72, or

[401(a)(9)(C)(ii)(II)](II) for purposes of section 408(a)(6) or (b)(3) .

[401(a)(9)(C)(iii)](iii) Actuarial adjustment. In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70 ½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70 ½ in which the employee was not receiving any benefits under the

plan.

[401(a)(9)(C)(iv)](iv) Exception for governmental and church plans. Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term "church plan" means a plan maintained by a church for church employees, and the term "church" means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

[401(a)(9)(D)](D) Life expectancy. For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

[401(a)(9)(E)](E) Definitions and rules relating to designated beneficiaries. For purposes of this paragraph-

[401(a)(9)(E)(i)](i) Designated beneficiary. The term "designated beneficiary" means any individual designated as a beneficiary by the employee.

[401(a)(9)(E)(ii)](ii) Eligible designated beneficiary. The term "eligible designated beneficiary" means, with respect to any employee, any designated beneficiary who is-

[401(a)(9)(E)(ii)(I)](I) the surviving spouse of the employee,

[401(a)(9)(E)(ii)(II)](II) subject to clause (iii), a child of the employee who has not reached majority (within the meaning of subparagraph (F) ),

[401(a)(9)(E)(ii)(III)](III) disabled (within the meaning of section 72(m)(7)),

[401(a)(9)(E)(ii)(IV)](IV) a chronically ill individual (within the meaning of section

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), or

[401(a)(9)(E)(ii)(V)](V) an individual not described in any of the preceding subclauses who is not more than 10 years younger than the employee.

The determination of whether a designated beneficiary is an eligible designated beneficiary shall be made as of the date of death of the employee.

[401(a)(9)(E)(iii)](iii) Special rule for children. Subject to subparagraph (F), an individual described in clause (ii)(II) shall cease to be an eligible designated beneficiary as of the date the individual reaches majority and any remainder of the portion of the individual's interest to which subparagraph (H)(ii) applies shall be distributed within 10 years after such date.

[401(a)(9)(F)](F) Treatment of payments to children. Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations).

[401(a)(9)(G)](G) Treatment of incidental death benefit distributions. For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph.

[401(a)(9)(H)](H) Special rules for certain defined contribution plans. In the case of a defined contribution plan, if an employee dies before the distribution of the employee's entire interest-

[401(a)(9)(H)(i)](i) In general. Except in the case of a beneficiary who is not a designated beneficiary, subparagraph (B)(ii)-

[401(a)(9)(H)(i)(I)](I) shall be applied by substituting "10 years" for "5 years", and

[401(a)(9)(H)(i)(II)](II) shall apply whether or not distributions of the employee's interests have begun in accordance with subparagraph (A).

[401(a)(9)(H)(ii)](ii) Exception for eligible designated beneficiaries. Subparagraph (B)(iii) shall apply only in the case of an eligible designated beneficiary.

[401(a)(9)(H)(iii)](iii) Rules upon death of eligible designated beneficiary. If an eligible designated beneficiary dies before the portion of the employee's interest to which this subparagraph applies is entirely distributed, the exception under clause (ii) shall not apply to any beneficiary of such eligible designated beneficiary and the remainder of such portion shall be distributed within 10 years after the death of such eligible designated beneficiary.

[401(a)(9)(H)(iv)](iv) Special rule in case of certain trusts for disabled or chronically ill beneficiaries. In the case of an applicable multi-beneficiary trust, if under the terms of the trust-

[401(a)(9)(H)(iv)(I)](I) it is to be divided immediately upon the death of the employee into separate trusts for each beneficiary, or

[401(a)(9)(H)(iv)(II)](II) no individual (other than a eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii)) has any right to the employee's interest in the plan until the death of all such eligible designated beneficiaries with respect to the trust,

for purposes of a trust described in subclause (I), clause (ii) shall be applied separately with respect to the portion of the employee's interest that is payable to any eligible designated

beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii); and, for purposes of a trust described in subclause (II), subparagraph (B)(iii) shall apply to the distribution of the employee's interest and any beneficiary who is not such an eligible designated beneficiary shall be treated as a beneficiary of the eligible designated beneficiary upon the death of such eligible designated beneficiary.

[401(a)(9)(H)(v)](v) Applicable multi-beneficiary trust. For purposes of this subparagraph, the term "applicable multi-beneficiary trust" means a trust-

[401(a)(9)(H)(v)(I)](I) which has more than one beneficiary,

[401(a)(9)(H)(v)(II)](II) all of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the distribution period pursuant to this paragraph, and

[401(a)(9)(H)(v)(III)](III) at least one of the beneficiaries of which is an eligible designated beneficiary described in subclause (III) or (IV) of subparagraph (E)(ii).

[401(a)(9)(H)(vi)](vi) Application to certain eligible retirement plans. For purposes of applying the provisions of this subparagraph in determining amounts required to be distributed pursuant to this paragraph, all eligible retirement plans (as defined in section 402(c)(8)(B), other than a defined benefit plan described in clause (iv) or (v) thereof or a qualified trust which is a part of a defined benefit plan) shall be treated as a defined contribution plan.

[401(a)(9)(I)](I) Temporary waiver of minimum required distribution.

[401(a)(9)(I)(i)](i) In general. The requirements of this paragraph shall not apply for calendar year 2020 to-

[401(a)(9)(I)(i)(I)](I) a defined contribution plan which is described in this subsection or in

section 403(a) or 403(b),

[401(a)(9)(I)(i)(II)](II) a defined contribution plan which is an eligible deferred compensation plan described in section 457(b) but only if such plan is maintained by an employer described in section 457(e)(1)(A), or

[401(a)(9)(I)(i)(III)](III) an individual retirement plan.

[401(a)(9)(I)(ii)](ii) Special rule for required beginning dates in 2020. Clause (i) shall apply to any distribution which is required to be made in calendar year 2020 by reason of-

[401(a)(9)(I)(ii)(I)](I) a required beginning date occurring in such calendar year, and

[401(a)(9)(I)(ii)(II)](II) such distribution not having been made before January 1, 2020.

[401(a)(9)(I)(iii)](iii) Special rules regarding waiver period. For purposes of this paragraph-

[401(a)(9)(I)(iii)(I)](I) the required beginning date with respect to any individual shall be determined without regard to this subparagraph for purposes of applying this paragraph for calendar years after 2020, and

[401(a)(9)(I)(iii)(II)](II) if clause (ii) of subparagraph (B) applies, the 5-year period described in such clause shall be determined without regard to calendar year 2020.

## XII. SECURE Act – Effective dates

— P.L. 116-136, Sec. 2203(a), Div. A, added sbpara. (a)(9)(I), effective as provided in Sec. 2203(c) of this Act, which provides:

“(c) Effective dates.

“(1) In general. The amendments made by this section shall apply for calendar years beginning after December 31, 2019.

“(2) Provisions relating to plan or contract amendments.

“(A) In general. If this paragraph applies to any plan or contract amendment—

“(i) such plan or contract shall not fail to be treated as being operated in accordance with the terms of the plan during the period described in subparagraph (B)(ii) solely because the plan operates in accordance with this section, and

“(ii) except as provided by the Secretary of the Treasury (or the Secretary's delegate), such plan or contract shall not fail to meet the requirements of section 411(d)(6) of the Internal Revenue Code of 1986 and section 204(g) of the Employee Retirement Income Security Act of 1974 by reason of such amendment.

“(B) Amendments to which paragraph applies.

“(i) In general. This paragraph shall apply to any amendment to any plan or annuity contract which—

“(I) is made pursuant to the amendments made by this section, and

“(II) is made on or before the last day of the first plan year beginning on or after January 1, 2022.

“In the case of a governmental plan, subclause (II) shall be applied by substituting '2024' for '2022'.

“(ii) Conditions. This paragraph shall not apply to any amendment unless during the period beginning on the effective date of the amendment and ending on December 31, 2020, the plan or contract is operated as if such plan or contract amendment were in effect.”

— P.L. 116-94, Sec. 401(a)(1), Div. O, added subpara. (a)(9)(H) P.L. 116-94, Sec. 401(a)(2), Div. O, amended subpara. (a)(9)(E), effective as provided in Sec. 401(b), Div. O of this Act, which reads as follows:

“(b) Effective dates.

“(1) In general. Except as provided in this subsection, the amendments made by this section shall apply to distributions with respect to employees who die after December 31, 2019.

“(2) Collective bargaining exception. In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before the date of enactment of this Act, the amendments made by this section shall apply to distributions with respect to employees who die in calendar 1 years beginning after the earlier of—

“(A) the later of—

“(i) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof agreed to on or after the date of the enactment of this Act), or

“(ii) December 31, 2019, or

“(B) December 31, 2021. For purposes of subparagraph (A)(i), any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by this section shall not be treated as a termination of such collective bargaining agreement.

“(3) Governmental plans. In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), paragraph (1) shall be applied by substituting “December 31, 20 2021” for “December 31, 2019”.

“(4) Exception for certain existing annuity contracts.

“(A) In general. The amendments made by this section shall not apply to a qualified annuity which is a binding annuity contract in effect on the date of enactment of this Act and at all times thereafter.

“(B) Qualified annuity. For purposes of this paragraph, the term “qualified annuity” means, with respect to an employee, an annuity—

“(i) which is a commercial annuity (as defined in section 3405(e)(6) of the Internal Revenue Code of 1986);

“(ii) under which the annuity payments are made over the life of the employee or over the joint lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the joint life expectancy of such employee and a designated beneficiary) in accordance with the regulations described in section 401(a)(9)(A)(ii) of such Code (as in effect before such amendments) and which meets the other requirements of section 401(a)(9) of such Code (as so in effect) with respect to such payments; and

“(iii) with respect to which—

“(I) annuity payments to the employee have begun before the date of enactment of this Act, and the employee has made an irrevocable election before such date as to the method and amount of the annuity payments to the employee or any designated beneficiaries; or

“(II) if subclause (I) does not apply, the employee has made an irrevocable election before the date of enactment of this Act as to the method and amount of the annuity payments to the employee or any designated beneficiaries.

“(5) Exception for certain beneficiaries.

“(A) In general. If an employee dies before the effective date, then, in applying the amendments made by this section to such employee's designated beneficiary who dies after such date—

“(i) such amendments shall apply to any beneficiary of such designated beneficiary; and

“(ii) the designated beneficiary shall be treated as an eligible designated beneficiary for purposes of applying section 401(a)(9)(H)(ii) of the Internal Revenue Code of 1986 (as in effect after such amendments).

“(B) Effective date. For purposes of this paragraph, the term “effective date” means the first day of the first calendar year to which the amendments made by this section apply to a plan with respect to employees dying on or after such date.”

Prior to amendment, subpara. (a)(9)(E) read as follows:

“(E) Designated beneficiary. For purposes of this paragraph, the term 'designated beneficiary' means any individual designated as a beneficiary by the employee.”

## XIII. Explanation of Law from Preamble to Final Regulations

SUPPLEMENTARY INFORMATION:

[The heading numbering was added by Word when I copied.]

### A. Background

This document sets forth amendments to the Income Tax Regulations (26 CFR part 1) under section 401(a)(9) of the Internal Revenue Code of 1986 (Code). These regulations address the required minimum distribution requirements for plans qualified under section 401(a) and update the regulations to reflect the amendments made to section 401(a)(9) by sections 114 and 401 of the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), enacted on December 20, 2019, as Division O of the Further Consolidated Appropriations Act, 2020, Public Law 116-94, 133 Stat. 2534 (2019) and by various sections of the SECURE 2.0 Act of 2022 (SECURE 2.0 Act), enacted on December 29, 2022, as Division T of the Consolidated Appropriations Act, 2023, Public Law 117-328, 136 Stat. 4459 (2022).

The rules of section 401(a)(9) are adopted by reference in section 408(a)(6) and (b)(3) for individual retirement accounts and individual retirement annuities (collectively, IRAs); section 403(b)(10) for annuity contracts, custodial accounts, and retirement income accounts described in section 403(b) (section 403(b) plans); and section 457(d)(2) for eligible deferred compensation plans. The determination of the required minimum distribution is also relevant for purposes of the related excise tax under section 4974 and the definition of eligible rollover distribution in section 402(c). Accordingly, this document also sets forth conforming amendments to the Income Tax Regulations (26 CFR part 1) under sections 402(c), 403(b), 408, and 457, and to the Pension Excise Tax Regulations (26 CFR part 54) under section 4974.

#### 1. Section 401(a)(9)—Required Minimum Distributions

Section 401(a)(9) provides rules for distributions from a qualified plan during the life of the employee in section 401(a)(9)(A) and after the death of the employee in section 401(a)(9)(B). The rules set forth a required beginning date for distributions and identify the period over which the employee's entire interest must be distributed.

Specifically, section 401(a)(9)(A)(ii) provides that the entire interest of an employee in a qualified plan must be distributed, beginning not later than the employee's required beginning date, in accordance with regulations, over the life of the employee or over the lives of the employee and a designated beneficiary (or over a period not extending beyond the life expectancy of the employee and a designated beneficiary). Section 401(a)(9)(B)(i) provides that, if the employee dies after distributions have begun, the employee's remaining interest must be distributed at least as rapidly as under the distribution method used by the employee as of the date of the employee's death (referred to in this preamble as the “at least as rapidly” rule).

Section 401(a)(9)(B)(ii) and (iii) provides that, if the employee dies before required minimum distributions have begun, the employee's interest must either be: (1) distributed within 5years after the death of the employee; or (2) distributed (in accordance with regulations) over the life or life expectancy of the designated beneficiary with the distributions generally beginning not later than 1 year after the date of the employee's death.

However, under section 401(a)(9)(B)(iv) (as amended by section 327 of the SECURE 2.0 Act), a surviving spouse may elect to: (1) be treated as if the surviving spouse were the employee for purposes of section 401(a)(9)(B)(iii)(II); (2) wait until the date the employee would have attained the applicable age (as defined in section 401(a)(9)(C)(v)) to begin taking required minimum distributions; and (3) have the beneficiaries of the surviving spouse be treated as beneficiaries of the employee if the surviving spouse dies before distributions to the spouse begin.

Section 401(a)(9)(C)(i) (as amended by section 114 of the SECURE Act and further amended by section 107 of the SECURE 2.0 Act) defines the required beginning date for an employee (other than a 5-percent owner or IRA owner) as April 1 of the calendar year following the later of the calendar year in which the employee attains the applicable age or the calendar year in which the employee retires. Section 401(a)(9)(C)(v)(I) provides that in the case of an individual who attains age 72 after December 31, 2022, and age 73 before January 1, 2033, the applicable age is 73. Section 401(a)(9)(C)(v)(II) provides that in the case of an individual who attains age 74 after December 31, 2032, the applicable age is 75. For a 5-percent owner or an IRA owner, the required beginning date is April 1 of the calendar year following the calendar year in which the individual attains the applicable age, even if the individual has not retired.

Section 401(a)(9)(C)(iii) provides that certain employees who commence benefits under a defined benefit plan after the year in which they attain age 70 1/2 must receive an actuarial increase. However, section 401(a)(9)(C)(iv) provides that the actuarial increase requirement does not apply for a governmental plan or for a church plan (as defined in section 401(a)(9)(C)(iv)).

Section 401(a)(9)(D) provides that (except in the case of a life annuity) the life expectancy of an employee and the employee's spouse (used to measure the period over which payments must be made) may be redetermined, but not more frequently than annually.

Section 401(a)(9)(E)(i) defines the term *designated beneficiary* as any individual designated as a beneficiary by the employee. Section 401(a)(9)(E)(ii) (which was added to the Code as part of section 401 of the SECURE Act) defines the term *eligible designated beneficiary,* with respect to any employee, as any designated beneficiary who, as of the date of the employee's death, is: (1) the surviving spouse of the employee; (2) a child of the employee who has not reached the age of majority (within the meaning of section 401(a)(9)(F)); (3) disabled (within the meaning of section 72(m)(7)); (4) a chronically ill individual (within the meaning of section 7702B(c)(2), subject to certain exceptions); or (5) an individual not described elsewhere in section 401(a)(9)(E)(ii) who is not more than 10 years younger than the employee.

Section 401(a)(9)(E)(iii) provides that, subject to the rule in section 401(a)(9)(F), the treatment of an employee's child as an eligible designated beneficiary ends when the child attains the age of majority and that any remaining interest must be distributed within 10 years of that date. Section 401(a)(9)(F) provides that, under regulations, any amount paid to a child is treated as if it had been paid to the surviving spouse if it will become payable to the surviving spouse upon that child reaching the age of majority (or other designated event permitted under regulations).

Section 401(a)(9)(G) provides that any distribution required to satisfy the incidental death benefit requirement of section 401(a) is treated as a required minimum distribution.

Section 401(a)(9)(H) (which was added to the Code as part of section 401 of the SECURE Act) provides special rules that generally apply to the distribution of an employee's remaining interest in a defined contribution plan after the death of that employee. Specifically, section 401(a)(9)(H)(i)

provides that, except in the case of a beneficiary who is not a designated beneficiary, section 401(a)(9)(B)(ii): (1) is applied by substituting 10 years for 5 years; and (2) applies whether or not distributions of the employee's interest have begun in accordance with section 401(a)(9)(A). Section 401(a)(9)(H)(ii) provides that section 401(a)(9)(B)(iii) (permitting payments over the life or life expectancy of the designated beneficiary as an alternative to the 10-year rule) applies only in the case of an eligible designated beneficiary. Section 401(a)(9)(H)(iii) provides that if an eligible designated beneficiary dies before that individual's portion of the employee's interest in the plan has been entirely distributed, then section 401(a)(9)(H)(ii) does not apply to the beneficiary of the eligible designated beneficiary, and the remainder of that portion must be distributed within 10 years after the death of the eligible designated beneficiary.

Section 401(a)(9)(H)(iv) provides that in the case of an applicable multi-beneficiary trust, if, under the terms of the trust, it is to be divided immediately upon the death of the employee into separate trusts for each beneficiary, then section 401(a)(9)(H)(ii) is applied separately with respect to the portion of the employee's interest that is payable to any disabled or chronically ill eligible designated beneficiary. Section 401(a)(9)(H)(iv) (as amended by section 337 of the SECURE 2.0 Act) also provides that in the case of an applicable multi-beneficiary trust, if, under the terms of the trust, no beneficiary (other than an eligible designated beneficiary who is disabled or chronically ill) has any right to the employee's interest in the plan until the death of all of those disabled or chronically ill eligible designated beneficiaries with respect to the trust, then: (1) section 401(a)(9)(B)(iii) (permitting payments over the life expectancy of a beneficiary) will apply to the distribution of the employee's interest; and (2) any beneficiary who is not disabled or chronically ill will be treated as a beneficiary of the eligible designated beneficiary who is disabled or chronically ill upon the death of that eligible designated beneficiary.

Section 401(a)(9)(H)(v) (as amended by section 337 of the SECURE 2.0 Act) defines the term *applicable multi-beneficiary trust* as a trust: (1) that has more than one beneficiary; (2) all of the beneficiaries of which are treated as designated beneficiaries for purposes of determining the distribution period pursuant to section 401(a)(9); and (3) at least one of the beneficiaries of which is an eligible designated beneficiary who is either disabled or chronically ill. Section 401(a)(9)(H)(v) also provides that, for purposes of that definition, in the case of a trust described in section 401(a)(9)(H)(iv)(II), any beneficiary which is an organization described in section 408(d)(8)(B)(i) is treated as a designated beneficiary.

Section 401(a)(9)(H)(vi) provides that, for purposes of applying section 401(a)(9)(H), an eligible retirement plan defined in section 402(c)(8)(B) (other than a defined benefit plan described in section 402(c)(8)(B)(iv) or (v) [1] or a qualified trust that is a part of a defined benefit plan) is treated as a defined contribution plan.

Section 401(a)(9)(J) (which was added to the Code by section 201 of the SECURE 2.0 Act) provides that a commercial annuity (within the meaning of section 3405(e)(6)) that is issued in connection with any eligible retirement plan (within the meaning of section 402(c)(8)(B), other than a defined benefit plan) is not prohibited from making any of the following types of payments: (1) annuity payments that increase by a constant percentage, applied not less frequently than annually, at a rate that is less than 5 percent per year; (2) certain lump sum payments; [2] (3) an amount which is in the nature of a dividend or similar distribution, provided that the issuer of the contract determines the amount using reasonable actuarial methods and assumptions, as determined in good faith by the issuer of the contract, when calculating the initial annuity payments and the issuer's experience with respect to those factors; or (4) a final payment upon death that

does not exceed the excess of the total amount of the consideration paid for the annuity payments, less the aggregate amount of prior distributions or payments from or under the contract.

### 2. Effective Date of SECURE Act Section 401

Generally, under section 401(b)(1) of the SECURE Act, the amendments made by section 401 of the SECURE Act to section 401(a)(9)(E) and (H) of the Code apply to distributions with respect to employees who die after December 31, 2019.

Section 401(b)(2) of the SECURE Act provides that in the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before December 20, 2019, the amendments to section 401(a)(9)(E) and (H) of the Code apply to distributions with respect to employees who die in calendar years beginning after December 31, 2021, or if earlier, the later of: (1) December 31, 2019; and (2) the date on which the last of the collective bargaining agreements terminated, without regard to any extension agreed to on or after the date of enactment of the SECURE Act (December 20, 2019).

Section 401(b)(3) of the SECURE Act provides that, in the case of a governmental plan (as defined in section 414(d) of the Code), the amendments to section 401(a)(9)(E) and (H) apply to distributions with respect to employees who die after December 31, 2021.

Section 401(b)(4) of the SECURE Act provides that the amendments made to section 401(a)(9)(E) and (H) of the Code do not apply to a qualified annuity that is a binding annuity contract in effect on the date of enactment of the SECURE Act (December 20, 2019) and at all times thereafter.[3]

Section 401(b)(5) of the SECURE Act provides that if an employee dies before the effective date of section 401(a)(9)(H) of the Code for a plan, then, in applying the amendments made to section 401(a)(9)(E) and (H) to the employee's designated beneficiary who dies on or after the effective date, (1) the amendments apply to any beneficiary of the designated beneficiary, and (2) the designated beneficiary is treated as an eligible designated beneficiary for purposes of section 401(a)(9)(H)(ii).

### 3. SECURE 2.0 Act Provisions

Prior to amendment by section 107 of the SECURE 2.0 Act, section 401(a)(9)(C) of the Code defined the required beginning date by reference to the calendar year in which the employee attains age 72. Section 107 of the SECURE 2.0 Act changes the age by reference to which the required beginning date is determined from 72 to either 73 or 75 (depending on an employee's date of birth). Section 107(e) of the SECURE 2.0 Act provides that the amendments made by section 107 of the SECURE 2.0 Act apply to distributions required to be made after December 31, 2022, with respect to individuals who attain age 72 after that date.
Section 202 of the SECURE 2.0 Act instructs the Secretary of the Treasury (or that person's delegate) to make certain amendments to § 1.401(a)(9)-6. Those amendments are: (1) to eliminate the requirement that premiums for an individual's qualifying longevity annuity contracts (QLACs) be limited to 25-percent of an individual's account balance; (2) to increase the dollar limitation on premiums for an individual's QLACs from $125,000 to $200,000 (adjusted for inflation); (3) to provide that, in the case of a QLAC purchased with joint and survivor annuity benefits for an individual and the individual's spouse, a divorce occurring after the original purchase and before the date that the annuity payments commence under the contract will not

affect the permissibility of the joint and survivor benefits if certain conditions related to an associated qualified domestic relations order (or, if applicable, a divorce or separation agreement) are met; and (4) to provide that a QLAC may include a provision under which an employee may rescind the purchase of the contract within a period not exceeding 90 days from the date of purchase.

Section 204 of the SECURE 2.0 Act instructs the Secretary of the Treasury (or that person's delegate) to amend the section 401(a)(9) regulations to provide that if an employee's benefit is in the form of an individual account under a defined contribution plan, then the plan may allow the employee to elect to have the amount required to be distributed for a calendar year from that account to be calculated as the excess of the total required amount for that year over the annuity amount for that year. For this purpose, section 204(b)(1) of the SECURE 2.0 Act defines the total required amount with respect to a calendar year as the amount that would be required to be distributed under § 1.401(a)(9)-5 by including in the balance of that account the value of all annuity contracts that were purchased with a portion of that account. Section 204(b)(2) of the SECURE 2.0 Act defines the annuity amount with respect to a calendar year as the total amount distributed in that year from all annuity contracts purchased with a portion of the employee's account under the plan. Section 204(c) of the SECURE 2.0 Act instructs the Secretary of the Treasury (or that person's delegate) to make conforming amendments to the regulations that apply to individual retirement plans (as defined in section 7701(a)(37) of the Code), section 403(b) plans, and section 457(b) eligible deferred compensation plans.

Section 325 of the SECURE 2.0 Act amended section 402A of the Code (relating to designated Roth accounts) to add a new paragraph (d)(5) providing that the rules requiring minimum distributions to be paid during the employee's lifetime do not apply to a designated Roth account. Section 325(b)(1) of the SECURE 2.0 Act provides that this amendment applies to taxable years beginning after December 31, 2023. However, section 325(b)(2) of the SECURE 2.0 Act provides that the amendment does not apply to a required minimum distribution for a year beginning before January 1, 2024, that is permitted to be paid by April 1, 2024.

### 4. Section 402(c)—Rollovers

Section 402(c) of the Code provides rules related to the rollover of a distribution from a qualified plan to another eligible retirement plan. Prior to being amended by section 641 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, 115 Stat. 38 (2001) (EGTRRA), section 402(c)(2) of the Code limited the portion of a distribution that could be rolled over to the amount that would have been includible in income in the absence of the rollover. Section 641 of EGTRRA and section 411(q) of the Job Creation and Worker Assistance Act of 2002, Public Law 107-147, 116 Stat. 21 (2002), expanded the rollover rules to permit a rollover to an IRA of the portion of the distribution that would have been excluded from gross income in the absence of the rollover (that is, the portion of the amount distributed that consists of the employee's investment in the contract). In addition, that portion may be transferred in a direct trustee-to-trustee transfer to a qualified trust or to an annuity contract described in section 403(b) of the Code, but only if the trust or annuity contract separately accounts for the amount that consists of the employee's investment in the contract. If only a portion of an eligible rollover distribution is rolled over or transferred, then the amount rolled over or transferred is treated as consisting first of the portion of the distribution that is not allocable to the employee's investment in the contract.

Under section 402(c), any amount distributed from a qualified plan generally will be excluded from income if it is transferred to an eligible retirement plan no later than the 60th day following the day the distribution is received. Section 402(c)(3)(B) was added to the Code by section 644 of EGTRRA to provide that the Secretary may waive the 60-day rollover requirement in certain circumstances. Section 402(c)(3)(C) was added to the Code by section 13613 of the Tax Cuts and Jobs Act, Public Law 115-97, 131 Stat. 2054 (2017) (TCJA), to provide an extended rollover deadline for qualified plan loan offset (QPLO) amounts.[4] Specifically, the deadline for rollover of any portion of a QPLO amount is extended so that it ends no earlier than the distributee's tax filing due date (including extensions) for the taxable year in which the offset occurs.

Subject to certain exclusions, section 402(c)(4) provides that an eligible rollover distribution means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan. Section 402(c)(4)(A) excludes from the definition of an eligible rollover distribution any distribution that is one of a series of substantially equal periodic payments payable for the life (or life expectancy) of the employee (or the employee and the employee's designated beneficiary), or for a specified period of 10 years or more. Section 402(c)(4)(B) provides that any distribution that is required under section 401(a)(9) is excluded from the definition of an eligible rollover distribution. Section 402(c)(4)(C), which was added to the Code by section 636(b)(1) of EGTRRA, excludes hardship distributions from the definition of an eligible rollover distribution.

Prior to being amended by section 641 of EGTRRA, section 402(c)(8)(B) of the Code provided that the only type of eligible retirement plan permitted to receive a rollover from a qualified plan was another qualified plan or an IRA. Section 641 of EGTRRA amended section 402(c)(8)(B) of the Code to expand the list of retirement plans eligible to receive rollovers to include an annuity contract described in section 403(b), and an eligible deferred compensation plan described in section 457(b) that is maintained by an eligible employer described in section 457(e)(1)(A). Section 617(c) of EGTRRA amended section 402(c)(8)(B) of the Code to provide that if any portion of an eligible rollover distribution is attributable to distributions from a designated Roth account (as defined in section 402A), that portion may be rolled over only to another designated Roth account or a Roth IRA (as described in section 408A). Section 641 of EGTRRA also added section 402(c)(10) to the Code to provide that an eligible deferred compensation plan described in section 457(b) maintained by an eligible employer described in section 457(e)(1)(A) may accept rollovers from a different type of eligible retirement plan only if it separately accounts for the amounts rolled into the plan.

Section 402(c)(9) provides that, if any distribution attributable to an employee is paid to the spouse of the employee after the employee's death, then section 402(c) applies to that distribution in the same manner as if the spouse were the employee. At the time section 402(c)(9) was enacted, a surviving spouse was permitted to roll over an eligible rollover distribution only to an IRA. However, section 641 of EGTRRA amended section 402(c)(9) of the Code to expand the type of eligible retirement plan permitted to receive a spousal rollover to include not just an IRA, but also any other eligible retirement plan.

Section 402(c)(11) was added to the Code by section 829 of the Pension Protection Act of 2006, Public Law 109-280, 120 Stat. 780 (2006) (PPA), to provide that an individual who is not the surviving spouse of the employee and who is a designated beneficiary (as defined by section 401(a)(9)(E) of the Code) may elect to have any portion of a distribution made in the form of a direct trustee-to-trustee transfer to an IRA established for the purpose of receiving that distribution. If a direct trustee-to-trustee transfer is made pursuant to section 402(c)(11), then the

required minimum distribution rules applicable to distributions after the employee's death in section 401(a)(9)(B) (other than section 401(a)(9)(B)(iv)) will apply to the IRA. Section 402(c)(11)(B) provides that the Secretary may prescribe rules under which a trust for the benefit of one or more designated beneficiaries may be treated as a designated beneficiary for purposes of section 402(c)(11).

The rollover rules of section 402(c) also apply to a distribution from a section 403(a) qualified annuity plan, a section 403(b) plan, and an eligible deferred compensation plan described in section 457(b) maintained by an eligible employer described in section 457(e)(1)(A). See sections 403(a)(4)(B), 403(b)(8)(B), and 457(e)(16)(B), respectively.

### 5. Sections 403(a), 403(b), 408, and 457—Other Arrangements Subject to Section 401(a)(9)

Under section 403(a)(1), a qualified annuity plan under section 403(a) must meet the requirements of section 404(a)(2) (which provides that an annuity plan must satisfy the required minimum distribution rules under section 401(a)(9)). Sections 403(b)(10), 408(a)(6), and 408(b)(3) provide that a section 403(b) plan, an individual retirement account, and an individual retirement annuity, respectively, must satisfy rules similar to the requirements of section 401(a)(9) and the incidental death benefit requirements of section 401(a). Under section 457(b)(5) and (d)(2), a plan is an eligible deferred compensation plan described in section 457(b) only if it satisfies the minimum distribution requirements of section 401(a)(9).

### 6. Section 4974—Excise Tax on Failure To Satisfy Section 401(a)(9)

Section 4974(a) (as amended by section 302(a) of the SECURE 2.0 Act) provides that if the amount distributed during the taxable year of a payee under any qualified retirement plan (as defined in section 4974(c)) or any eligible deferred compensation plan (as defined in section 457(b)) is less than that taxable year's minimum required distribution (as defined in section 4974(b)), then an excise tax is imposed on the payee equal to 25 percent of the amount by which the minimum required distribution for the taxable year exceeds the amount actually distributed in that taxable year.

Section 4974(d) provides that if the taxpayer establishes to the satisfaction of the Secretary that the failure to distribute the entire amount required in a taxable year was due to reasonable error and reasonable steps are being taken to remedy that shortfall, then the Secretary may waive the excise tax imposed in section 4974(a) for that taxable year.

Section 4974(e) (as added to the Code by section 302(b) of the SECURE 2.0 Act) provides that in the case of a taxpayer who, by the last day of the correction window: (1) receives a distribution from the qualified retirement plan or eligible deferred compensation plan of the amount by which the required minimum distribution exceeds the actual amount distributed during the calendar year from that plan (the shortfall); and (2) submits a return reflecting that tax (as modified by section 4974(e)), then the tax imposed under section 4974(a) is 10 percent of the shortfall (in lieu of 25 percent). For this purpose, the correction window ends on the earliest of: (1) the date a notice of deficiency under section 6212 with respect to the tax imposed by section 4974(a) is mailed; (2) the date on which the tax imposed by section 4974(a) is assessed; or (3) the last day of the second taxable year that begins after the end of the taxable year in which the tax under section 4974(a) is imposed.

### 7. Good Faith Compliance Standard for Governmental Plans

Section 823 of PPA provides that a governmental plan (as defined in section 414(d) of the Code) is treated as having complied with section 401(a)(9) if the plan complies with a reasonable, good faith interpretation of section 401(a)(9).

### 8. 2002 Final Regulations and Other Published Guidance

Final regulations relating to required minimum distributions from a qualified plan, an IRA, and a section 403(b) plan have been subject to a series of amendments and additions since they were published in the **Federal Register** on April 17, 2002 (67 FR 18834) (referred to in this preamble as the "2002 final regulations"). Final regulations relating to required minimum distributions from defined benefit plans and annuity contracts were published in the **Federal Register** on June 15, 2004 (69 FR 63288) (referred to in this preamble as the "2004 final regulations"). Final regulations published in the **Federal Register** on September 8, 2009 (74 FR 45993) updated the rules to permit a governmental plan to comply with the required minimum distribution rules using a reasonable, good faith interpretation of section 401(a)(9). Final regulations relating to qualifying longevity annuity contracts were published in the **Federal Register** on July 2, 2014 (79 FR 37633). Final regulations published in the **Federal Register** on November 12, 2020 (85 FR 72472) updated the life expectancy and distribution period tables for distribution calendar years that begin on or after January 1, 2022.

Final regulations relating to section 402(c) and eligible rollover distributions were published in the **Federal Register** on September 22, 1995 (60 FR 49199). Since those regulations were issued, section 402(c) has been amended several times, and guidance related to those amendments has generally been issued in the Internal Revenue Bulletin rather than through the issuance of new regulations. For example, Notice 2007-7, 2007-1 CB 395, provided guidance related to the amendments to section 402(c) made by PPA. However, final regulations related to the extended period of time to roll over a QPLO amount under section 402(c)(3)(C) were published in the **Federal Register** on January 6, 2021 (86 FR 464). See § 1.402(c)-3.

### 9. Proposed Regulations and Enactment of SECURE 2.0 Act

Proposed regulations under section 401(a)(9) and related statutory provisions were published in the **Federal Register** on February 24, 2022 (87 FR 10504).[5] Comments were received on the proposed regulations, and a public hearing was held on June 15, 2022. After the close of the comment period, the SECURE 2.0 Act, which affected many of the provisions included in the proposed regulations was enacted.

After consideration of the comments and taking into account the enactment of the SECURE 2.0 Act, the proposed regulations are adopted by this Treasury decision with certain changes described in the section of this preamble entitled "Summary of Comments and Explanation of Revisions." Some of the rules in these final regulations that reflect provisions of the SECURE 2.0 Act are a clear application of statutory language for which it is unnecessary to solicit comments (see 5 U.S.C. 553(b)). Other rules in these final regulations are the logical outgrowth of rules in the proposed regulations that take into account both the comments received on those proposed rules and the subsequent enactment of the SECURE 2.0 Act. A notice of proposed rulemaking (REG-103529-23) in the Proposed Rules section of this issue of the **Federal Register** sets forth proposed rules that reflect other provisions of the SECURE 2.0 Act relating to section 401(a)(9) of the Code.

## B. Summary of Comments and Explanation of Revisions

These regulations update several existing regulations under sections 401(a)(9), 402(c), 403(b), 457, and 4974 to reflect statutory amendments that have been made since those regulations were last issued and to clarify certain issues that have been raised in public comments and private letter ruling requests. These regulations also replace the question-and-answer format of the existing regulations under sections 401(a)(9), 402(c), 408, and 4974 with a standard format. Rules under the 2002 final regulations and the 2004 final regulations that were proposed to be retained in the updated regulations generally were not discussed in the Explanation of Provisions that accompanied the proposed regulations. Similarly, rules under the proposed regulations that are included in these final regulations without change generally are not discussed in this Summary of Comments and Explanation of Revisions.

## XIV. Uniform Lifetime Table (on or after January 1, 2022)

| Age of employee | Distribution period |
|---|---|
| 72 | 27.4 |
| 73 | 26.5 |
| 74 | 25.5 |
| 75 | 24.6 |
| 76 | 23.7 |
| 77 | 22.9 |
| 78 | 22.0 |
| 79 | 21.1 |
| 80 | 20.2 |
| 81 | 19.4 |
| 82 | 18.5 |
| 83 | 17.7 |
| 84 | 16.8 |
| 85 | 16.0 |
| 86 | 15.2 |
| 87 | 14.4 |
| 88 | 13.7 |
| 89 | 12.9 |
| 90 | 12.2 |
| 91 | 11.5 |
| 92 | 10.8 |
| 93 | 10.1 |
| 94 | 9.5 |
| 95 | 8.9 |
| 96 | 8.4 |
| 97 | 7.8 |
| 98 | 7.3 |
| 99 | 6.8 |
| 100 | 6.4 |
| 101 | 6.0 |
| 102 | 5.6 |
| 103 | 5.2 |
| 104 | 4.9 |

| Age of employee | Distribution period |
|---|---|
| 105 | 4.6 |
| 106 | 4.3 |
| 107 | 4.1 |
| 108 | 3.9 |
| 109 | 3.7 |
| 110 | 3.5 |
| 111 | 3.4 |
| 112 | 3.3 |
| 113 | 3.1 |
| 114 | 3.0 |
| 115 | 2.9 |
| 116 | 2.8 |
| 117 | 2.7 |
| 118 | 2.5 |
| 119 | 2.3 |
| 120+ | 2.0 |

Distribution calendar years (as defined in § 1.401(a)(9)-5, Q&A-1(b)), beginning on or after January 1, 2022

**XV.Single Life Table (on or after January 1, 2022)**

| Age | Life expectancy |
|---|---|
| 0 | 84.6 |
| 1 | 83.7 |
| 2 | 82.8 |
| 3 | 81.8 |
| 4 | 80.8 |
| 5 | 79.8 |
| 6 | 78.8 |
| 7 | 77.9 |
| 8 | 76.9 |
| 9 | 75.9 |
| 10 | 74.9 |
| 11 | 73.9 |
| 12 | 72.9 |
| 13 | 71.9 |
| 14 | 70.9 |
| 15 | 69.9 |
| 16 | 69.0 |
| 17 | 68.0 |
| 18 | 67.0 |
| 19 | 66.0 |
| 20 | 65.0 |
| 21 | 64.1 |
| 22 | 63.1 |
| 23 | 62.1 |
| 24 | 61.1 |
| 25 | 60.2 |
| 26 | 59.2 |
| 27 | 58.2 |
| 28 | 57.3 |
| 29 | 56.3 |
| 30 | 55.3 |
| 31 | 54.4 |

| Age | Life expectancy |
|---|---|
| 32 | 53.4 |
| 33 | 52.5 |
| 34 | 51.5 |
| 35 | 50.5 |
| 36 | 49.6 |
| 37 | 48.6 |
| 38 | 47.7 |
| 39 | 46.7 |
| 40 | 45.7 |
| 41 | 44.8 |
| 42 | 43.8 |
| 43 | 42.9 |
| 44 | 41.9 |
| 45 | 41.0 |
| 46 | 40.0 |
| 47 | 39.0 |
| 48 | 38.1 |
| 49 | 37.1 |
| 50 | 36.2 |
| 51 | 35.3 |
| 52 | 34.3 |
| 53 | 33.4 |
| 54 | 32.5 |
| 55 | 31.6 |
| 56 | 30.6 |
| 57 | 29.8 |
| 58 | 28.9 |
| 59 | 28.0 |
| 60 | 27.1 |
| 61 | 26.2 |
| 62 | 25.4 |
| 63 | 24.5 |
| 64 | 23.7 |
| 65 | 22.9 |
| 66 | 22.0 |

| Age | Life expectancy |
|---|---|
| 67 | 21.2 |
| 68 | 20.4 |
| 69 | 19.6 |
| 70 | 18.8 |
| 71 | 18.0 |
| 72 | 17.2 |
| 73 | 16.4 |
| 74 | 15.6 |
| 75 | 14.8 |
| 76 | 14.1 |
| 77 | 13.3 |
| 78 | 12.6 |
| 79 | 11.9 |
| 80 | 11.2 |
| 81 | 10.5 |
| 82 | 9.9 |
| 83 | 9.3 |
| 84 | 8.7 |
| 85 | 8.1 |
| 86 | 7.6 |
| 87 | 7.1 |
| 88 | 6.6 |
| 89 | 6.1 |
| 90 | 5.7 |
| 91 | 5.3 |
| 92 | 4.9 |
| 93 | 4.6 |
| 94 | 4.3 |
| 95 | 4.0 |
| 96 | 3.7 |
| 97 | 3.4 |
| 98 | 3.2 |
| 99 | 3.0 |
| 100 | 2.8 |
| 101 | 2.6 |

| Age | Life expectancy |
|---|---|
| 102 | 2.5 |
| 103 | 2.3 |
| 104 | 2.2 |
| 105 | 2.1 |
| 106 | 2.1 |
| 107 | 2.1 |
| 108 | 2.0 |
| 109 | 2.0 |
| 110 | 2.0 |
| 111 | 2.0 |
| 112 | 2.0 |
| 113 | 1.9 |
| 114 | 1.9 |
| 115 | 1.8 |
| 116 | 1.8 |
| 117 | 1.6 |
| 118 | 1.4 |
| 119 | 1.1 |
| 120+ | 1.0 |

Distribution calendar years (as defined in § 1.401(a)(9)-5, Q&A-1(b)), beginning on or after January 1, 2022

## XVI. Comparison of Final Regulations to Proposed Regulations

### Final regulations

**Par. 2.** For each section set forth below, revise the section by removing the text that appears in the column labeled "Remove" and replacing it with the text that appears in the column labeled "Insert":

| Regulation section | Remove | Insert |
|---|---|---|
| § 1.72(p)-1, Q&A-12 | "§ 1.402(c)-2, Q&A-4(d)" | "§ 1.402(c)-2(c)(3)". |
| § 1.72(p)-1, Q&A-13(a)(2) | "§ 1.402(c)-2, Q&A-9(b)" | "§ 1.402(c)-2(g)(3)(i)". |
| § 1.72(p)-1, Q&A-13(b) | "§ 1.402(c)-2, Q&A-9(c), Example 6" | "Example 6 in § 1.402(c)-2(g)(5)(vi)". |
| § 1.401(a)(31)-1, Q&A-1(a) | "§ 1.402(c)-2, Q&A-3 through Q&A-10 and Q&A-14" | "§ 1.402(c)-2". |
| § 1.401(a)(31)-1, Q&A-1(a) | "§ 1.402(c)-2, Q&A-2" | "§ 1.402(c)-2(a)(1)(iii)". |
| § 1.401(a)(31)-1, Q&A-1(a) | "§ 1.402(c)-2, Q&A-3 through Q&A-10 and Q&A-14" | "§ 1.402(c)-2". |
| § 1.401(a)(31)-1, Q&A-14(b)(1) | "§ 1.402-2(c)-2, Q&A-1" | "§ 1.402(c)-2(a)". |
| § 1.401(a)(31)-1, Q&A-14(b)(1) | "§ 1.402(c)-2, Q&A-9" | "§ 1.402(c)-2(g)". |
| § 1.401(a)(31)-1, Q&A-14(b)(2) | "§ 1.402(c)-2, Q&A-1" | "§ 1.402(c)-2(a)". |
| § 1.401(a)(31)-1, Q&A-16 | "§ 1.402(c)-2(b), Q&A-9" | "§ 1.402(c)-2(g)". |
| § 1.401(a)(31)-1, Q&A-17 | "§ 1.402(c)-2), Q&A-10" | "§ 1.402(c)-2(h))". |
| § 1.401(a)(31)-1, Q&A-17 | "Section 1.402(c)-2, Q&A-10" | "Section 1.402(c)-2(h)". |
| § 1.401(a)(31)-1, Q&A-18(a) | "§ 1.402(c)-2, Q&A-15" | "§ 1.402(c)-2(k)(2)". |
| § 1.401(k)-2(b)(2)(vi) | "§ 1.402(c)-2, A-4" | "§ 1.402(c)-2(c)(3)". |
| § 1.401(k)-2(b)(2)(vii)(C) | "§ 1.401(a)(9)-5, A-9(b)" | "§§ 1.401(a)(9)-5(g)(2)(ii) and 1.402(c)-2(c)(3)". |
| § 1.401(k)-4(e)(1) | "§ 1.402(c)-2, Q&A-1(a)" | "§ 1.402(c)-2(a)". |
| § 1.401(m)-2(b)(2)(vi)(A) | "§ 1.402(c)-2, A-4" | "§ 1.402(c)-2(c)(3)". |
| § 1.401(m)-2(b)(3)(iii) | "§ 1.401(a)(9)-5, A-9(b)" | "§§ 1.401(a)(9)-5(g)(2)(ii) and 1.402(c)-2(c)(3)". |
| § 1.402(a)-1(a)(2) | "1.401(a)(9)-6, Q&A-4" | "1.401(a)(9)-6(d)". |

| Regulation section | Remove | Insert |
|---|---|---|
| § 1.402A-1, Q&A-11 | "A-4 of § 1.402(c)-2" | "§ 1.402(c)-2(c)(3)". |
| § 1.402A-1, Q&A-14 | "§ 1.402(c)-2, A-10(a)" | "§ 1.402(c)-2(h)". |
| § 1.408A-4, Q&A 14(b)(3) | "§ 1.401(a)(9)-6, Q&A-12" | "§ 1.401(a)(9)-6(m)(2)". |
| § 1.408A-4, Q&A 14(b)(3)(iii) | "§ 1.401(a)(9)-6, Q&A-12(c)(1) and (c)(2)" | "§ 1.401(a)(9)-6(m)(3)". |
| § 1.408A-6, Q&A-14(d) | "A-3 of § 1.401(a)(9)-5" | "§ 1.401(a)(9)-5(b)(4)". |
| § 1.408A-6, Q&A-14(d) | "A-12 of § 1.408-8" | "§ 1.408-8(h)". |
| § 1.408A-6, Q&A-14(d) | "A-17 of § 1.401(a)(9)-6" | "§ 1.401(a)(9)-6(q)". |
| § 1.409A-2(b)(2)(ii)(B)(5) | "§ 1.401(a)(9)-6, Q&A-14(a)(1) or (2)" | "§ 1.401(a)(9)-6(o)(1)(i) or (ii)". |
| § 1.411(b)(5)-1(d)(4)(iii) | "§ 1.401(a)(9)-6, A-14(b)" | "§ 1.401(a)(9)-6(o)(2)". |
| § 1.411(b)(5)-1(d)(4)(iii) | "§ 1.401(a)(9)-6, A-14(b)(2)" | "§ 1.401(a)(9)-6(o)(2)(ii)". |
| § 1.6047-2(a)(1) | "A-17 of § 1.401(a)(9)-6" | "§ 1.401(a)(9)-6(q)". |
| § 1.6047-2(b)(1) | "A-17(d)(2)(ii) of § 1.401(a)(9)-6" | "§ 1.401(a)(9)-6(q)(4)(ii)(B)". |

**Par. 3.** Revise and republish §§ 1.401(a)(9)-0 through 1.401(a)(9)-8 to read as follows:

§ 1.401(a)(9)-0
Required minimum distributions; table of contents.

This table of contents lists the regulations relating to required minimum distributions under section 401(a)(9) of the Internal Revenue Code as follows:

*§ 1.401(a)(9)-1 Minimum distribution requirement in general.*

(a) Plans subject to minimum distribution requirement.

(1) In general.

(2) Participant in multiple plans.

(3) Governmental plans.

(b) Statutory effective date.

(1) In general.

(2) Effective date for section 401(a)(9)(H).

(3) Examples.

(c) Required and optional plan provisions.

(1) Required provisions.

(2) Optional provisions.

(d) Regulatory applicability date.

*§ 1.401(a)(9)-2 Distributions commencing during an employee's lifetime.*

(a) Distributions commencing during an employee's lifetime.

(1) In general.

(2) Amount required to be distributed for a calendar year.

(3) Distributions commencing before required beginning date.

(4) Distributions after death.

(b) Determination of required beginning date.

(1) General rule.

(2) Definition of applicable age.

(3) Required beginning date for 5-percent owner.

(4) Uniform required beginning date.

(5) Plans maintained by more than one employer.

*§ 1.401(a)(9)-3 Death before required beginning date.*

(a) Distribution requirements.

(1) In general.

(2) Special rule for designated Roth accounts.

(b) Distribution requirements in the case of a defined benefit plan.

(1) In general.

(2) 5-year rule.

(3) Annuity payments.

(4) Determination of which rule applies.

(c) Distributions in the case of a defined contribution plan.

(1) In general.

(2) 5-year rule.

(3) 10-year rule.

(4) Life expectancy payments.

(5) Determination of which rule applies.

(d) Permitted delay for surviving spouse beneficiaries.

(e) Distributions that commence after surviving spouse's death.

(1) In general.

(2) Remarriage of surviving spouse.

(3) When distributions are treated as having begun to surviving spouse.

*§ 1.401(a)(9)-4 Determination of the designated beneficiary.*

(a) Beneficiary designated under the plan.

(1) In general.

(2) Entitlement to employee's interest in the plan.

(3) Specificity of beneficiary designation.

(4) Affirmative and default elections of designated beneficiary.

(b) Designated beneficiary must be an individual.

(c) Rules for determining beneficiaries.

(1) Time period for determining the beneficiary.

(2) Circumstances under which a beneficiary is disregarded as a beneficiary of the employee.

(3) Examples.

(d) Application of beneficiary designation rules to surviving spouse.

(e) Eligible designated beneficiaries.

(1) In general.

(2) Multiple designated beneficiaries.

(3) Determination of age of majority.

(4) Disabled individual.

(5) Chronically ill individual.

(6) Individual not more than 10 years younger than the employee.

(7) Documentation requirements for disabled or chronically ill individuals.

(8) Applicability of definition of eligible designated beneficiary to beneficiary of surviving spouse.

(9) Examples.

(f) Special rules for trusts.

(1) Look-through of trust to determine designated beneficiaries.

(2) Trust requirements.

(3) Trust beneficiaries treated as beneficiaries of the employee.

(4) Multiple trust arrangements.

(5) Identifiability of trust beneficiaries.

(6) Examples.

(g) Applicable multi-beneficiary trust.

(1) Certain see-through trusts with disabled or chronically ill beneficiaries.

(2) Termination of interest in trust.

(3) Special definition of designated beneficiary.

(h) Documentation requirements for trusts.

(1) General rule.

(2) Required minimum distributions while employee is still alive.

(3) Required minimum distributions after death.

(4) Relief for discrepancy between trust instrument and employee certifications or earlier trust instruments.

*§ 1.401(a)(9)-5 Required minimum distributions from defined contribution plans.*

(a) General rules.

(1) In general.

(2) Distribution calendar year.

(3) Time for distributions.

(4) Minimum distribution incidental benefit requirement.

(5) Annuity contracts.

(6) Impact of additional distributions in prior years.

(b) Determination of account balance.

(1) General rule.

(2) Adjustment for subsequent allocations and distributions.

(3) Adjustment for designated Roth accounts.

(4) Exclusion for QLAC.

(5) Treatment of rollovers.

(c) Determination of applicable denominator during employee's lifetime.

(1) General rule.

(2) Spouse is sole beneficiary.

(d) Applicable denominator after employee's death.

(1) Death on or after the employee's required beginning date.

(2) Death before an employee's required beginning date.

(3) Remaining life expectancy.

(e) Distribution of employee's entire interest required.

(1) In general.

(2) 10-year limit for designated beneficiary who is not an eligible designated beneficiary.

(3) 10-year limit following death of eligible designated beneficiary.

(4) 10-year limit after minor child of the employee reaches age of majority.

(f) Rules for multiple designated beneficiaries.

(1) Determination of applicable denominator.

(2) Determination of when entire interest is required to be distributed.

(g) Special rules.

(1) Treatment of nonvested amounts.

(2) Distributions taken into account.

(3) Surviving spouse election under section 401(a)(9)(B)(iv).

*§ 1.401(a)(9)-6 Required minimum distributions for defined benefit plans and annuity contracts.*

(a) General rules.

(1) In general.

(2) Definition of life annuity.

(3) Annuity commencement.

(4) Single-sum distributions.

(5) Death benefits.

(6) Separate treatment of separate identifiable components.

(7) Additional guidance.

(b) Application of incidental benefit requirement.

(1) Life annuity for employee.

(2) Joint and survivor annuity.

(3) Period certain and annuity features.

(4) Deemed satisfaction of incidental benefit rule.

(c) Period certain annuity.

(1) Distributions commencing during the employee's life.

(2) Distributions commencing after the employee's death.

(d) Use of annuity contract.

(1) In general.

(2) Applicability of section 401(a)(9)(H).

(e) Treatment of additional accruals.

(1) General rule.

(2) Administrative delay.

(f) Treatment of nonvested benefits.

(g) Requirement for actuarial increase.

(1) General rule.

(2) Nonapplication to 5-percent owners.

(3) Nonapplication to governmental plans.

(4) Nonapplication to church plans and church employees.

(h) Amount of actuarial increase.

(1) In general.

(2) Actuarial equivalence basis.

(3) Coordination with section 411 actuarial increase.

(i) [Reserved]

(j) Distributions restricted pursuant to section 436.

(1) General rule.

(2) Payments restricted under section 436(d)(3).

(3) Payments restricted under section 436(d)(1) or (2).

(k) Treatment of early commencement.

(1) General rule.

(2) Joint and survivor annuity, non-spouse beneficiary.

(3) Limitation on period certain.

(l) Early commencement for surviving spouse.

(m) Determination of entire interest under annuity contract.

(1) General rule.

(2) Entire interest.

(3) Exclusions.

(4) Examples.

(n) Change in annuity payment period.

(1) In general.

(2) Reannuitization.

(3) Conditions.

(4) Examples.

(o) Increase in annuity payments.

(1) General rules.

(2) Eligible cost of living index.

(3) Additional permitted increases for annuity contracts purchased from insurance companies.

(4) Additional permitted increases for annuity payments from a qualified trust.

(5) Actuarial gain defined.

(6) Examples.

(p) Payments to children.

(1) In general.

(2) Age of majority.

(q) Qualifying longevity annuity contract.

(1) Definition of qualifying longevity annuity contract.

(2) Limitation on premiums.

(3) Payments after death of the employee.

(4) Rules of application.

*§ 1.401(a)(9)-7 Rollovers and transfers.*

(a) Treatment of rollover from distributing plan.

(b) Treatment of rollover by receiving plan.

(c) Treatment of transfer under transferor plan.

(1) Generally not treated as distribution.

(2) Account balance decreased after transfer.

(d) Treatment of transfer under transferee plan.

(e) Treatment of spinoff or merger.

*§ 1.401(a)(9)-8 Special rules.*

(a) Use of separate accounts.

(1) Separate application of section 401(a)(9) for each beneficiary.

(2) Separate accounting requirements.

(b) Application of consent requirements.

(c) Definition of spouse.

(d) Treatment of QDROs.

(1) Continued treatment of spouse.

(2) Separate accounts.

(3) Other situations.

(e) Application of section 401(a)(9) pending determination of whether a domestic relations order is a QDRO is being made.

(f) Application of section 401(a)(9) when insurer is in State delinquency proceedings.

(g) In-service distributions required to satisfy section 401(a)(9).

(h) TEFRA section 242(b) elections.

(1) In general.

(2) Application of section 242(b) election after transfer.

(3) Application of section 242(b) election after rollover.

(4) Revocation of section 242(b) election.

*§ 1.401(a)(9)-9 Life expectancy and Uniform Lifetime tables.*

(a) In general.

(b) Single Life Table.

(c) Uniform Lifetime Table.

(d) Joint and Last Survivor Table.

(e) Mortality rates.

(f) Applicability dates.

(1) In general.

(2) Application to life expectancies that may not be recalculated.

§ 1.401(a)(9)-1
Minimum distribution requirement in general.

(a) *Plans subject to minimum distribution requirement* —(1) *In general.* Under section 401(a)(9), all stock bonus, pension, and profit-sharing plans qualified under section 401(a) and annuity contracts described in section 403(a) are subject to required minimum distribution rules. See this section and §§ 1.401(a)(9)-2 through 1.401(a)(9)-9 for the distribution rules applicable to these plans. Under section 403(b)(10), annuity contracts and custodial accounts described in section 403(b) are subject to required minimum distribution rules. See § 1.403(b)-6(e) for the distribution rules applicable to these annuity contracts and custodial accounts. Under section 408(a)(6) and 408(b)(3), individual retirement accounts and individual retirements annuities (collectively, IRAs) are subject to required minimum distribution rules. See § 1.408-8 for the minimum distribution rules applicable to IRAs and § 1.408A-6 for the minimum distribution rules applicable to Roth IRAs under section 408A. Under section 457(d)(2), eligible deferred compensation plans described in section 457(b) for employees of tax-exempt organizations or employees of State and local governments are subject to required minimum distribution rules. See § 1.457-6(d) for the minimum distribution rules applicable to those eligible deferred compensation plans.

(2) *Participant in multiple plans.* If an employee is a participant in more than one plan, the plans in which the employee participates are not permitted to be aggregated for purposes of testing whether the distribution requirements of section 401(a)(9) are met. Thus, the distribution of the benefit of the employee under each plan must separately meet the requirements of section 401(a)(9). For this purpose, a plan described in section 414(k) is treated as two separate plans, a defined contribution plan to the extent benefits are based on an individual account and a defined benefit plan with respect to the remaining benefits.

(3) *Governmental plans.* A governmental plan (within the meaning of section 414(d)), or an eligible governmental plan described in § 1.457-2(f), is treated as having complied with section 401(a)(9) if the plan complies with a reasonable, good faith interpretation of section 401(a)(9). Thus, the terms of a governmental plan that reflect a reasonable, good faith interpretation of section 401(a)(9) do not have to provide that distributions will be made in accordance with this section and §§ 1.401(a)(9)-2 through 1.401(a)(9)-9. Similarly, a governmental plan may apply the rules of section 401(a)(9)(F) using the rules of § 1.401(a)(9)-6, Q&A-15 (as it appeared in the April 1, 2023, edition of 26 CFR part 1).

(b) *Statutory effective date* —(1) *In general.* The distribution rules of section 401(a)(9) generally apply to all account balances and benefits in existence on or after January 1, 1985.

(2) *Effective date for section 401(a)(9)(H)* —(i) *General effective date.* Except as otherwise provided in this paragraph (b)(2), section 401(a)(9)(H) applies with respect to employees who die on or after January 1, 2020. However, in the case of a governmental plan (as defined in section 414(d)), section 401(a)(9)(H) applies with respect to employees who die on or after January 1, 2022.

(ii) *Delayed effective date for collectively bargained plans* —(A) *General rule.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before December 20, 2019 (the date of enactment of the Further Consolidated Appropriations Act, 2020, Public Law 116-94, 133 Stat. 2534 (2019)), section 401(a)(9)(H) generally applies with respect to employees who die on or after January 1, 2022.

(B) *Earlier effective date if agreements terminate.* Notwithstanding paragraph (b)(2)(ii)(A) of this section, section 401(a)(9)(H) applies to a plan maintained pursuant to one or more collective bargaining agreements with respect to employees who die in 2020 or 2021 if—

( *1*) The year in which the employee dies begins after the date on which the last of the collective bargaining agreements described in paragraph (b)(2)(ii)(A) of this section terminates (determined without regard to any extension thereof to which the parties agreed on or after December 20, 2019), and

( *2*) Section 401(a)(9)(H) would apply with respect to the employee under the rules of paragraph (b)(2)(i) of this section.

(C) *Rules of application.* For purposes of this paragraph (b)(2)(ii)—

( *1*) A plan is treated as maintained pursuant to one or more collective bargaining agreements only if the plan constitutes a collectively bargained plan under the rules of § 1.436-1(a)(5)(ii)(B), and

( *2*) Any plan amendment made pursuant to a collective bargaining agreement that amends the plan solely to conform to the requirements of section 401(a)(9)(H) is not treated as a termination of the collective bargaining agreement.

(iii) *Applicability upon death of designated beneficiary* —(A) *In general.* Except as otherwise provided in this paragraph (b)(2)(iii), if an employee who died before the effective date described in paragraph (b)(2)(i) or (ii) of this section (whichever applies to the plan) has only one designated beneficiary and that beneficiary dies on or after that effective date, then, upon the death of the designated beneficiary, section 401(a)(9)(H) applies with respect to any beneficiary of the employee's designated beneficiary. Section 401(b)(5) of Division O of the Further Consolidated Appropriations Act, 2020 (known as the SECURE Act) provides that, if an employee dies before the effective date, then a designated beneficiary of an employee is treated as an eligible designated beneficiary. Accordingly, once the rules of section 401(a)(9)(H) apply with respect to the employee's designated beneficiary, the rules of section 401(a)(9)(H)(iii) (requiring full distribution of the employee's interest within 10 years after the death of an eligible designated beneficiary) apply upon the designated beneficiary's death.

(B) *Employee with multiple designated beneficiaries.* If an employee described in paragraph (b)(2)(iii)(A) of this section has more than one designated beneficiary, then whether section 401(a)(9)(H) applies is determined based on the date of death of the oldest of the employee's designated beneficiaries. Thus, section 401(a)(9)(H) will apply upon the death of the oldest of the employee's designated beneficiaries if that designated beneficiary is still alive on or after the effective date of section 401(a)(9)(H) for the plan as determined under the rules of paragraph (b)(2)(i) or (ii) of this section. However, see § 1.401(a)(9)-8(a) for rules related to the separate application of section 401(a)(9) with respect to multiple beneficiaries if certain requirements are met.

(C) *Surviving spouse of the employee dies before employee's required beginning date.* If an employee described in paragraph (b)(2)(iii)(A) of this section dies before the employee's required beginning date and the employee's surviving spouse is waiting to begin distributions until the year for which the employee would have been required to begin distributions pursuant to section 401(a)(9)(B)(iv)(II), then, in applying the rules of this paragraph (b)(2)(iii), the surviving spouse is treated as the employee. Thus, for example, if an employee with a required beginning date of April 1, 2025, names the employee's surviving spouse as the sole beneficiary of the employee's interest in the plan, both the employee and the employee's surviving spouse die before the effective date of section 401(a)(9)(H) for the plan, and that spouse's designated beneficiary dies on or after that effective date, then section 401(a)(9)(H) applies with respect to the surviving spouse's designated beneficiary upon the death of that designated beneficiary (so that full distribution of the employee's interest must be made no later than the end of the calendar year that includes the tenth anniversary of the date of that designated beneficiary's death).

(iv) *Qualified annuity exception* —(A) *In general.* Section 401(a)(9)(H) does not apply to a commercial annuity (as defined in section 3405(e)(6))—

( *1*) That is a binding annuity contract in effect as of December 20, 2019;

( *2*) Under which payments satisfy the requirements of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9 (as those sections appeared in the April 1, 2019, edition of 26 CFR part 1); and

( *3*) That satisfies the irrevocability requirements of paragraph (b)(2)(iv)(B) of this section.

(B) *Irrevocability requirements applicable to annuity contract.* A contract satisfies the requirements of this paragraph (b)(2)(iv)(B) if the employee (or, if the employee has died, the designated beneficiary) has made an irrevocable election before December 20, 2019, as to the method and amount of annuity payments to the employee and any designated beneficiary.

(3) *Examples.* The following examples illustrate the applicability date rules of this paragraph (b).

(i) *Example 1.* Employer M maintains a defined contribution plan, Plan X. Employee A died in 2017, at the age of 68, and designated A's 40-year-old child, B, who was not disabled or chronically ill at the time of A's death, as the sole beneficiary of A's interest in Plan X. Pursuant to a plan provision in Plan X, B elected to take distributions over B's life expectancy under section 401(a)(9)(B)(iii). B dies in 2024, after the effective date of section 401(a)(9)(H). Because section 401(b)(5) of the SECURE Act treats B as an eligible designated beneficiary, the rules of section 401(a)(9)(H)(iii) apply to B's beneficiaries. Therefore, A's remaining interest in Plan X must be distributed by the end of 2034 (the calendar year that includes the tenth anniversary of B's death).

(ii) *Example 2.* The facts are the same as in paragraph (b)(3)(i) of this section ( *Example 1*), except that B died in 2019. Because A's designated beneficiary died before the effective date of section 401 of the SECURE Act, the rules of section 401(a)(9)(H) do not apply to B's beneficiaries.

(iii) *Example 3.* The facts are the same as in paragraph (b)(3)(i) of this section ( *Example 1*) except that, pursuant to a provision in Plan X, B elected the 5-year rule under section 401(a)(9)(B)(ii). Accordingly, A's entire interest is required to be distributed by the end of 2022. Because A died before January 1, 2020, section 401(a)(9)(H) does not apply with respect to B. Therefore, section 401(a)(9)(H)(i)(I) does not extend the 5-year period under B's election to a 10-year period. Although B's election required A's entire interest to be distributed by the end of 2022, the enactment of section 401(a)(9)(I)(iii)(II) (permitting disregard of 2020 when the 5-year period applies) permits distribution of A's entire interest in the plan to be delayed until the end of 2023.

(iv) *Example 4.* The facts are the same as in paragraph (b)(3)(i) of this section ( *Example 1*), except that A designates a see-through trust that satisfies the requirements of § 1.401(a)(9)-4(f)(2) as the sole beneficiary of A's interest in Plan X. All of the trust beneficiaries are alive as of January 1, 2020. The oldest of the trust beneficiaries, C, died in 2022. Because section 401(b)(5) of the SECURE Act treats C as an eligible designated beneficiary, the rules of section 401(a)(9)(H)(iii) apply to the other trust beneficiaries. Thus, unless the rules of § 1.401(a)(9)-5(f)(2)(ii)(B) or (iii) apply, A's remaining interest in Plan X must be distributed by the end of 2032 (the calendar year that includes the tenth anniversary of C's death).

(v) *Example 5.* The facts are the same as in paragraph (b)(3)(iv) of this section ( *Example 4*), except that C died in 2019. Because the oldest designated beneficiary died before January 1, 2020, the rules of section 401(a)(9)(H) do not apply to any of the other trust beneficiaries.

(vi) *Example 6.* The facts are the same as in paragraph (b)(3)(i) of this section ( *Example 1*), except that B elected to purchase an annuity that pays over B's lifetime with a 15-year certain period starting in the calendar year following the calendar year of A's death. Because B died after the effective date of section 401(a)(9)(H), the rules of section 401(a)(9)(H)(iii) apply, and accordingly, the annuity may not provide distributions any later than the end of 2034.

(c) *Required and optional plan provisions* —(1) *Required provisions.* In order to satisfy section 401(a)(9), a plan must include the provisions described in this paragraph (c)(1) reflecting section

401(a)(9). First, a plan generally must set forth the statutory rules of section 401(a)(9), including the incidental death benefit requirement in section 401(a)(9)(G). Second, a plan must provide that distributions will be made in accordance with this section and §§ 1.401(a)(9)-2 through 1.401(a)(9)-9. A plan document also must provide that the provisions reflecting section 401(a)(9) override any distribution options in the plan that are inconsistent with section 401(a)(9). A plan also must include any other provisions reflecting section 401(a)(9) that are prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

(2) *Optional provisions.* A plan may also include optional provisions governing plan distributions that do not conflict with section 401(a)(9). For example, a defined benefit plan may include a provision described in § 1.401(a)(9)-3(b)(4)(ii) (requiring that the 5-year rule apply to an employee who has a designated beneficiary). Similarly, a defined contribution plan may provide for an election by an eligible designated beneficiary as described in § 1.401(a)(9)-3(c)(5)(iii).

(d) *Regulatory applicability date.* This section and §§ 1.401(a)(9)-2 through 1.401(a)(9)-9 apply for purposes of determining required minimum distributions for calendar years beginning on or after January 1, 2025. For earlier calendar years, the rules of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9 (as those sections appeared in the April 1, 2023, edition of 26 CFR part 1) apply.

§ 1.401(a)(9)-2
Distributions commencing during an employee's lifetime.

(a) *Distributions commencing during an employee's lifetime* —(1) *In general.* In order to satisfy section 401(a)(9)(A), the entire interest of each employee must be distributed to the employee not later than the required beginning date, or must be distributed, beginning not later than the required beginning date, over the life of the employee or the joint lives of the employee and a designated beneficiary or over a period not extending beyond the life expectancy of the employee or the joint life and last survivor expectancy of the employee and the designated beneficiary. Under section 401(a)(9)(G), lifetime distributions must satisfy the incidental death benefit requirements of § 1.401-1(b)(1).

(2) *Amount required to be distributed for a calendar year.* The amount required to be distributed for each calendar year in order to satisfy section 401(a)(9)(A) and (G) generally depends on whether the amount to be distributed is from an individual account under a defined contribution plan, is an annuity payment from a defined benefit plan, or is a payment under an annuity contract. For the method of determining the required minimum distribution in accordance with section 401(a)(9)(A) and (G) from an individual account under a defined contribution plan, see § 1.401(a)(9)-5. For the method of determining the required minimum distribution in accordance with section 401(a)(9)(A) and (G) in the case of annuity payments from a defined benefit plan or under an annuity contract (including an annuity contract purchased under a defined contribution plan), see § 1.401(a)(9)-6.

(3) *Distributions commencing before required beginning date* —(i) *In general.* Lifetime distributions made before the employee's required beginning date for calendar years before the employee's first distribution calendar year, as defined in § 1.401(a)(9)-5(a)(2)(ii), need not be made in accordance with section 401(a)(9). However, if distributions commence before the employee's required beginning date under a particular distribution option (such as in the form of an annuity) and, under the terms of that distribution option, distributions to be made for the employee's first distribution calendar year (or any subsequent calendar year) will fail to satisfy

section 401(a)(9), then the distribution option fails to satisfy section 401(a)(9) at the time distributions commence.

(ii) *Date distributions are treated as having begun.* Except as otherwise provided in paragraph (a)(3)(iii) of this section and § 1.401(a)(9)-6(k), distributions to the employee are not treated as having begun in accordance with section 401(a)(9)(A)(ii) until the employee's required beginning date, as determined in accordance with paragraph (b)(1) or (3) of this section, whichever applies to the employee. The preceding sentence applies even if the employee has received distributions before the employee's required beginning date (either pursuant to plan terms that require distributions to begin by an earlier date or pursuant to the employee's election). Thus, even if payments have been made before the employee's required beginning date, the rules of § 1.401(a)(9)-3 will apply if the employee dies before that date. For example, if A is an employee who retires in 2023, the calendar year A attains age 71, and begins receiving installment distributions from a profit-sharing plan over a period not exceeding the joint life and last survivor expectancy of A and A's spouse, benefits are not treated as having begun in accordance with section 401(a)(9)(A)(ii) until April 1, 2026 (the April 1 following the calendar year in which A attains age 73). Consequently, if A dies before April 1, 2026 (A's required beginning date), distributions after A's death must be made in accordance with § 1.401(a)(9)-3 (addressing payments to beneficiaries pursuant to section 401(a)(9)(B)(ii), (iii), or (iv), whichever applies, in cases in which required distributions have not begun) rather than section 401(a)(9)(B)(i) (addressing payments to beneficiaries in cases in which required distributions have begun). This is the case without regard to whether, before A's death, the plan distributed the minimum distribution for the A's first distribution calendar year (as defined in § 1.401(a)(9)-5(a)(2)(ii)).

(iii) *Exception for uniform required beginning date.* If a plan provides, in accordance with paragraph (b)(4) of this section, that the required beginning date for purposes of section 401(a)(9) for all employees is April 1 of the calendar year following the calendar year described in paragraph (b)(1)(i) of this section, without regard to whether the employee is a 5-percent owner, then an employee who dies on or after the required beginning date determined under the plan terms is treated as dying after distributions have begun in accordance with section 401(a)(9)(A)(ii) (even if the employee dies before the April 1 following the calendar year in which the employee retires).

(4) *Distributions after death.* Section 401(a)(9)(B)(i) provides that, if the distribution of an employee's interest has begun in accordance with section 401(a)(9)(A)(ii), and the employee dies before the employee's entire interest has been distributed to the employee, the remaining portion of the employee's interest must be distributed at least as rapidly as under the distribution method being used under section 401(a)(9)(A)(ii) as of the date of the employee's death. For the method of determining the required minimum distribution in accordance with section 401(a)(9)(B)(i) from an individual account under a defined contribution plan, see § 1.401(a)(9)-5. In the case of annuity payments from a defined benefit plan or under an annuity contract (including an annuity contract purchased under a defined contribution plan), see § 1.401(a)(9)-6.

(b) *Determination of required beginning date* —(1) *General rule.* Except as otherwise provided in this paragraph (b), the employee's required beginning date (within the meaning of section 401(a)(9)(C)) is April 1 of the calendar year following the later of—

(i) The calendar year in which the employee attains the applicable age; and

(ii) The calendar year in which the employee retires from employment with the employer maintaining the plan.

(2) *Definition of applicable age* —(i) *In general.* The applicable age is determined using the employee's date of birth as set forth in this paragraph (b)(2).

(ii) *Employees born before July 1, 1949.* In the case of an employee born before July 1, 1949, the applicable age is age 70 1/2 .

(iii) *Other employees born before 1951.* In the case of an employee born on or after July 1, 1949, but before January 1, 1951, the applicable age is age 72;

(iv) *Employees born in 1951 through 1958.* In the case of an employee born on or after January 1, 1951, but before January 1, 1959, the applicable age is age 73;

(v) [Reserved]

(vi) *Employees born after 1959.* In the case of an employee born on or after January 1, 1960, the applicable age is age 75.

(3) *Required beginning date for 5-percent owner* —(i) *In general.* In the case of an employee who is a 5-percent owner, the employee's required beginning date is April 1 of the calendar year following the calendar year in which the employee attains the applicable age.

(ii) *Definition of 5-percent owner.* For purposes of section 401(a)(9), a 5-percent owner is an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains the applicable age.

(iii) *No applicability to governmental plan or church plan.* This paragraph (b)(3) does not apply in the case of a governmental plan (within the meaning of section 414(d)) or a church plan (within the meaning of § 1.401(a)(9)-6(g)(4)(i)).

(4) *Uniform required beginning date.* A plan is permitted to provide that the required beginning date for purposes of section 401(a)(9) for all employees is April 1 of the calendar year following the calendar year described in paragraph (b)(1)(i) of this section, without regard to whether the employee is a 5-percent owner.

(5) *Plans maintained by more than one employer.* In the case of a plan maintained by more than one employer, an employee who retires from employment with any of those employers but continues to be employed by another employer that maintains the plan is not treated as having retired for purposes of paragraph (b)(1)(ii) of this section.

§ 1.401(a)(9)-3
Death before required beginning date.

(a) *Distribution requirements* —(1) *In general.* Except as otherwise provided in §§ 1.401(a)(9)-2(a)(3) and 1.401(a)(9)-6(k), if an employee dies before the employee's required beginning date (and thus before distributions are treated as having begun in accordance with section 401(a)(9)(A)(ii)), then—

(i) In the case of a defined benefit plan, distributions are required to be made in accordance with paragraph (b) of this section, and

(ii) In the case of a defined contribution plan, distributions are required to be made in accordance with paragraph (c) of this section.

(2) *Special rule for designated Roth accounts.* If an employee's entire interest under a defined contribution plan is in a designated Roth account (as described in section 402A(b)(2)), then no distributions are required to be made to the employee during the employee's lifetime. Upon the employee's death, that employee is treated as having died before his or her required beginning date (so that distributions must be made in accordance with the requirements of paragraph (c) of this section).

(b) *Distribution requirements in the case of a defined benefit plan* —(1) *In general.* Distributions from a defined benefit plan are made in accordance with this paragraph (b) if the distributions satisfy either paragraph (b)(2) or (3) of this section, whichever applies with respect to the employee. The determination of whether paragraph (b)(2) or (3) of this section applies is made in accordance with paragraph (b)(4) of this section.

(2) *5-year rule.* Except as otherwise provided in § 1.401(a)(9)-6(j) (relating to defined benefit plans subject to limitations under section 436), distributions satisfy this paragraph (b)(2) if the employee's entire interest is distributed by the end of the calendar year that includes the fifth anniversary of the date of the employee's death. For example, if an employee dies on any day in 2022, then in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii), the entire interest generally must be distributed by the end of 2027.

(3) *Annuity payments.* Distributions satisfy this paragraph (b)(3) if annuity payments that satisfy the requirements of § 1.401(a)(9)-6 commence no later than the end of the calendar year following the calendar year in which the employee died, except as provided in paragraph (d) of this section (permitting a surviving spouse to delay the commencement of distributions).

(4) *Determination of which rule applies* —(i) *No plan provision.* If a defined benefit plan does not provide for an optional provision described in paragraph (b)(4)(ii) or (b)(4)(iii) of this section specifying the method of distribution after the death of an employee, then distributions must be made as follows—

(A) If the employee has no designated beneficiary, as determined under § 1.401(a)(9)-4, distributions must satisfy paragraph (b)(2) of this section; and

(B) If the employee has a designated beneficiary, distributions must satisfy paragraph (b)(3) of this section.

(ii) *Optional plan provisions.* A defined benefit plan will not fail to satisfy section 401(a)(9) merely because it includes a provision specifying that the 5-year rule in paragraph (b)(2) of this section (rather than the annuity payment rule in paragraph (b)(3) of this section) will apply with respect to some or all of the employees who have a designated beneficiary.

(iii) *Elections.* A defined benefit plan will not fail to satisfy section 401(a)(9) merely because it includes a provision that applies with respect to some or all of the employees who have a designated beneficiary under which the employee (or designated beneficiary) is permitted to elect whether the 5-year rule in paragraph (b)(2) of this section or the annuity payment rule in paragraph (b)(3) of this section applies. If a plan provides for this type of an election, then—

(A) The plan must specify the method of distribution that applies if neither the employee nor the designated beneficiary makes the election unless that method is the method specified in paragraph (b)(4)(i) of this section;

(B) The election must be made no later than the end of the earlier of the calendar year by which distributions must be made in order to satisfy paragraph (b)(2) of this section and the calendar year in which distributions would be required to begin in order to satisfy the requirements of paragraph (b)(3) of this section or, if applicable, paragraph (d) of this section; and

(C) As of the last date the election may be made, the election must be irrevocable with respect to the beneficiary (and all subsequent beneficiaries) and must apply to all subsequent calendar years.

(c) *Distributions in the case of a defined contribution plan* —(1) *In general.* The requirements of this paragraph (c) are satisfied if distributions are made in accordance with paragraph (c)(2), (3), or (4) of this section, whichever applies with respect to the employee. The determination of whether paragraph (c)(2), (3), or (4) of this section applies is made in accordance with paragraph (c)(5) of this section.

(2) *5-year rule.* Distributions satisfy this paragraph (c)(2) if the employee's entire interest is distributed by the end of the calendar year that includes the fifth anniversary of the date of the employee's death. For example, if an employee dies on any day in 2022, the entire interest must be distributed by the end of 2027 in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii). For purposes of this paragraph (c)(2), if an employee died before January 1, 2020, then the 2020 calendar year is disregarded when determining the calendar year that includes the fifth anniversary of the date of the employee's death.

(3) *10-year rule.* Distributions satisfy this paragraph (c)(3) if the employee's entire interest is distributed by the end of the calendar year that includes the tenth anniversary of the date of the employee's death. For example, if an employee died on any day in 2021, the entire interest must be distributed by the end of 2031 in order to satisfy the 5-year rule in section 401(a)(9)(B)(ii), as extended to 10 years by section 401(a)(9)(H)(i).

(4) *Life expectancy payments.* Distributions satisfy this paragraph (c)(4) if annual distributions that satisfy the requirements of § 1.401(a)(9)-5 commence by the end of the calendar year following the calendar year in which the employee died, except as provided in paragraph (d) of this section (permitting a surviving spouse to delay the commencement of distributions). The requirement to take an annual distribution in accordance with the preceding sentence continues to apply for all subsequent calendar years until the employee's interest is fully distributed. Thus, a required minimum distribution is due for the calendar year of the eligible designated beneficiary's death, and that amount must be distributed during that calendar year to any beneficiary of the deceased eligible designated beneficiary to the extent it has not already been distributed to the eligible designated beneficiary.

(5) *Determination of which rule applies* —(i) *No plan provision.* If a defined contribution plan does not include an optional provision described in paragraph (c)(5)(ii) or (c)(5)(iii) of this section specifying the method of distribution after the death of an employee, distributions must be made as follows—

(A) If the employee does not have a designated beneficiary, as determined under § 1.401(a)(9)-4, distributions must satisfy the 5-year rule described in paragraph (c)(2) of this section;

(B) If the employee dies on or after the effective date of section 401(a)(9)(H) (as determined in § 1.401(a)(9)-1(b)(2)(i) or (ii), whichever applies to the plan) and has a designated beneficiary who is not an eligible designated beneficiary (as determined under § 1.401(a)(9)-4(e)), distributions must satisfy the 10-year rule described in paragraph (c)(3) of this section; and

(C) If the employee has an eligible designated beneficiary, distributions must satisfy the life expectancy rule described in paragraph (c)(4) of this section.

(ii) *Optional plan provisions.* A defined contribution plan will not fail to satisfy section 401(a)(9) merely because it includes a provision specifying that the 10-year rule described in paragraph (c)(3) of this section (rather than the life expectancy rule described in paragraph (c)(4) of this section) will apply with respect to some or all of the employees who have an eligible designated beneficiary or will apply to some categories of eligible designated beneficiaries.

(iii) *Elections.* A defined contribution plan will not fail to satisfy section 401(a)(9) merely because it includes a provision that applies with respect to some or all of the employees who have an eligible designated beneficiary or to some categories of eligible designated beneficiaries, under which the employee (or eligible designated beneficiary) is permitted to elect whether the 10-year rule in paragraph (c)(3) of this section or the life expectancy rule in paragraph (c)(4) of this section applies. If a plan provides for this type of election, then—

(A) The plan must specify the method of distribution that applies if neither the employee nor the designated beneficiary makes the election unless that method is the method specified in paragraph (c)(5)(i) of this section;

(B) The election must be made no later than the end of the earlier of the calendar year by which distributions must be made in order to satisfy paragraph (c)(3) of this section and the calendar year in which distributions would be required to begin in order to satisfy the requirements of paragraph (c)(4) of this section (or, if applicable, paragraph (d) of this section); and

(C) As of the last date the election may be made, the election must be irrevocable with respect to the beneficiary (and all subsequent beneficiaries) and must apply to all subsequent calendar years.

(d) *Permitted delay for surviving spouse beneficiaries.* If the employee's surviving spouse is the employee's sole beneficiary, then the commencement of distributions under paragraph (b)(3) or (c)(4) of this section may be delayed until the end of the calendar year in which the employee would have attained the applicable age.

(e) *Distributions that commence after surviving spouse's death* —(1) *In general.* If the employee's surviving spouse is the employee's sole beneficiary and dies before distributions have commenced under paragraph (d) of this section, then the 5-year rule in paragraph (b)(2) or (c)(2) of this section, the 10-year rule in paragraph (c)(3) of this section, the annuity payment rules in paragraph (b)(3) of this section, or the life expectancy rules in paragraph (c)(4) of this section, are to be applied as if the surviving spouse were the employee. For this purpose, the date of death of the surviving spouse is substituted for the date of death of the employee.

(2) *Remarriage of surviving spouse.* If the delayed commencement in paragraph (d) of this section applies to the surviving spouse of the employee, and the surviving spouse remarries but dies before distributions have begun, then the rules in paragraph (d) of this section are not available to the surviving spouse of the deceased employee's surviving spouse.

(3) *When distributions are treated as having begun to surviving spouse.* For purposes of section 401(a)(9)(B)(iv)(III), distributions are considered to have begun to the surviving spouse of an employee on the date, determined in accordance with paragraph (d) of this section, on which distributions are required to commence to the surviving spouse without regard to whether payments have actually been made before that date. However, see § 1.401(a)(9)-6(l) for an exception to this rule in the case of an annuity that commences early.

§ 1.401(a)(9)-4
Determination of the designated beneficiary.

(a) *Beneficiary designated under the plan* —(1) *In general.* This section provides rules for purposes of determining the designated beneficiary under section 401(a)(9). For this purpose, a designated beneficiary is an individual who is a beneficiary designated under the plan.

(2) *Entitlement to employee's interest in the plan.* A beneficiary designated under the plan is a person who is entitled to a portion of an employee's benefit, contingent on the employee's death or another specified event. The determination of whether a beneficiary designated under the plan is taken into account for purposes of section 401(a)(9) is made in accordance with paragraph (c) of this section or, if applicable, paragraph (d) of this section.

(3) *Specificity of beneficiary designation.* A beneficiary need not be specified by name in the plan or by the employee to the plan in order for the beneficiary to be designated under the plan, provided that the person who is to be the beneficiary is identifiable pursuant to the designation. For example, a designation of the employee's children as beneficiaries of equal shares of the employee's interest in the plan is treated as a designation of beneficiaries under the plan even if the children are not specified by name. The fact that an employee's interest under the plan passes to a certain person under a will or otherwise under applicable State law does not make that person a beneficiary designated under the plan absent a designation under the plan.

(4) *Affirmative and default elections of designated beneficiary.* A beneficiary designated under the plan may be designated by a default election under the terms of the plan or, if the plan so provides, by an affirmative election of the employee (or the employee's surviving spouse). The choice of beneficiary is subject to the requirements of sections 401(a)(11), 414(p), and 417. See §§ 1.401(a)(9)-8(d) and (e) for rules that apply to qualified domestic relations orders.

(b) *Designated beneficiary must be an individual.* A person that is not an individual, such as the employee's estate, is not a designated beneficiary. If a person other than an individual is a beneficiary designated under the plan, the employee will be treated as having no designated beneficiary, even if individuals are also designated as beneficiaries. However, see paragraphs (f)(1) and (3) of this section for a rule under which certain beneficiaries of a see-through trust that is designated as the employee's beneficiary under the plan are treated as the employee's beneficiaries under the plan rather than the trust and § 1.401(a)(9)-8(a) for rules under which section 401(a)(9) is applied separately with respect to the separate interests of each of the employee's beneficiaries under the plan.

(c) *Rules for determining beneficiaries* —(1) *Time period for determining the beneficiary.* Except as provided in paragraphs (d) and (f) of this section and § 1.401(a)(9)-6(b)(2)(i), a person is a beneficiary taken into account for purposes of section 401(a)(9) if, as of the date of the employee's death, that person is a beneficiary designated under the plan and none of the events described in paragraph (c)(2) of this section has occurred with respect to that person by September 30 of the calendar year following the calendar year of the employee's death.

(2) *Circumstances under which a beneficiary is disregarded as a beneficiary of the employee.* With respect to a beneficiary who was designated as a beneficiary under the plan as of the date of the employee's death (including a beneficiary who is treated as having been designated as a beneficiary pursuant to paragraph (f) of this section), if any of the following events occurs by September 30 of the calendar year following the calendar year of the employee's death, then that beneficiary is not treated as a beneficiary—

(i) The beneficiary predeceases the employee;

(ii) The beneficiary is treated as having predeceased the employee pursuant to a simultaneous death provision under applicable State law or pursuant to a qualified disclaimer satisfying section 2518 that applies to the entire interest to which the beneficiary is entitled; or

(iii) The beneficiary receives the entire benefit to which the beneficiary is entitled.

(3) *Examples.* The following examples illustrate the rules of this paragraph (c).

(i) *Example 1.* Employer M maintains a defined contribution plan, Plan X. Employee A dies in 2024 having designated A's three children—B, C, and D—as beneficiaries, each with a one-third share of A's interest in Plan X. B executes a disclaimer of B's entire share of A's interest in Plan X within 9 months of A's death and the disclaimer satisfies the other requirements of a qualified disclaimer under section 2518. Pursuant to the qualified disclaimer, B is disregarded as a beneficiary.

(ii) *Example 2.* The facts are the same as in paragraph (c)(3)(i) of this section ( *Example 1*), except that B does not execute the disclaimer until 10 months after A's death. Even if the disclaimer is executed by September 30 of the calendar year following the calendar year of A's death, the disclaimer is not a qualified disclaimer (because B does not meet the 9-month requirement of section 2518) and B remains a designated beneficiary of A.

(iii) *Example 3.* The facts are the same as in paragraph (c)(3)(i) of this section ( *Example 1*) except that, in exchange for B's disclaimer of the one-third share of A's interest in Plan X, C transfers C's interest in real property to B. Because B has received consideration for B's disclaimer of the one-third share, it is not a qualified disclaimer under section 2518 and B remains a designated beneficiary.

(iv) *Example 4.* The facts are the same as in paragraph (c)(3)(i) of this section ( *Example 1*), except that Charity E (an organization exempt from taxation under section 501(c)(3)) also is a beneficiary designated under the plan as of the date of A's death, with B, C, D, and Charity E each having a one-fourth share of A's interest in Plan X. Plan X distributes Charity E's one-fourth share of A's interest in the plan by September 30 of the calendar year following the calendar year of A's death. Accordingly, Charity E is disregarded as A's beneficiary, and B, C, and D are treated as A's designated beneficiaries.

(v) *Example 5.* The facts are the same as in paragraph (c)(3)(i) of this section ( *Example 1*), except that A's spouse, F, also is a beneficiary designated under the plan. A and F were residents of State Z so that State Z law applies. The laws of State Z include a simultaneous death provision under which two individuals who die within a 120-hour period of one another are treated as predeceasing each other. F dies four hours after A and under the laws of State Z, F is treated as predeceasing A. Because, under applicable State law, F is treated as predeceasing A, F is disregarded as a beneficiary of A.

(vi) *Example 6.* The facts are the same as in paragraph (c)(3)(i) of this section ( *Example 1*), except that B, who was alive as of the date of A's death, dies before September 30 of the calendar year following the calendar year of A's death. Prior to B's death, none of the events described in paragraph (c)(2) of this section occurred with respect to B. Accordingly, B is still a beneficiary taken into account for purposes of section 401(a)(9) regardless of the identity of B's successor beneficiaries.

(d) *Application of beneficiary designation rules to surviving spouse.* This paragraph (d) applies in the case of distributions to which § 1.401(a)(9)-3(e) applies (because the employee's spouse is the employee's sole beneficiary as of September 30 of the calendar year following the calendar year of the employee's death, and the surviving spouse dies before distributions to the spouse have begun). If this paragraph (d) applies, then the determination of whether a person is a beneficiary of the surviving spouse is made using the rules of paragraph (c) of this section, except that the date of the surviving spouse's death is substituted for the date of the employee's death. Thus, a person is a beneficiary if, as of the date of the surviving spouse's death, that person is a beneficiary designated under the plan and remains a beneficiary as of September 30 of the calendar year following the calendar year of the surviving spouse's death.

(e) *Eligible designated beneficiaries* —(1) *In general.* A designated beneficiary of the employee is an eligible designated beneficiary if, at the time of the employee's death, the designated beneficiary is—

(i) The surviving spouse of the employee;

(ii) A child of the employee (within the meaning of section 152(f)(1)) who has not reached the age of majority within the meaning of paragraph (e)(3) of this section;

(iii) Disabled within the meaning of paragraph (e)(4) of this section;

(iv) Chronically ill within the meaning of paragraph (e)(5) of this section;

(v) Not more than 10 years younger than the employee as determined under paragraph (e)(6) of this section; or

(vi) A designated beneficiary of an employee if the employee died before the effective date of section 401(a)(9)(H) described in § 1.401(a)(9)-1(b)(2)(i) and (ii), whichever applies to the plan.

(2) *Multiple designated beneficiaries* —(i) *In general.* Except as provided in paragraphs (e)(2)(ii) and (iii) of this section and § 1.401(a)(9)-8(a) (relating to separate account treatment), if the employee has more than one designated beneficiary, and at least one of those beneficiaries is not an eligible designated beneficiary, then the employee is treated as not having an eligible designated beneficiary.

(ii) *Special rule for children.* If any of the employee's designated beneficiaries is an eligible designated beneficiary because the beneficiary is the child of the employee who had not reached the age of majority at the time of the employee's death, then the employee is treated as having an eligible designated beneficiary even if the employee has other designated beneficiaries who are not eligible designated beneficiaries.

(iii) *Special rule for applicable multi-beneficiary trust.* If a trust that is designated as the beneficiary of an employee under a plan is an applicable multi-beneficiary trust described in paragraph (g) of this section, then the trust beneficiaries described in paragraph (g)(1)(ii) of this section are treated as eligible designated beneficiaries even if one or more of the other trust beneficiaries are not eligible designated beneficiaries.

(3) *Determination of age of majority.* An individual reaches the age of majority on the individual's 21st birthday.

(4) *Disabled individual*— (i) *In general.* Subject to the documentation requirements of paragraph (e)(7) of this section, an individual is disabled if, as of the date of the employee's death—

(A) The individual is described in paragraph (e)(4)(ii) or (iii) of this section; or

(B) Paragraph (e)(4)(iv) of this section applies to the individual.

(ii) *Disability defined for individual who is age 18 or older.* An individual who, as of the date of the employee's death, is age 18 or older is disabled if, as of that date, the individual is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration.

(iii) *Disability defined for individual who is not age 18 or older.* An individual who, as of the date of the employee's death, is not age 18 or older is disabled if, as of that date, that individual has a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or to be of long-continued and indefinite duration.

(iv) *Use of social security disability determination.* If the Commissioner of Social Security has determined that, as of the date of the employee's death, an individual is disabled within the meaning of 42 U.S.C. 1382c(a)(3), then that individual will be deemed to be disabled within the meaning of this paragraph (e)(4).

(5) *Chronically ill individual.* An individual is chronically ill if the individual is chronically ill within the definition of section 7702B(c)(2) and satisfies the documentation requirements of paragraph (e)(7) of this section. However, for purposes of the preceding sentence, an individual will be treated as chronically ill under section 7702B(c)(2)(A)(i) only if there is a certification from a licensed health care practitioner (as that term is defined in section 7702B(c)(4)) that, as of the date of the certification, the individual is unable to perform (without substantial assistance from another individual) at least 2 activities of daily living and the period of that inability is an indefinite one that is reasonably expected to be lengthy in nature.

(6) *Individual not more than 10 years younger than the employee.* Whether a designated beneficiary is not more than 10 years younger than the employee is determined based on the

dates of birth of the employee and the beneficiary. Thus, for example, if an employee's date of birth is October 1, 1953, then the employee's beneficiary is not more than 10 years younger than the employee if the beneficiary was born on or before October 1, 1963.

(7) *Documentation requirements for disabled or chronically ill individuals.* This paragraph (e)(7) is satisfied with respect to an individual described in paragraph (e)(1)(iii) or (iv) of this section if documentation of the disability or chronic illness described in paragraph (e)(4) or (5) of this section, respectively, is provided to the plan administrator by October 31 of the calendar year following the calendar year of the employee's death (or October 31, 2025, if later). For individuals described in paragraph (e)(1)(iv) of this section, the documentation must include a certification from a licensed health care practitioner (as that term is defined in section 7702B(c)(4)).

(8) *Applicability of definition of eligible designated beneficiary to beneficiary of surviving spouse.* In a case to which § 1.401(a)(9)-3(e) applies, a designated beneficiary of the employee's surviving spouse is an eligible designated beneficiary provided that designated beneficiary would be an eligible designated beneficiary described in paragraph (e)(1) of this section if that paragraph were to be applied by substituting the surviving spouse for the employee.

(9) *Examples.* The following examples illustrate the rules of this paragraph (e).

(i) *Example 1.* Employer M maintains a defined contribution plan, Plan X. Employee A designates A's child, B, as the sole beneficiary of A's interest in Plan X. B will not reach the age of majority until 2024. A dies on July 1, 2022, after A's required beginning date. As of the date of A's death, B is disabled within the meaning of paragraph (e)(4) of this section. On November 1, 2024, B satisfies the requirements of paragraph (e)(7) of this section by providing the plan administrator a letter from a licensed health care practitioner stating that, as of July 1, 2022, B is unable to engage in any substantial gainful activity by reason of a physical impairment that can be expected to be of long-continued and indefinite duration. Due to B's disability, B remains an eligible designated beneficiary even after reaching the age of majority in 2024, and Plan X is not required to distribute A's remaining interest in the plan by the end of 2034 pursuant to the rules of § 1.401(a)(9)-5(e)(4), but instead may continue life expectancy payments to B during B's lifetime.

(ii) *Example 2.* The facts are the same as in paragraph (e)(9)(i) of this section ( *Example 1*), except that the documentation requirements of paragraph (e)(7) of this section are not timely satisfied with respect to B. B ceases to be an eligible designated beneficiary upon reaching the age of majority in 2024, and Plan X is required to distribute A's remaining interest in the plan by the end of 2034 pursuant to the rules of § 1.401(a)(9)-5(e)(4).

(iii) *Example 3.* The facts are the same as in paragraph (e)(9)(i) of this section ( *Example 1*), except that B becomes disabled in 2023 (after A's death in 2022). Because B was not disabled as of the date of A's death, B ceases to be an eligible designated beneficiary upon reaching the age of majority in 2024, and Plan X is required to distribute A's remaining interest in the plan by the end of 2034 pursuant to the rules of § 1.401(a)(9)-5(e)(4).

(f) *Special rules for trusts* —(1) *Look-through of trust to determine designated beneficiaries* —(i) *In general.* If a trust that is designated as the beneficiary of an employee under a plan meets the requirements of paragraph (f)(2) of this section, then certain beneficiaries of the trust that are described in paragraph (f)(3) of this section (and not the trust itself) are treated as having been designated as beneficiaries of the employee under the plan, provided that those beneficiaries are

not disregarded under paragraph (c)(2) of this section. A trust described in the preceding sentence is referred to as a see-through trust.

(ii) *Types of trusts.* The determination of which beneficiaries of a see-through trust are treated as having been designated as beneficiaries of the employee under the plan depends on whether the see-through trust is a conduit trust or an accumulation trust. For this purpose—

(A) The term *conduit trust* means a see-through trust, the terms of which provide that, with respect to the deceased employee's interest in the plan, all distributions will, upon receipt by the trustee, be paid directly to, or for the benefit of, specified trust beneficiaries; and

(B) The term *accumulation trust* means any see-through trust that is not a conduit trust.

(2) *Trust requirements.* The requirements of this paragraph (f)(2) are met if, during any period for which required minimum distributions are being determined by treating the beneficiaries of the trust as having been designated as beneficiaries of the employee under the plan, the following requirements are met—

(i) The trust is a valid trust under State law or would be but for the fact that there is no corpus.

(ii) The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.

(iii) The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's interest in the plan are identifiable (within the meaning of paragraph (f)(5) of this section) from the trust instrument.

(iv) The documentation requirements in paragraph (h) of this section have been satisfied.

(3) *Trust beneficiaries treated as beneficiaries of the employee* —(i) *In general.* Subject to the rules of paragraphs (f)(3)(ii) and (iii) of this section, the following beneficiaries of a see-through trust are treated as having been designated as beneficiaries of the employee under the plan—

(A) Any beneficiary that could receive amounts in the trust representing the employee's interest in the plan that are neither contingent upon, nor delayed until, the death of another trust beneficiary who did not predecease (and who is not treated as having predeceased) the employee; and

(B) Any beneficiary of an accumulation trust that could receive amounts in the trust representing the employee's interest in the plan that were not distributed to beneficiaries described in paragraph (f)(3)(i)(A) of this section.

(ii) *Certain trust beneficiaries disregarded* —(A) *Entitlement conditioned on death of beneficiary.* Any beneficiary of an accumulation trust who could receive amounts from the trust representing the employee's interest in the plan solely because of the death of another beneficiary described in paragraph (f)(3)(i)(B) of this section is not treated as having been designated as a beneficiary of the employee under the plan. The preceding sentence does not apply if the deceased beneficiary described in paragraph (f)(3)(i)(B) of this section—

( *1*) Predeceased (or is treated as having predeceased) the employee; or

( *2*) Also is described in paragraph (f)(3)(i)(A) of this section.

(B) *Entitlement conditioned on death of young individual.* If a beneficiary of a see-through trust is an individual who is treated as a beneficiary of the employee under paragraph (f)(3)(i)(A) of this section, and the terms of the trust require full distribution of amounts in the trust representing the employee's interest in the plan to that individual by the later of the end of the calendar year following the calendar year of the employee's death or the end of the calendar year that includes the tenth anniversary of the date on which that individual reaches the age of majority (within the meaning of paragraph (e)(3) of this section), then any other beneficiary of the trust who could receive amounts in the trust representing the employee's interest in the plan if that individual dies before full distribution to that individual is made is not treated as having been designated as a beneficiary of the employee under the plan. The preceding sentence does not apply if the beneficiary who could receive amounts in the trust conditioned on the death of that individual also is described in paragraph (f)(3)(i)(A) of this section.

(iii) *Certain accumulations disregarded.* For purposes of this paragraph (f)(3), a trust will not fail to be treated as a conduit trust merely because the trust terms requiring that distributions from the plan, upon receipt by the trustee, are paid directly to, or for the benefit of, trust beneficiaries do not apply after the death of all of the beneficiaries described in paragraph (f)(3)(i)(A) of this section.

(iv) *Treatment of payments for the benefit of a trust beneficiary.* For purposes of this paragraph (f)(3), a trust beneficiary will be treated as if the beneficiary could receive amounts in the trust representing the employee's interest in the plan regardless of whether those amounts could be paid to that beneficiary or for the benefit of that beneficiary. Thus, for example, if a trust beneficiary is a minor child of the employee, payments that could be made to a custodial account for the benefit of that child are treated as amounts that could be received by the child.

(4) *Multiple trust arrangements.* If a beneficiary of a see-through trust is another trust, the beneficiaries of the second trust will be treated as beneficiaries of the first trust, provided that the requirements of paragraph (f)(2) of this section are satisfied with respect to the second trust. In that case, the beneficiaries of the second trust are treated as having been designated as beneficiaries of the employee under the plan.

(5) *Identifiability of trust beneficiaries* —(i) *In general.* Except as otherwise provided in this paragraph (f)(5), trust beneficiaries described in paragraph (f)(3) of this section are identifiable if it is possible to identify each person eligible to receive a portion of the employee's interest in the plan through the trust. For this purpose, the specificity requirements of paragraph (a)(3) of this section apply.

(ii) *Power of appointment* —(A) *Exercise or release of power of appointment by September 30.* A trust does not fail to satisfy the identifiability requirements of this paragraph (f)(5) merely because an individual (powerholder) has the power to appoint a portion of the employee's interest to one or more beneficiaries that are not identifiable within the meaning of paragraph (f)(5)(i) of this section. If the power of appointment is exercised in favor of one or more identifiable beneficiaries by September 30 of the calendar year following the calendar year of the employee's death, then those identifiable beneficiaries are treated as beneficiaries designated under the plan. The preceding sentence also applies if, by that September 30, in lieu of exercising the power of

appointment, the powerholder restricts it so that the power can be exercised at a later time in favor of only two or more identifiable beneficiaries (in which case, those identified beneficiaries are treated as beneficiaries designated under the plan). However, if, by that September 30, the power of appointment is not exercised (or restricted) in favor of one or more beneficiaries that are identifiable within the meaning of paragraph (f)(5)(i) of this section, then each taker in default (that is, any person that is entitled to the portion that represents the employee's interest in the plan subject to the power of appointment in the absence of the powerholder's exercise of the power) is treated as a beneficiary designated under the plan.

(B) *Exercise of power of appointment after September 30 of the calendar year following the calendar year of the employee's death.* If an individual has a power of appointment to appoint a portion of the employee's interest to one or more beneficiaries and the individual exercises the power of appointment after September 30 of the calendar year following the calendar year of the employee's death, then the rules of paragraph (f)(5)(iv) of this section apply with respect to any trust beneficiary that is added pursuant to the exercise of the power of appointment.

(iii) *Modification of trust terms* —(A) *State law will not cause trust to fail to satisfy identifiability requirement.* A trust will not fail to satisfy the identifiability requirements of this paragraph (f)(5) merely because the trust is subject to State law that permits the trust terms to be modified after the death of the employee (such as through a court reformation or a permitted decanting) and thus, permits changing the beneficiaries of the trust.

(B) *Modification of trust to remove trust beneficiaries.* If a trust beneficiary described in paragraph (f)(3) of this section is removed pursuant to a modification of trust terms (such as through a court reformation or a permitted decanting) by September 30 of the calendar year following the calendar year of the employee's death, then that person is disregarded in determining the employee's designated beneficiary.

(C) *Modification of trust to add trust beneficiaries.* If a trust beneficiary described in paragraph (f)(3) of this section is added through a modification of trust terms (such as through a court reformation or a permitted decanting) on or before September 30 of the calendar year following the calendar year of the employee's death, then paragraph (c) of this section will apply taking into account the beneficiary that was added. If the beneficiary is added after that September 30, then the rules of paragraph (f)(5)(iv) of this section will apply with respect to the addition of that beneficiary.

(iv) *Addition of beneficiary after September 30.* If, after September 30 of the calendar year following the calendar year of the employee's death, a trust beneficiary described in paragraph (f)(3) of this section is added as a trust beneficiary (whether through the exercise of a power of appointment, the modification of trust terms, or otherwise), then—

(A) The addition of the beneficiary will not cause the trust to fail to satisfy the identifiability requirements of this paragraph (f)(5);

(B) Beginning in the calendar year following the calendar year in which the new trust beneficiary was added, the rules of § 1.401(a)(9)-5(f)(1) will apply taking into account the new beneficiary and all of the beneficiaries of the trust that were treated as beneficiaries of the employee before the addition of the new beneficiary; and

(C) Subject to paragraph (f)(5)(v) of this section, the rules of paragraphs (b) and (e)(2) of this section and § 1.401(a)(9)-5(f)(2) will apply taking into account the new beneficiary and all of the beneficiaries of the trust that were treated as beneficiaries of the employee before the addition of the new beneficiary.

(v) *Delay in full distribution requirement.* This paragraph (f)(5)(v) provides a special rule that applies if a full distribution of the employee's entire interest in the plan is not required in a calendar year pursuant to § 1.401(a)(9)-5(e), but a beneficiary is added in that calendar year. In that case, if, taking into account the added beneficiary pursuant to paragraph (f)(5)(iv)(C) of this section, a full distribution of the employee's entire interest in the plan would have been required in that calendar year or an earlier calendar year, then a full distribution of the employee's entire interest in the plan will not be required until the end of the calendar year following the calendar year in which the beneficiary is added. For example, if life expectancy payments are being made to an eligible designated beneficiary and, more than 10 years after the employee's death, a beneficiary is added who is not an eligible designated beneficiary as described in paragraph (e) of this section, then the employee is treated as not having an eligible designated beneficiary for purposes of § 1.401(a)(9)-5(e)(2) (so that a full distribution of the employee's entire interest in the plan would have been required within 10 years of the employee's death). However, pursuant to this paragraph (f)(5)(v), the full distribution of the employee's entire interest in the plan is not required until the end of the calendar year following the calendar year in which the new trust beneficiary was added.

(6) *Examples.* The following examples illustrate the see-through trust rules of this paragraph (f).

(i) *Example 1*— (A) *Facts.* Employer L maintains a defined contribution plan, Plan W. Unmarried Employee C died in 2024 at age 30. Prior to C's death, C named a testamentary trust (Trust T) that satisfies the requirements of paragraph (f)(2) of this section, as the beneficiary of C's interest in Plan W. The terms of Trust T require that all distributions received from Plan W, upon receipt by the trustee, be paid directly to D, C's sibling, who is 5 years older than C. The terms of Trust T also provide that, if D dies before C's entire account balance has been distributed to D, E will be the beneficiary of C's remaining account balance.

(B) *Analysis.* Pursuant to paragraph (f)(1)(ii)(A) of this section, Trust T is a conduit trust. Because Trust T is a conduit trust (meaning the residual beneficiary rule in paragraph (f)(3)(i)(B) of this section does not apply) and because E is only entitled to any portion of C's account if D dies before the entire account has been distributed, E is disregarded in determining C's designated beneficiary. Because D is an eligible designated beneficiary, D may use the life expectancy rule of § 1.401(a)(9)-3(c)(4). Accordingly, even if D dies before C's entire interest in Plan W is distributed to Trust T, D's life expectancy continues to be used to determine the applicable denominator. Note, however, that because § 1.401(a)(9)-5(e)(3) applies in this situation, a distribution of C's entire interest in Plan W will be required no later than the end of the calendar year that includes the tenth anniversary of D's death.

(ii) *Example 2* —(A) *Facts related to plan and beneficiary.* Employer M maintains a defined contribution plan, Plan X. Employee A died in 2024 at the age of 55, survived by Spouse B, who was then 50 years old. A's account balance in Plan X is invested only in productive assets and was includible in A's gross estate under section 2039. A named a testamentary trust (Trust P) as the beneficiary of all amounts payable from A's account in Plan X after A's death. Trust P satisfies the see-through trust requirements of paragraph (f)(2) of this section.

(B) *Facts related to trust.* Under the terms of Trust P, all trust income is payable annually to B, and no one has the power to appoint or distribute Trust P principal to any person other than B. A's sibling, C, who is less than 10 years younger than A (and thus is an eligible designated beneficiary) and is younger than B, is the sole residual beneficiary of Trust P. Also, under the terms of Trust P, if C predeceases B, then, upon B's death, all Trust P principal is distributed to Charity Z (an organization exempt from tax under section 501(c)(3)). No other person has a beneficial interest in Trust P. Under the terms of Trust P, B has the power, exercisable annually, to compel the trustee to withdraw from A's account balance in Plan X an amount equal to the income earned during the calendar year on the assets held in A's account in Plan X and to distribute that amount through Trust P to B. Plan X includes no prohibition on withdrawal from A's account of amounts in excess of the annual required minimum distributions under section 401(a)(9). In accordance with the terms of Plan X, the trustee of Trust P elects to take annual life expectancy payments pursuant to section 401(a)(9)(B)(iii). If B exercises the withdrawal power, the trustee must withdraw from A's account under Plan X the greater of the amount of income earned in the account during the calendar year or the required minimum distribution. However, under the terms of Trust P, and applicable State law, only the portion of the Plan X distribution received by the trustee equal to the income earned by A's account in Plan X is required to be distributed to B (along with any other trust income).

(C) *Analysis.* Because Trust P does not require that distributions from A's account in Plan X to Trust P, upon receipt by the trustee, be paid directly to (or for the benefit of) B, Trust P is not a conduit trust and accordingly is an accumulation trust (as described in paragraph (f)(1)(ii)(B) of this section). Pursuant to paragraph (f)(3)(i)(B) of this section, C, as the residual beneficiary of Trust P, is treated as a beneficiary designated under Plan X (even though access to those amounts is delayed until after B's death). Pursuant to paragraph (f)(2)(iii)(A) of this section, because Charity Z's entitlement to amounts in the trust is based on the death of a beneficiary described in paragraph (f)(3)(i)(B) of this section who is not also described in paragraph (f)(3)(i)(A) of this section, Charity Z is disregarded as a beneficiary of A. Under § 1.401(a)(9)- 5(f)(1), the designated beneficiary used to determine the applicable denominator is the oldest of the designated beneficiaries of Trust P's interest in Plan X. B is the oldest of the beneficiaries of Trust P's interest in Plan X (including residual beneficiaries). Thus, the applicable denominator for purposes of section 401(a)(9)(B)(iii) is B's life expectancy. Because C is a beneficiary of A's account in Plan X in addition to B, B is not the sole beneficiary of A's account and the special rule in section 401(a)(9)(B)(iv) and § 1.401(a)(9)-3(d) is not available. Accordingly, the annual required minimum distributions from the account to Trust P must begin no later than the end of the calendar year following the calendar year of A's death.

(iii) *Example 3* —(A) *Facts.* The facts are the same as in paragraph (f)(6)(ii) of this section ( *Example 2*), except that C is more than 10 years younger than A, meaning that at least one of the beneficiaries of Trust P's interest in Plan X is not an eligible designated beneficiary.

(B) *Analysis.* Pursuant to paragraph (e)(2)(i) of this section, A is treated as not having an eligible designated beneficiary. Pursuant to § 1.401(a)(9)-3(c)(5), the trustee of Trust P is not permitted to make an election to take annual life expectancy distributions and the 10-year rule of § 1.401(a)(9)-3(c)(3) applies.

(iv) *Example 4* —(A) *Facts related to plan and beneficiary.* Employer N maintains a defined contribution plan, Plan Y. Employee F died in 2025 at the age of 60. F named a testamentary trust (Trust Q), which was established under F's will, as the beneficiary of all amounts payable from

F's account in Plan X after F's death. Trust Q satisfies the see-through trust requirements of paragraph (f)(2) of this section.

(B) *Facts related to trust.* Under the terms of Trust Q, all trust income is payable to F's surviving spouse G for life, no person has the power to appoint or distribute Trust Q principal to any person other than G, and G has a testamentary power of appointment to name the beneficiaries of the remainder in Trust Q. The power of appointment provides that, if G does not exercise the power, then upon G's death, F's descendants, per stirpes, are entitled to the remainder interest in Trust Q. As of the date of F's death, F has two children, K and L, neither of whom is disabled, chronically ill, or under age 21. Before September 30 of the calendar year following the calendar year in which F died, G irrevocably restricts G's power of appointment so that G may exercise the power to appoint the remainder beneficiaries of Trust Q only in favor of G's siblings (who all are less than 10 years younger than F and thus, are eligible designated beneficiaries).

(C) *Analysis.* Pursuant to paragraph (f)(5)(ii)(A) of this section, because G timely restricted the power of appointment so that G may exercise the power to appoint the residual interest in Trust Q only in favor of G's siblings, the designated beneficiaries are G and G's siblings. Because all of the designated beneficiaries are eligible designated beneficiaries, annual life expectancy payments are permitted under section 401(a)(9)(B)(iii). Note, however, that because § 1.401(a)(9)-5(e)(3) applies, a distribution of the remaining interest is required by no later than 10 years after the calendar year in which the oldest of G and G's siblings dies.

(v) *Example 5* —(A) *Facts.* The facts are the same as in paragraph (f)(6)(iv) of this section ( *Example 4*), except that G does not restrict the power by September 30 of the calendar year following the calendar year of F's death.

(B) *Analysis.* Pursuant to paragraph (f)(5)(ii)(A) of this section, G, K, and L are treated as F's beneficiaries. Pursuant to § 1.401(a)(9)-3(c)(5), because K and L are not eligible designated beneficiaries, the trustee of Trust Q is not permitted to make an election to take annual life expectancy distributions, and the 10-year rule of § 1.401(a)(9)-3(c)(3) applies.

(g) *Applicable multi-beneficiary trust* —(1) *Certain see-through trusts with disabled or chronically ill beneficiaries.* An applicable multi-beneficiary trust is a see-through trust with more than one beneficiary and with respect to which—

(i) All of the trust beneficiaries are designated beneficiaries;

(ii) The trust terms identify one or more individuals, each of whom is disabled (as defined in paragraph (e)(1)(iii) of this section) or chronically ill (as defined in paragraph (e)(1)(iv) of this section), who are described in paragraph (f)(3)(i)(A) of this section; and

(iii) The terms of the trust provide that no beneficiary (other than an individual described in paragraph (g)(1)(ii) of this section) has any right to the employee's interest in the plan until the death of all of the eligible designated beneficiaries described in paragraph (g)(1)(ii) of this section.

(2) *Termination of interest in trust.* A provision in the trust agreement that permits the termination of the interest in the trust of a beneficiary described in paragraph (g)(1)(ii) of this section prior to that beneficiary's death will not cause the trust to fail to be treated as an applicable multi-beneficiary trust, but only if paragraph (g)(1)(iii) of this section continues to apply. Upon the death of the last to survive of the beneficiaries described in paragraph (g)(1)(ii) of this section, the trust

is treated as having been modified as of the date of that death to add the other trust beneficiaries. Thus, if the death occurs after September 30 of the calendar year following the calendar year of the employee's death, the rules of paragraph (f)(5)(iv) of this section will apply.

(3) *Special definition of designated beneficiary.* For purposes of paragraph (g)(1)(i) of this section, any beneficiary that is an organization described in section 408(d)(8)(B)(i) (certain organizations to which a charitable contribution may be made) is treated as a designated beneficiary.

(h) *Documentation requirements for trusts* —(1) *General rule.* The documentation requirements of this paragraph (h) are satisfied if—

(i) With respect to required minimum distributions for a distribution calendar year that begins on or before the date of the employee's death, paragraph (h)(2) of this section is satisfied no later than the first day of the distribution calendar year; or

(ii) With respect to required minimum distributions for a distribution calendar year that begins after the date of the employee's death, or that begins after the employee's surviving spouse has died in a case to which § 1.401(a)(9)-3(d) applies, paragraph (h)(3) of this section is satisfied no later than October 31 of the calendar year following the calendar year that includes the employee's date of death or the date of death of the employee's surviving spouse, respectively.

(2) *Required minimum distributions while employee is still alive* —(i) *In general.* If an employee designates a trust as the beneficiary of the employee's entire benefit and the employee's spouse is the only beneficiary of the trust treated as a beneficiary of the employee pursuant to the rules of paragraph (f) of this section, then, in order to satisfy the documentation requirements of this paragraph (h)(2) (so that the applicable denominator for a distribution calendar year may be determined under the rules of § 1.401(a)(9)-5(c)(2), assuming the other requirements of paragraph (f)(2) of this section are satisfied), the employee must satisfy either the requirements of paragraph (h)(2)(ii) of this section (requiring the employee to provide a copy of the trust instrument) or the requirements of paragraph (h)(2)(iii) of this section (requiring the employee to provide a list of beneficiaries). The plan administrator may determine which of the two alternatives in the preceding sentence is available to the employee.

(ii) *Employee to provide copy of trust instrument.* An employee satisfies the requirements of this paragraph (h)(2)(ii) if the employee—

(A) Provides the plan administrator a copy of the trust instrument; and

(B) Agrees that, if the trust instrument is amended at any time in the future, the employee will, within a reasonable time, provide the plan administrator a copy of each amendment.

(iii) *Employee to provide list of beneficiaries.* An employee satisfies the requirements of this paragraph (h)(2)(iii) if the employee—

(A) Provides the plan administrator a list of all of the beneficiaries of the trust (including contingent beneficiaries) with a description of the conditions on their entitlement sufficient to establish that the spouse is the only beneficiary of the trust treated as a beneficiary of the employee pursuant to the rules of paragraph (f) of this section;

(B) Certifies that, to the best of the employee's knowledge, the list described in paragraph (h)(2)(iii)(A) of this section is correct and complete and that the requirements of paragraphs (f)(2)(i) through (iii) of this section are satisfied; and

(C) Agrees that, if the trust instrument is amended at any time in the future, the employee will, within a reasonable time, provide the plan administrator corrected certifications to the extent that the amendment changes any information previously certified; and

(D) Agrees to provide a copy of the trust instrument to the plan administrator upon request.

(3) *Required minimum distributions after death* —(i) *In general.* In order to satisfy the documentation requirement of this paragraph (h)(3) for required minimum distributions after the death of the employee (or after the death of the employee's surviving spouse in a case to which § 1.401(a)(9)-3(d) applies), the trustee of the trust must satisfy the requirements of either paragraph (h)(3)(ii) (requiring the trustee to provide a list of beneficiaries) or paragraph (h)(3)(iii) of this section (requiring the trustee to provide a copy of the trust instrument). The plan administrator may determine which of the two alternatives in the preceding sentence is available for the trust.

(ii) *Trustee to provide list of beneficiaries.* A trustee satisfies the requirements of this paragraph (h)(3)(ii) if the trustee—

(A) Provides the plan administrator a final list of all beneficiaries of the trust as of September 30 of the calendar year following the calendar year of the death (including contingent beneficiaries) with a description of the conditions on their entitlement sufficient to establish which of those beneficiaries are treated as beneficiaries of the employee (or surviving spouse, if applicable);

(B) Certifies that, to the best of the trustee's knowledge, this list is correct and complete and that the requirements of paragraphs (f)(2)(i) through (iii) of this section are satisfied; and

(C) Agrees to provide a copy of the trust instrument to the plan administrator upon request.

(iii) *Trustee to provide copy of trust instrument.* A trustee satisfies the requirements of this paragraph (h)(3)(iii) if the trustee provides the plan administrator with a copy of the actual trust document for the trust that is named as a beneficiary of the employee under the plan as of the employee's date of death.

(4) *Relief for discrepancy between trust instrument and employee certifications or earlier trust instruments* —(i) *In general.* If required minimum distributions are determined based on the information provided to the plan administrator in certifications or trust instruments described in paragraph (h)(2) or (3) of this section, a plan will not fail to satisfy section 401(a)(9) merely because the actual terms of the trust instrument are inconsistent with the information in those certifications or trust instruments previously provided to the plan administrator, but only if—

(A) The plan administrator reasonably relied on the information provided; and

(B) The required minimum distributions for calendar years after the calendar year in which the discrepancy is discovered are determined based on the actual terms of the trust instrument.

(ii) *Excise tax.* For purposes of determining the amount of the excise tax under section 4974, the required minimum distribution is determined for any year based on the actual terms of the trust in effect during the year.

§ 1.401(a)(9)-5
Required minimum distributions from defined contribution plans.

(a) *General rules* —(1) *In general.* Subject to the rules of paragraph (e) of this section (requiring distribution of an employee's entire interest by a specified deadline in certain situations), if an employee's accrued benefit is in the form of an individual account under a defined contribution plan, the minimum amount required to be distributed for each distribution calendar year beginning with the first distribution calendar year for the employee or designated beneficiary (as determined under paragraph (a)(2) of this section) is equal to the quotient obtained by dividing the account balance (determined under paragraph (b) of this section) by the applicable denominator (determined under paragraph (c) or (d) of this section, whichever applies). However, the required minimum distribution amount will never exceed the entire account balance on the date of the distribution. See paragraph (g)(1) of this section for rules that apply if a portion of the employee's account is not vested.

(2) *Distribution calendar year* —(i) *In general.* A calendar year for which a minimum distribution is required is a distribution calendar year.

(ii) *First distribution calendar year for employee if employee dies on or after required beginning date.* If an employee's required beginning date is April 1 of the calendar year following the calendar year in which the employee attains the applicable age, then the employee's first distribution calendar year is the year the employee attains the applicable age. If an employee's required beginning date is April 1 of the calendar year following the calendar year in which the employee retires, the employee's first distribution calendar year is the calendar year in which the employee retires.

(iii) *First distribution calendar year for designated beneficiary if employee dies before required beginning date.* In the case of an employee who dies before the required beginning date, if the life expectancy rule in § 1.401(a)(9)-3(c)(4) applies, then the first distribution calendar year for the designated beneficiary is the calendar year following the calendar year in which the employee died (or, if applicable, the calendar year described in § 1.401(a)(9)-3(d)). See § 1.401(a)(9)-3(c)(5) to determine whether the life expectancy rule applies.

(3) *Time for distributions.* The distribution required for the employee's first distribution calendar year (as described in paragraph (a)(2)(ii) of this section) may be made on or before April 1 of the following calendar year. The required minimum distribution for any other distribution calendar year (including the required minimum distribution for the distribution calendar year in which the employee's required beginning date occurs or the first distribution calendar year for the designated beneficiary) must be made on or before the end of that distribution calendar year.

(4) *Minimum distribution incidental benefit requirement.* If distributions of an employee's account balance under a defined contribution plan are made in accordance with this section—

(i) With respect to the retirement benefits provided by that account balance, to the extent the incidental benefit requirement of § 1.401-1(b)(1)(i) requires distributions, that requirement is deemed satisfied; and

(ii) No additional distributions are required to satisfy section 401(a)(9)(G).

(5) *Annuity contracts* —(i) *Purchase of annuity contract permitted.* A plan may satisfy section 401(a)(9) by the purchase of an annuity contract from an insurance company in accordance with § 1.401(a)(9)-6(d) with the employee's entire individual account, provided that the terms of the annuity satisfy § 1.401(a)(9)-6. However, a distribution of an annuity contract is not a distribution for purposes of this section.

(ii) *Transition from defined contribution rules to defined benefit rules.* If an annuity is purchased in accordance with paragraph (a)(5)(i) of this section after distributions are required to commence (the required beginning date, in the case of distributions commencing before death, or the calendar year determined under § 1.401(a)(9)-3(c)(4) or, if applicable, § 1.401(a)(9)-3(d), in the case of distributions commencing after death), then the plan will satisfy section 401(a)(9) only if, in the year of purchase, distributions from the individual account satisfy this section, and for calendar years following the year of purchase, payments under the annuity contract are made in accordance with § 1.401(a)(9)-6. Payments under the annuity contract during the year in which the annuity contract is purchased are treated as distributions from the individual account for purposes of determining whether the distributions from the individual account satisfy this section in the calendar year of purchase.

(iii) *Bifurcation if annuity contract is purchased with portion of employee's account.* A portion of an employee's account balance under a defined contribution plan is permitted to be used to purchase an annuity contract while another portion remains in the account, provided that the requirements of paragraphs (a)(5)(i) and (ii) of this section are satisfied (other than the requirement that the contract be purchased with the employee's entire individual account). In that case, in order to satisfy section 401(a)(9) for calendar years after the calendar year of purchase, the remaining account balance under the plan must be distributed in accordance with this section.

(iv) *Optional aggregation rule.* In the case of an annuity contract purchased with a portion of the employee's account balance, in lieu of applying section 401(a)(9) separately with respect to the annuity contract and the remaining account balance as described in paragraph (a)(5)(iii) of this section, a plan may permit an employee to elect to satisfy section 401(a)(9) for the annuity contract and that account balance in the aggregate by—

(A) Adding the fair market value of the contract to the remaining account balance determined under paragraph (b) of this section; and

(B) Treating payments under the annuity contract as distributions from the employee's individual account.

(v) [Reserved]

(6) *Impact of additional distributions in prior years.* If, for any distribution calendar year, the amount distributed exceeds the required minimum distribution for that calendar year, no credit towards a required minimum distribution will be given in subsequent calendar years for the excess distribution.

(b) *Determination of account balance* —(1) *General rule.* In the case of an individual account under a defined contribution plan, the benefit used in determining the required minimum distribution for a distribution calendar year is the account balance as of the last valuation date in

the calendar year preceding that distribution calendar year (valuation calendar year) adjusted in accordance with this paragraph (b). For this purpose, all of an employee's accounts under the plan are aggregated. Thus, all separate accounts, including a separate account for employee contributions under section 72(d)(2), are aggregated for purposes of this section.

(2) *Adjustment for subsequent allocations and distributions* —(i) *Subsequent allocations.* The account balance is increased by the amount of any contributions or forfeitures allocated to the account balance as of dates in the valuation calendar year after the valuation date. For this purpose, contributions that are allocated to the account balance as of dates in the valuation calendar year after the valuation date, but that are not actually made during the valuation calendar year, may be excluded.

(ii) *Subsequent distributions.* The account balance is decreased by distributions made in the valuation calendar year after the valuation date.

(3) *Adjustment for designated Roth accounts.* For distribution calendar years up to and including the calendar year that includes the employee's date of death, the account balance does not include amounts held in a designated Roth account (as described in section 402A(b)(2)).

(4) *Exclusion for QLAC.* The account balance does not include the value of any qualifying longevity annuity contract (QLAC), defined in § 1.401(a)(9)-6(q), that is held under the plan.

(5) *Treatment of rollovers.* If an amount is distributed from a plan and rolled over to another plan (receiving plan), then the rules of § 1.401(a)(9)-7(b) apply for purposes of determining the benefit and required minimum distribution under the receiving plan. If an amount is transferred from one plan (transferor plan) to another plan (transferee plan) in a transfer to which section 414(l) applies, then the rules of §§ 1.401(a)(9)-7(c) and (d) apply for purposes of determining the amount of the benefit and required minimum distribution under both the transferor and transferee plans.

(c) *Determination of applicable denominator during employee's lifetime* —(1) *General rule.* Except as provided in paragraph (c)(2) of this section (relating to a spouse beneficiary who is more than 10 years younger than the employee), the applicable denominator for required minimum distributions for each distribution calendar year beginning with the employee's first distribution calendar year (as described in paragraph (a)(2)(ii) of this section) is determined using the Uniform Lifetime Table in § 1.401(a)(9)-9(c) for the employee's age as of the employee's birthday in the relevant distribution calendar year. The requirement to take an annual distribution calculated in accordance with the preceding sentence applies for every distribution calendar year up to and including the calendar year that includes the employee's date of death. Thus, a required minimum distribution is due for the calendar year of the employee's death, and that amount must be distributed during that year to any beneficiary to the extent it has not already been distributed to the employee.

(2) *Spouse is sole beneficiary* —(i) *Determination of applicable denominator.* If the employee's surviving spouse who is more than 10 years younger than the employee is the employee's sole beneficiary, then the applicable denominator is the joint and last survivor life expectancy for the employee and spouse determined using the Joint and Last Survivor Table in § 1.401(a)(9)-9(d) for the employee's and spouse's ages as of their birthdays in the relevant distribution calendar year (rather than the applicable denominator determined under paragraph (c)(1) of this section).

(ii) *Spouse must be sole beneficiary at all times.* Except as otherwise provided in paragraph (c)(2)(iii) of this section (relating to a death or divorce in a calendar year), the spouse is the sole beneficiary for purposes of determining the applicable denominator for a distribution calendar year during the employee's lifetime only if the spouse is the sole beneficiary of the employee's entire interest at all times during the distribution calendar year.

(iii) *Change in marital status.* If the employee and the employee's spouse are married on January 1 of a distribution calendar year, but do not remain married throughout that year (that is, the employee or the employee's spouse dies or they become divorced during that year), the employee will not fail to have a spouse as the employee's sole beneficiary for that year merely because they are not married throughout that year. However, the change in beneficiary due to the death or divorce of the spouse in a distribution calendar year will be effective for purposes of determining the applicable denominator under section 401(a)(9) and this paragraph (c) for the following calendar years.

(d) *Applicable denominator after employee's death* —(1) *Death on or after the employee's required beginning date* —(i) *In general.* If an employee dies after distribution has begun as determined under § 1.401(a)(9)-2(a)(3) (generally, on or after the employee's required beginning date), distributions must satisfy section 401(a)(9)(B)(i). In order to satisfy this requirement, the applicable denominator for distribution calendar years that begin after the employee's death is determined under the rules of this paragraph (d)(1) (or is determined under the rules of paragraph (g)(3) of this section, if applicable). The requirement to take an annual distribution in accordance with the preceding sentence continues to apply for every distribution calendar year until the employee's interest is fully distributed. Thus, a required minimum distribution is due for the calendar year of the beneficiary's death, and that amount must be distributed during that calendar year to any beneficiary of the deceased beneficiary to the extent it has not already been distributed to the deceased beneficiary. If section 401(a)(9)(H) applies to the employee's interest in the plan, then the distributions also must satisfy either section 401(a)(9)(B)(ii) (applied by substituting 10 years for 5 years) or, if the beneficiary is an eligible designated beneficiary, section 401(a)(9)(B)(iii) (taking into account sections 401(a)(9)(E)(iii) and 401(a)(9)(H)(iii)). In order to satisfy those requirements, in addition to determining the applicable denominator under the rules of this paragraph (d)(1), the distributions must satisfy any applicable requirements under paragraph (e) of this section.

(ii) *Employee with designated beneficiary.* If the employee has a designated beneficiary as of the date determined under § 1.401(a)(9)-4(c), the applicable denominator is the greater of—

(A) The designated beneficiary's remaining life expectancy; and

(B) The employee's remaining life expectancy.

(iii) *Employee with no designated beneficiary.* If the employee does not have a designated beneficiary as of the date determined under § 1.401(a)(9)-4(c), the applicable denominator is the employee's remaining life expectancy.

(2) *Death before an employee's required beginning date.* If an employee dies before distributions have begun (as determined under § 1.401(a)(9)-2(a)(3)) and the life expectancy rule described in § 1.401(a)(9)-3(c)(4) applies, then the applicable denominator for distribution calendar years beginning with the first distribution calendar year for the designated beneficiary (as described in

paragraph (a)(2)(iii) of this section) is the designated beneficiary's remaining life expectancy (or is determined under the rules of paragraph (g)(3) of this section, if applicable).

(3) *Remaining life expectancy* —(i) *Life expectancy table.* For purposes of this paragraph (d), all life expectancies are determined using the Single Life Table in § 1.401(a)(9)-9(b).

(ii) *Employee's life expectancy.* The employee's remaining life expectancy is determined initially using the employee's age as of the employee's birthday in the calendar year of the employee's death. In subsequent calendar years, the remaining life expectancy is determined by reducing that initial life expectancy by one for each calendar year that has elapsed after that first calendar year.

(iii) *Non-spouse designated beneficiary.* If the designated beneficiary is not the employee's surviving spouse, then the designated beneficiary's remaining life expectancy is determined initially using the beneficiary's age as of the beneficiary's birthday in the calendar year following the calendar year of the employee's death. Except as otherwise provided in paragraph (d)(3)(iv) of this section, for subsequent calendar years, the designated beneficiary's remaining life expectancy is determined by reducing that initial life expectancy by one for each calendar year that has elapsed after that first calendar year.

(iv) *Spouse as designated beneficiary.* If the surviving spouse of the employee is the employee's sole beneficiary, then the surviving spouse's remaining life expectancy is redetermined each distribution calendar year up to and including the calendar year of the spouse's death using the surviving spouse's age as of the surviving spouse's birthday in the distribution calendar year. For each calendar year following the calendar year of the spouse's death, the spouse's remaining life expectancy is determined by reducing the spouse's remaining life expectancy in the calendar year of the spouse's death by one for each calendar year that has elapsed after that calendar year.

(e) *Distribution of employee's entire interest required* —(1) *In general.* Except as provided in paragraph (f) of this section, if an employee's accrued benefit is in the form of an individual account under a defined contribution plan, then the entire interest of the employee must be distributed by the end of the earliest of the calendar years described in paragraph (e)(2), (3), or (4) of this section. However, the preceding sentence does not apply if section 401(a)(9)(H) does not apply with respect to the employee (for example, if both the employee and the employee's designated beneficiary died before January 1, 2020). See § 1.401(a)(9)-1(b) for rules relating to the section 401(a)(9)(H) effective date.

(2) *10-year limit for designated beneficiary who is not an eligible designated beneficiary.* If the employee's designated beneficiary is not an eligible designated beneficiary (as determined in accordance with § 1.401(a)(9)-4(e)), then the calendar year described in this paragraph (e)(2) is the calendar year that includes the tenth anniversary of the date of the employee's death.

(3) *10-year limit following death of eligible designated beneficiary.* If the employee's designated beneficiary is an eligible designated beneficiary (as determined in accordance with § 1.401(a)(9)-4(e)), then the calendar year described in this paragraph (e)(3) is the calendar year that includes the tenth anniversary of the date of the designated beneficiary's death.

(4) *10-year limit after minor child of the employee reaches age of majority.* If the employee's designated beneficiary is an eligible designated beneficiary only because the beneficiary is the child of the employee who has not reached the age of majority at the time of the employee's

death, then the calendar year described in this paragraph (e)(4) is the calendar year that includes the tenth anniversary of the date the designated beneficiary reaches the age of majority.

(f) *Rules for multiple designated beneficiaries* —(1) *Determination of applicable denominator* —(i) *General rule.* Except as otherwise provided in paragraph (f)(1)(ii) of this section and § 1.401(a)(9)-8(a), if the employee has more than one designated beneficiary, then the determination of the applicable denominator under paragraph (d) of this section is made using the oldest designated beneficiary of the employee.

(ii) *Applicable multi-beneficiary trusts.* If an employee's beneficiary is an applicable multi-beneficiary trust described in § 1.401(a)(9)-4(g)(1), then only the trust beneficiaries described in § 1.401(a)(9)-4(g)(1)(ii) are taken into account in determining the oldest designated beneficiary for purposes of paragraph (f)(1)(i) of this section.

(2) *Determination of when entire interest is required to be distributed* —(i) *General rule.* Except as otherwise provided in paragraphs (f)(2)(ii) and (iii) of this section and § 1.401(a)(9)-8(a), if an employee has more than one designated beneficiary, then paragraph (e)(1) of this section is applied with respect to the oldest of the employee's designated beneficiaries.

(ii) *Special rule for employee's minor child.* If any of the employee's designated beneficiaries is an eligible designated beneficiary because that designated beneficiary is described in § 1.401(a)(9)-4(e)(1)(ii) (relating to the child of the employee who has not reached the age of majority at the time of the employee's death), then—

(A) Paragraph (e)(2) of this section does not apply;

(B) Paragraph (e)(3) of this section applies as if the death of the employee's eligible designated beneficiary does not occur until the death of all of the designated beneficiaries who are described in § 1.401(a)(9)-4(e)(1)(ii); and

(C) Paragraph (e)(4) of this section applies as if the attainment of the age of majority of the employee's eligible designated beneficiary described in § 1.401(a)(9)-4(e)(1)(ii) does not occur until the youngest of those eligible designated beneficiaries reaches the age of majority.

(iii) *Applicable multi-beneficiary trust.* If an employee's beneficiary is an applicable multi-beneficiary trust described in § 1.401(a)(9)-4(g)(1), then paragraph (e)(3) of this section applies as if the death of the employee's eligible designated beneficiary does not occur until the death of the last to survive of the trust beneficiaries who are described in § 1.401(a)(9)-4(g)(1)(ii).

(g) *Special rules* —(1) *Treatment of nonvested amounts.* If the employee's benefit is in the form of an individual account under a defined contribution plan, the benefit used to determine the required minimum distribution for any distribution calendar year will be determined in accordance with paragraph (a) of this section without regard to whether or not all of the employee's benefit is vested. If, as of the end of a distribution calendar year (or as of the employee's required beginning date, in the case of the employee's first distribution calendar year), the total amount of the employee's vested benefit is less than the required minimum distribution for the calendar year, only the vested portion, if any, of the employee's benefit is required to be distributed by the end of the calendar year (or, if applicable, by the employee's required beginning date). However, the required minimum distribution for the subsequent calendar year must be increased by the sum of amounts not distributed in prior calendar years because the employee's vested benefit was less

than the required minimum distribution determined in accordance with paragraph (a) of this section.

(2) *Distributions taken into account* —(i) *General rule.* Except as provided in this paragraph (g)(2), all amounts distributed from an individual account under a defined contribution plan are distributions that are taken into account in determining whether this section is satisfied for a calendar year, regardless of whether the amount is includible in income. Thus, for example, amounts that are excluded from income as recovery of investment in the contract under section 72 generally are taken into account for purposes of determining whether this section is satisfied for a calendar year. Similarly, amounts excluded from income as net unrealized appreciation on employer securities generally are taken into account for purposes of satisfying this section.

(ii) *Amounts not eligible for rollover.* An amount is not taken into account in determining whether this section is satisfied for a calendar year if that amount is described in § 1.402(c)-2(c)(3) (relating to amounts that are not treated as eligible rollover distributions).

(iii) [Reserved]

(iv) [Reserved]

(3) *Surviving spouse election under section 401(a)(9)(B)(iv)* —(i) *In general.* A defined contribution plan may include a provision, applicable to an employee whose sole beneficiary is that employee's surviving spouse, under which the surviving spouse may elect to be treated as the employee for purposes of determining the required minimum distribution for a calendar year under this section.

(ii) [Reserved]

§ 1.401(a)(9)-6
Required minimum distributions for defined benefit plans and annuity contracts.

(a) *General rules* —(1) *In general.* In order to satisfy section 401(a)(9), except as otherwise provided in this section, distributions of the employee's entire interest under a defined benefit plan or under an annuity contract must be paid in the form of periodic annuity payments for the employee's life (or the joint lives of the employee and beneficiary) or over a period certain that does not exceed the maximum length of the period certain determined in accordance with paragraph (c) of this section. The interval between payments for the annuity must not exceed one year and, except as otherwise provided in this section, must be uniform over the entire distribution period. Once payments have commenced over a period, the period may only be changed in accordance with paragraph (n) of this section. Life (or joint and survivor) annuity payments must satisfy the minimum distribution incidental benefit requirements of paragraph (b) of this section. Except as otherwise provided in this section (for example, permitted increases described in paragraph (o) of this section), all payments (whether paid over an employee's life, joint lives, or a period certain) also must be nonincreasing.

(2) *Definition of life annuity.* An annuity described in this section may be a life annuity (or joint and survivor annuity) with a period certain, provided that the life annuity (or joint and survivor annuity, if applicable) and the period certain payments each meet the requirements of paragraph (a)(1) of this section. For purposes of this section, if distributions are permitted to be made over the lives of the employee and the designated beneficiary, references to a life annuity include a joint and survivor annuity.

(3) *Annuity commencement* —(i) *First payment and frequency.* Annuity payments must commence on or before the employee's required beginning date (within the meaning of § 1.401(a)(9)-2(b)). The first payment, which must be made on or before the employee's required beginning date, must be the payment that is required for one payment interval. The second payment need not be made until the end of the next payment interval even if that payment interval ends in the next calendar year. Similarly, if the employee dies before the required beginning date, and distributions are to be made in accordance with section 401(a)(9)(B)(iii) (or, if applicable, section 401(a)(9)(B)(iv)), then the first payment, which must be made on or before the last day of the calendar year following the calendar year in which the employee died (or the date determined under § 1.401(a)(9)-3(d), if applicable), must be the payment that is required for one payment interval. Payment intervals are the periods for which payments are received, for example, bimonthly, monthly, semi-annually, or annually. All benefit accruals as of the last day of the first distribution calendar year must be included in the calculation of the amount of annuity payments for payment intervals ending on or after the employee's required beginning date.

(ii) *Example.* A defined benefit plan (Plan X) provides monthly annuity payments for the life of unmarried participants with a 10-year period certain. An unmarried, retired participant A in Plan X attains age 73 in 2025. A's monthly annuity payment under this single life annuity based on accruals through December 31, 2025, is $500. In order to meet the requirements of this paragraph (a)(3), the first monthly payment of $500 must be made on behalf of A on or before April 1, 2026, and monthly payments must continue to be made thereafter for the life of A (or over the 10-year period certain, if longer).

(4) *Single-sum distributions* —(i) *In general.* In the case of a single-sum distribution of an employee's entire accrued benefit during a distribution calendar year, the portion of the distribution that is the required minimum distribution for the distribution calendar year (and thus not an eligible rollover distribution pursuant to section 402(c)(4)(B)) is determined using the rule in either paragraph (a)(4)(ii) or (iii) of this section.

(ii) *Treatment as individual account.* The portion of the single-sum distribution that is a required minimum distribution is determined by treating the single-sum-distribution as a distribution from an individual account plan and treating the amount of the single-sum distribution as the employee's account balance as of the end of the relevant valuation calendar year. If the single-sum distribution is being made in the calendar year that includes the required beginning date and the required minimum distribution for the employee's first distribution calendar year has not been distributed, the portion of the single-sum distribution that represents the required minimum distribution for the employee's first and second distribution calendar years is not eligible for rollover.

(iii) *Treatment as first annuity payment.* The portion of the single-sum distribution that is a required minimum distribution is permitted to be determined by expressing the employee's benefit as an annuity that would satisfy this section with an annuity starting date that is the first day of the distribution calendar year for which the required minimum distribution is being determined, and treating one year of annuity payments as the required minimum distribution for that year (and therefore, not an eligible rollover distribution). If the single-sum distribution is being made in the calendar year that includes the required beginning date, and the required minimum distribution for the employee's first distribution calendar year has not been made, then the benefit must be expressed as an annuity with an annuity starting date that is the first day of the first distribution calendar year, and the payments for the first two distribution calendar years are treated as required minimum distributions (and therefore not eligible rollover distributions).

(5) *Death benefits.* The rule in paragraph (a)(1) of this section prohibiting increasing payments under an annuity applies to payments made upon the death of an employee. However, the payment of an ancillary death benefit described in this paragraph (a)(5) may be disregarded in determining whether annuity payments are increasing, and it can be excluded in determining an employee's entire interest. A death benefit with respect to an employee's benefit is an ancillary death benefit for purposes of this paragraph (a) if—

(i) It is not paid as part of the employee's accrued benefit or under any optional form of the employee's benefit; and

(ii) The death benefit, together with any other potential payments with respect to the employee's benefit that may be provided to a survivor, satisfies the incidental benefit requirement of § 1.401-1(b)(1)(i).

(6) *Separate treatment of separate identifiable components.* If an employee's benefit under a defined benefit plan or annuity contract consists of separate identifiable components that are subject to different distribution elections, then the rules of this section may be applied separately to each of those components.

(7) *Additional guidance.* Additional guidance regarding how distributions under a defined benefit plan must be paid in order to satisfy section 401(a)(9) may be issued by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

(b) *Application of incidental benefit requirement* —(1) *Life annuity for employee.* If the employee's benefit is paid in the form of a life annuity for the life of the employee satisfying section 401(a)(9) without regard to the minimum distribution incidental benefit requirement under section 401(a)(9)(G) (MDIB requirement), then the MDIB requirement will be satisfied.

(2) *Joint and survivor annuity* —(i) *Determination of designated beneficiary.* If the employee's benefit is paid in the form of a life annuity for the lives of the employee and a designated beneficiary, then the designated beneficiary is determined as of the annuity starting date.

(ii) *Spouse beneficiary.* If the employee's sole beneficiary is the employee's spouse and the distributions satisfy section 401(a)(9) without regard to the MDIB requirement, the distributions to the employee will be deemed to satisfy the MDIB requirement. For example, if an employee's benefit is being distributed in the form of a joint and survivor annuity for the lives of the employee and the employee's spouse and the spouse is the sole beneficiary of the employee, the amount of the periodic payment payable to the spouse would not violate the MDIB requirement if it were 100 percent of the annuity payment payable to the employee, regardless of the difference in the ages between the employee and the employee's spouse.

(iii) *Joint and survivor annuity, non-spouse beneficiary.* If distributions commence in the form of a joint and survivor annuity for the lives of the employee and a beneficiary other than the employee's spouse, and the employee is the applicable age or older on the employee's birthday in the calendar year that includes the annuity starting date, then the MDIB requirement will not be satisfied as of the date distributions commence unless, under the distribution option, the annuity payments satisfy the conditions of this paragraph (b)(2)(iii). The periodic annuity payments to the survivor satisfy this paragraph (b)(2)(iii) only if, at any time on or after the employee's required beginning date, those payments do not exceed the applicable percentage of the periodic annuity

payment payable to the employee using the table in this paragraph (b)(2)(iii). The applicable percentage is based on the employee/ beneficiary age difference, which is equal to the excess of the age of the employee over the age of the beneficiary based on their ages on their birthdays in the calendar year that includes the annuity starting date. In the case of an annuity that provides for increasing payments, the requirement of this paragraph (b)(2)(iii) will not be violated merely because benefit payments to the beneficiary increase, provided the increase is determined in the same manner for the employee and the beneficiary. See paragraph (k)(2) of this section for rules regarding the application of the MDIB requirement in the case of annuity payments with an annuity starting date that is before the calendar year in which an employee attains the applicable age.

| Table 1 to Paragraph (b)(2)(iii) | |
|---|---|
| **Employee/beneficiary age difference** | **Applicable percentage** |
| 10 years or less | 100 |
| 11 | 96 |
| 12 | 93 |
| 13 | 90 |
| 14 | 87 |
| 15 | 84 |
| 16 | 82 |
| 17 | 79 |
| 18 | 77 |
| 19 | 75 |
| 20 | 73 |
| 21 | 72 |
| 22 | 70 |
| 23 | 68 |
| 24 | 67 |
| 25 | 66 |
| 26 | 64 |
| 27 | 63 |
| 28 | 62 |
| 29 | 61 |
| 30 | 60 |
| 31 | 59 |
| 32 | 59 |
| 33 | 58 |
| 34 | 57 |
| 35 | 56 |
| 36 | 56 |
| 37 | 55 |
| 38 | 55 |
| 39 | 54 |
| 40 | 54 |

| Table 1 to Paragraph (b)(2)(iii) | |
|---|---|
| **Employee/beneficiary age difference** | **Applicable percentage** |
| 41 | 53 |
| 42 | 53 |
| 43 | 53 |
| 44 and greater | 52 |

(3) *Period certain and annuity features.* If a distribution form includes a period certain, the amount of the annuity payments payable to the beneficiary need not be reduced during the period certain, but in the case of a joint and survivor annuity with a period certain, the amount of the annuity payments payable to the beneficiary must satisfy paragraph (b)(2)(iii) of this section after the expiration of the period certain.

(4) *Deemed satisfaction of incidental benefit rule.* Except in the case of distributions with respect to an employee's benefit that include an ancillary death benefit described in paragraph (a)(5) of this section, to the extent the incidental benefit requirement of § 1.401-1(b)(1)(i) requires a distribution, that requirement is deemed to be satisfied if distributions satisfy the MDIB requirement of this paragraph (b). If the employee's benefits include an ancillary death benefit described in paragraph (a)(5) of this section, the benefits (including the ancillary death benefit) must be distributed in accordance with the incidental benefit requirement described in § 1.401-1(b)(1)(i) and the benefits (excluding the ancillary death benefit) must also satisfy the MDIB requirement of this paragraph (b).

(c) *Period certain annuity* —(1) *Distributions commencing during the employee's life.* If the employee is the applicable age or older on the employee's birthday in the calendar year that includes the annuity starting date, then the period certain is not permitted to exceed the applicable denominator for the calendar year that includes the annuity starting date that would apply pursuant to § 1.401(a)(9)-5(c) if the plan were a defined contribution plan. However, that applicable denominator is determined taking into account the rules of § 1.401(a)(9)-5(c)(2) (relating to a spouse who is more than 10 years younger than the employee) only if the period certain is not provided in conjunction with a life annuity under paragraph (a)(2) of this section. See paragraph (k) of this section for the rule for annuity payments with an annuity starting date that is before the calendar year in which the employee attains the applicable age.

(2) *Distributions commencing after the employee's death.* If the employee dies before the required beginning date and annuity distributions commence after the death of the employee under the life expectancy rule (under section 401(a)(9)(B)(iii) or (iv)), the period certain for any distributions commencing after death may not exceed the applicable denominator that would apply pursuant to § 1.401(a)(9)-5(d)(2) for the calendar year that includes the annuity starting date if the plan were a defined contribution plan.

(d) *Use of annuity contract* —(1) *In general.* A plan will not fail to satisfy section 401(a)(9) merely because distributions are made from an annuity contract purchased from an insurance company that is licensed to do business under the laws of the State in which the contract is sold, provided that the payments satisfy the requirements of this section. Except in the case of a qualifying longevity annuity contract (QLAC) described in paragraph (q) of this section, if the annuity contract is purchased after the required beginning date, then the first payment interval must begin on or before the purchase date and the payment that is made at the end of that payment interval is the amount required for one payment interval. If the payments actually made under the annuity

contract do not meet the requirements of this section, the plan fails to satisfy section 401(a)(9). See also paragraph (o) of this section permitting certain increases under annuity contracts.

(2) *Applicability of section 401(a)(9)(H)* —(i) *Annuity contract subject to section 401(a)(9)(H).* If an annuity contract is purchased under a defined contribution plan, or the annuity contract is otherwise subject to section 401(a)(9)(H), payments under that annuity contract cannot extend past the calendar year described in § 1.401(a)(9)-5(e).

(ii) *Determination of an eligible designated beneficiary.* If an annuity contract is described in paragraph (d)(2)(i) of this section, then the determination of whether a beneficiary is an eligible designated beneficiary under section 401(a)(9)(E)(ii), is made as of the annuity starting date. For example, if, as of the annuity starting date, the employee's beneficiary under the contract is the employee's spouse, then the spouse is treated as an eligible designated beneficiary for purposes of applying the rules of section 401(a)(9)(H) even if the employee and spouse are subsequently divorced.

(e) *Treatment of additional accruals* —(1) *General rule.* If additional benefits accrue in a calendar year after the employee's first distribution calendar year, distribution of the amount that accrues in that later calendar year must commence in accordance with paragraph (a) of this section beginning with the first payment interval ending in the calendar year following the calendar year in which that amount accrues.

(2) *Administrative delay.* A plan will not fail to satisfy this section merely because there is an administrative delay in the commencement of the distribution of the additional benefits accrued in a calendar year, provided that—

(i) The payment commences no later than the end of the first calendar year following the calendar year in which the additional benefit accrues; and

(ii) The total amount paid during that first calendar year with respect to those additional benefits is no less than the total amount that was required to be paid during that year under paragraph (e)(1) of this section.

(f) *Treatment of nonvested benefits.* In the case of annuity distributions under a defined benefit plan, if any portion of the employee's benefit is not vested as of December 31 of a distribution calendar year, the portion that is not vested as of that date is treated as not having accrued for purposes of determining the required minimum distribution for that distribution calendar year. When an additional portion of the employee's benefit becomes vested, that portion will be treated as an additional accrual. See paragraph (e) of this section for the rules for distributing benefits that accrue under a defined benefit plan after the employee's first distribution calendar year.

(g) *Requirement for actuarial increase* —(1) *General rule* —(i) *Applicability of increase.* Except as otherwise provided in this paragraph (g), if an employee retires after the calendar year in which the employee attains age 70 1/2 , then, in order to satisfy section 401(a)(9)(C)(iii), the employee's accrued benefit under a defined benefit plan must be actuarially increased for the period (if any) from the start date described in paragraph (g)(1)(ii) of this section to the end date described in paragraph (g)(1)(iii) of this section.

(ii) *Start date for actuarial increase.* The start date for the required actuarial increase is April 1 following the calendar year in which the employee attains age 70 1/2 (or January 1, 1997, if the employee attained 70 1/2 prior to January 1, 1997).

(iii) *End date for actuarial increase.* The end date for the required actuarial increase is the date on which benefits commence after retirement in a form that satisfies paragraphs (a) and (h) of this section.

(iv) *Determination of when employee attains age 70 1/2 .* An employee attains age 70 1/2 as of the date six calendar months after the 70th anniversary of the employee's birth. For example, if the date of birth of an employee is June 30, 1955, the 70th anniversary of the employee's birth is June 30, 2025, and the employee attains age 70 1/2 in 2025. However, if the employee's date of birth is July 1, 1955, the 70th anniversary of the employee's birth is July 1, 2025, and the employee attains age 70 1/2 in 2026.

(2) *Nonapplication to 5-percent owners.* This paragraph (g) does not apply to an employee if that employee is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains the applicable age.

(3) *Nonapplication to governmental plans.* The actuarial increase required under this paragraph (g) does not apply to a governmental plan (within the meaning of section 414(d)).

(4) *Nonapplication to church plans and church employees* —(i) *Church plans.* The actuarial increase required under this paragraph (g) does not apply to a church plan. For purposes of this paragraph (g)(4)—

(A) The term *church plan* means a plan maintained by a church (as defined in section 3121(w)(3)(A)) or a qualified church-controlled organization (as defined in section 3121(w)(3)(B)) for its employees; and

(B) A plan is treated as a church plan only if at least 85 percent of the individuals covered by the plan are employees of a church or a qualified church-controlled organization.

(ii) *Determination of whether an individual is an employee of a church.* For purposes of this paragraph (g)(4), the determination of whether an individual is an employee of a church or a qualified church-controlled organization is made in accordance with the rules of section 414(e)(3)(B) other than section 414(e)(3)(B)(ii).

(iii) *Church employees covered in other plans.* If a plan is not a church plan within the meaning of paragraph (g)(4)(i) of this section, then the actuarial increase required under this paragraph (g) does not apply to benefits accrued under the plan by an individual that are attributable to the service the individual performs as an employee of a church or a qualified church-controlled organization (including service performed as an employee described in section 414(e)(3)(B)(i)).

(h) *Amount of actuarial increase* —(1) *In general.* In order to satisfy section 401(a)(9)(C)(iii), the retirement benefits payable with respect to an employee as of the end of the period for which actuarial increases must be provided as described in paragraph (g) of this section must be no less than—

(i) The actuarial equivalent of the employee's retirement benefits that would have been payable as of the start date described in paragraph (g)(1)(ii) of this section if benefits had commenced on that date; plus

(ii) The actuarial equivalent of any additional benefits accrued after that date; reduced by

(iii) The actuarial equivalent of any distributions made with respect to the employee's retirement benefits after that date.

(2) *Actuarial equivalence basis.* For purposes of this paragraph (h), actuarial equivalence is determined using reasonable actuarial assumptions. If the plan is subject to section 411, the plan's assumptions must be the same as the assumptions used for determining actuarial equivalence for purposes of satisfying section 411.

(3) *Coordination with section 411 actuarial increase.* Under section 411, in order for an employee's accrued benefit under a defined benefit plan to be nonforfeitable, the plan must make an actuarial adjustment to any portion of that accrued benefit, the payment of which is deferred past normal retirement age. The only exception to this rule is that, generally, no actuarial adjustment is required to reflect the period during which a benefit is suspended as permitted under section 411(a)(3)(B). The actuarial increase required under section 401(a)(9)(C)(iii) for the period (if any) described in paragraph (g)(1)(i) of this section generally is the same as, and not in addition to, the actuarial increase required for the same period under section 411 to reflect any delay in the payment of retirement benefits after normal retirement age. However, unlike the actuarial increase required under section 411, the actuarial increase required under section 401(a)(9)(C)(iii) must be provided even during any period during which an employee's benefit has been suspended in accordance with section 411(a)(3)(B).

(i) [Reserved]

(j) *Distributions restricted pursuant to section 436* —(1) *General rule.* If an employee's entire interest is being distributed in accordance with the 5-year rule of section 401(a)(9)(B)(ii), a plan is not treated as failing to satisfy section 401(a)(9) merely because of the application of a payment restriction under section 436(d), provided that distributions of the employee's interest commence by the end of the calendar year that includes the fifth anniversary of the date of the employee's death and, after the annuity starting date, those distributions are paid in a form that is as accelerated as permitted under section 436(d), as described in paragraph (j)(2) or (3) of this section.

(2) *Payments restricted under section 436(d)(3).* If the payment restriction of section 436(d)(3) applies at the time benefits commence under paragraph (j)(1) of this section, then distributions are made in a form that is as accelerated as permitted under section 436(d) if the benefits are paid in a single-sum payment equal to the maximum amount allowed under section 436(d)(3), with the remainder paid as a life annuity to the beneficiary (or over the course of 240 months pursuant to § 1.436-1(j)(6)(ii) in the case of a beneficiary that is not an individual), subject to a requirement that the benefit remaining is commuted to a single-sum payment when the section 436(d)(3) payment restriction ceases to apply (to the extent that a single-sum payment is permitted under section 436(d)(1) and (2)).

(3) *Payments restricted under section 436(d)(1) or (2).* If a plan is subject to the payment restriction in section 436(d)(1) or (2) at the time benefits commence under paragraph (j)(1) of this

section, then distributions are made in a form that is as accelerated as permitted under section 436(d) if the benefits are paid in the form of a life annuity to the beneficiary (or over the course of 240 months pursuant to § 1.436-1(j)(6)(ii), in the case of a beneficiary that is not an individual), subject to a requirement that the benefit remaining is commuted to a single-sum payment to the extent permitted under section 436(d) (for example, the maximum amount allowed under section 436(d)(3)) when the payment restriction under section 436(d)(1) or (2) ceases to apply.

(k) *Treatment of early commencement* —(1) *General rule.* Generally, the determination of whether a stream of payments satisfies the requirements of this section is made as of the required beginning date. However, if distributions start prior to the required beginning date in a distribution form that is an annuity under which distributions are made in accordance with the provisions of paragraph (a) of this section and are made over a period permitted under section 401(a)(9)(A)(ii), then, except as provided in this paragraph (k), the annuity starting date will be treated as the required beginning date for purposes of applying the rules of this section and § 1.401(a)(9)-2. Thus, for example, the determination of the designated beneficiary and the amount of distributions will be made as of the annuity starting date. Similarly, if the employee dies after the annuity starting date but before the required beginning date determined under § 1.401(a)(9)-2(b), then after the employee's death—

(i) The remaining portion of the employee's interest must continue to be distributed in accordance with this section over the remaining period over which distributions commenced; and

(ii) The rules in § 1.401(a)(9)-3 relating to death before the required beginning date do not apply.

(2) *Joint and survivor annuity, non-spouse beneficiary* —(i) *Application of MDIB requirement.* If distributions commence in the form of a joint and survivor annuity for the lives of the employee and a beneficiary other than the employee's spouse, and as of the employee's birthday in the calendar year that includes the annuity starting date, the employee is younger than the applicable age, then the MDIB requirement will not be satisfied as of the date distributions commence unless, under the distribution option, the annuity payments to be made on and after the employee's required beginning date satisfy the conditions of this paragraph (k)(2). The periodic annuity payments payable to the survivor satisfy this paragraph (k)(2) if, at all times on and after the employee's annuity starting date, those payments do not exceed the applicable percentage of the periodic annuity payment payable to the employee determined using the table in paragraph (b)(2)(iii) of this section (but based on the adjusted employee/beneficiary age difference). The adjusted employee/beneficiary age difference is determined by first calculating the employee/beneficiary age difference under paragraph (b)(2)(iii) of this section and then reducing that age difference by the number of years by which the employee is younger than the applicable age on the employee's birthday in the calendar year that includes the annuity starting date. In the case of an annuity that provides for increasing payments, the requirement of this paragraph (k)(2) will not fail to be satisfied merely because benefit payments to the beneficiary increase, provided the increase is determined in the same manner for the employee and the beneficiary.

(ii) *Example* —(A) *Facts.* Distributions under a defined benefit plan commence on January 1, 2025, to an employee Z, born March 1, 1958. Z's daughter Y, born February 5, 1989, is Z's beneficiary. The distributions are in the form of a joint and survivor annuity for the lives of Z and Y with payments of $500 a month to Z and upon Z's death of $500 a month to Y (so that the monthly payment to Y is 100 percent of the monthly amount payable to Z).

(B) *Analysis and conclusion.* Z's required beginning date is April 1, 2032 (that is, April 1 of the calendar year following the calendar year in which Z will attain age 73). Under paragraph (k)(1) of this section, because distributions commence prior to Z's required beginning date and are in the form of a joint and survivor annuity for the lives of Z and Y, compliance with the rules of this section is determined as of the annuity starting date. Under this paragraph (k)(2), the adjusted employee/beneficiary age difference is calculated by taking the excess of the employee's age over the beneficiary's age and subtracting the number of years the employee is younger than the applicable age (in this case, age 73). In 2025, Z attains age 67 and Y attains age 36. Accordingly, the employee/beneficiary age difference is 31. Because Z is commencing benefits 6 years before attaining the applicable age, the adjusted employee/beneficiary age difference is 25 years. Under table 1 to paragraph (b)(2)(iii) of this section, the applicable percentage for a 25-year adjusted employee/beneficiary age difference is 66 percent. The plan does not satisfy the MDIB requirement because, as of January 1, 2025 (the annuity starting date), the distribution option provides that, as of Z's required beginning date, the monthly payment to Y upon Z's death will exceed 66 percent of Z's monthly payment.

(3) *Limitation on period certain.* If, as of the employee's birthday in the calendar year that includes the annuity starting date, the employee is younger than the applicable age, then the period certain may not exceed the limitation on the period certain for an individual who has attained the applicable age as specified in paragraph (c)(1) of this section, increased by the number of years by which the employee is younger than the applicable age on that birthday.

(l) *Early commencement for surviving spouse.* Generally, the determination of whether a stream of payments satisfies the requirements of this section is made as of the date on which distributions are required to commence. However, if the employee dies prior to the required beginning date, distributions commence to the surviving spouse of an employee over a period permitted under section 401(a)(9)(B)(iii)(II) prior to the date on which distributions are required to commence, and the distribution form is an annuity under which distributions are made in accordance with the provisions of paragraph (a) of this section, then the annuity starting date will be considered the required beginning date for purposes of section 401(a)(9)(B)(iv)(III). Thus, if the surviving spouse dies after commencing benefits and before the date described in 401(a)(9)(B)(iv)(II), then after the surviving spouse's death—

(1) The rules in § 1.401(a)(9)-3(e)(1) relating to the death of the surviving spouse before the required beginning date under section 401(a)(9)(B)(iv)(III) will not apply upon the death of the surviving spouse; and

(2) The annuity distributions must continue to be made in accordance with paragraph (a) of this section over the remaining period over which distributions commenced.

(m) *Determination of entire interest under annuity contract* —(1) *General rule.* Prior to the date that an annuity contract under an individual account plan is annuitized, the interest of an employee or beneficiary under that contract is treated as an individual account for purposes of section 401(a)(9). Thus, the required minimum distribution for any year with respect to that interest is determined under § 1.401(a)(9)-5 rather than this section. See § 1.401(a)(9)-5(a)(5) for rules relating to the satisfaction of section 401(a)(9) in the year that annuity payments commence (including situations in which an annuity contract is purchased with a portion of an employee's account balance) and § 1.401(a)(9)-5(b)(4) for rules relating to QLACs (as defined in paragraph (q) of this section).

(2) *Entire interest.* For purposes of applying the rules in § 1.401(a)(9)-5, the entire interest under the annuity contract as of December 31 of the relevant valuation calendar year is treated as the account balance for the valuation calendar year described in § 1.401(a)(9)-5(c). The entire interest under an annuity contract is the dollar amount credited to the employee or beneficiary under the contract (that is, the notional account balance) plus the actuarial present value of any additional benefits (for example, survivor benefits in excess of the dollar amount credited to the employee or beneficiary) that will be provided under the contract. However, paragraph (m)(3) of this section describes certain additional benefits that may be disregarded in determining the employee's entire interest under the annuity contract. The actuarial present value of any additional benefits described under this paragraph (m) is to be determined using reasonable actuarial assumptions, including reasonable assumptions as to future distributions, and without regard to an individual's health.

(3) *Exclusions* —(i) *Additional value does not exceed 20 percent.* The actuarial present value of any additional benefits provided under an annuity contract described in paragraph (m)(2) of this section may be disregarded if the sum of the dollar amount credited to the employee or beneficiary under the contract and the actuarial present value of the additional benefits is no more than 120 percent of the dollar amount credited to the employee or beneficiary under the contract and the additional benefits are one or both of the following—

(A) Additional benefits that, in the case of a distribution, are reduced by an amount sufficient to ensure that the ratio of the sum to the dollar amount credited does not increase as a result of the distribution; and

(B) An additional benefit that is the right to receive a final payment upon death that does not exceed the amount by which the total consideration paid exceeds the amount of prior distributions.

(ii) *Return of premium death benefit.* If the only additional benefit provided under the contract is the additional benefit described in paragraph (m)(3)(i)(B) of this section, the additional benefit may be disregarded regardless of its value in relation to the dollar amount credited to the employee or beneficiary under the contract.

(iii) *Additional guidance.* The Commissioner, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter), may provide additional guidance on additional benefits that may be disregarded.

(4) *Examples.* The examples in this paragraph (m)(4), which use a 5 percent interest rate and the mortality table used for distributions subject to section 417(e)(3) provided in Notice 2019-67, 2019-52 IRB 1510, illustrate the application of the rules in this paragraph (m):

(i) *Example 1* —(A) *Facts.* G is the owner of a variable annuity contract (Contract S) under an individual account plan that has not been annuitized. Contract S provides a death benefit until the end of the calendar year in which the owner attains the age of 84 equal to the greater of the current Contract S notional account balance (dollar amount credited to G under the contract) and the largest notional account balance at any previous policy anniversary reduced proportionally for subsequent partial distributions (High Water Mark). Contract S provides a death benefit in calendar years after the calendar year in which the owner attains age 84 equal to the current notional account balance. Contract S provides that assets within the contract may be invested in a Fixed Account at a guaranteed rate of 2 percent. Contract S provides no other additional benefits.

(B) *Actuarial calculations.* At the end of 2028, when G has an attained age of 78 and 9 months, the notional account balance of Contract S (after the distribution for 2028 of 4.55 percent of the notional account balance as of December 31, 2027) is $550,000, and the High Water Mark, before adjustment for any withdrawals from Contract S in 2028, is $1,000,000. Thus, Contract S will provide additional benefits (that is, the death benefits in excess of the notional account balance) through 2034, the year S turns 84. The actuarial present value of these additional benefits at the end of 2028 is determined to be $67,978 (12 percent of the notional account balance). In making this determination, the following assumptions are made: on average, deaths occur mid-year; the investment return on G's notional account balance is 2 percent per annum; and minimum required distributions (determined without regard to additional benefits under the Contract S) are made at the end of each year. The following two tables summarize the actuarial methodology used in determining the actuarial present value of the additional benefit.

Table 2 to Paragraph (m)(4)(i)(B)

| Year | Death benefit during year | End-of-year notional account balance before withdrawal | Average notional account balance | Withdrawal at end of year | End-of-year notional account balance after withdrawal |
|---|---|---|---|---|---|
| 2028 | $1,000,000 | | | | $550,000 |
| 2029 | [1] 954,545 | [2] $561,000 | [3] $555,500 | [4] $26,606 | 534,934 |
| 2030 | 909,306 | 545,633 | 540,283 | 26,482 | 519,151 |
| 2031 | 864,291 | 529,534 | 524,342 | 26,760 | 502,774 |
| 2032 | 819,740 | 512,829 | 507,801 | 27,177 | 485,652 |
| 2033 | 775,430 | 495,365 | 490,509 | 27,438 | 467,927 |
| 2034 | 731,620 | 477,286 | 472,606 | 27,853 | 449,433 |

[1] $1,000,000 death benefit reduced 4.55 percent for withdrawal during 2028.

[2] Notional account balance at end of preceding year (after distribution) increased by 2 percent return for year.

[3] Average of $550,000 notional account balance at end of preceding year (after distribution) and $561,000 notional account balance at end of current year (before distribution).

[4] December 31, 2028 notional account balance (before distribution) divided by uniform lifetime table age 79 factor of 21.1.

Table 3 to Paragraph (m)(4)(i)(B)

| Year | Survivorship to start of year | Interest discount to end of 2028 | Mortality rate during year | Discounted additional benefits within year |
|---|---|---|---|---|
| 2028 | | | | |
| 2029 | 1.00000 | .97590 | [5] .03321 | 12,933 |
| 2030 | .96679 | [6] .92943 | .03739 | [7] 12,398 |
| 2031 | [8] .93064 | .88517 | .04198 | 11,756 |
| 2032 | .89157 | .84302 | .04715 | 11,055 |
| 2033 | .84953 | .80288 | .05305 | 10,310 |
| 2034 | .80446 | .76464 | .05979 | 9,526 |
| | | | | $67,978 |

[5] One-quarter age 78 rate plus three-quarters age 79 rate.

| Table 2 to Paragraph (m)(4)(i)(B) | | | | | |
|---|---|---|---|---|---|
| **Year** | **Death benefit during year** | **End-of-year notional account balance before withdrawal** | **Average notional account balance** | **Withdrawal at end of year** | **End-of-year notional account balance after withdrawal** |

[6] Five percent discounted 18 months ($1.05^{(-1.5)}$).

[7] Blended age 79/age 80 mortality rate (.03739) multiplied by the $369,023 excess of death benefit over the average notional account balance ($909,306 less $540,283) multiplied by .96679 probability of survivorship to the start of 2030 multiplied by 18-month interest discount of .92943.

[8] Survivorship to start of preceding year (.96679) multiplied by probability of survivorship during prior year (1−.03739).

(C) *Conclusion.* Because Contract S provides that, in the case of a distribution, the value of the additional death benefit (which is the only additional benefit available under the contract) is reduced by an amount that is at least proportional to the reduction in the notional account balance and, at age 78 and 9 months, the sum of the notional account balance (dollar amount credited to the employee under the contract) and the actuarial present value of the additional death benefit is no more than 120 percent of the notional account balance, the exclusion under paragraph (m)(3)(i) of this section applies for 2029. Therefore, for purposes of applying the rules in § 1.401(a)(9)-5, the entire interest under Contract S may be determined as the notional account balance (that is, without regard to the additional death benefit).

(ii) *Example 2*— (A) *Facts.* The facts are the same as in paragraph (m)(4)(i) of this section ( *Example 1*), except that the notional account balance is $550,000 at the end of 2028. In this instance, the actuarial present value of the death benefit in excess of the notional account balance in 2028 is determined to be $97,273 (24 percent of the notional account balance). The following two tables summarize the actuarial methodology used in determining the actuarial present value of the additional benefit.

| Table 4 to Paragraph (m)(4)(ii)(A) | | | | | |
|---|---|---|---|---|---|
| **Year** | **Death benefit during year** | **End-of-year notional account balance before withdrawal** | **Average notional account balance** | **Withdrawal at end of year** | **End-of-year notional account balance after withdrawal** |
| 2028 | $1,000,000 | | | | $400,000 |
| 2029 | 954,545 | $408,000 | $404,000 | $18,957 | 389,043 |
| 2030 | 909,306 | 396,824 | 392,933 | 19,260 | 377,564 |
| 2031 | 864,291 | 385,115 | 381,339 | 19,462 | 365,653 |
| 2032 | 819,740 | 372,966 | 369,310 | 19,765 | 353,201 |
| 2033 | 775,430 | 360,265 | 356,733 | 19,955 | 340,310 |
| 2034 | 731,620 | 347,116 | 343,713 | 20,257 | 326,859 |

| Table 5 to Paragraph (m)(4)(ii)(A) | | | | |
|---|---|---|---|---|
| **Year** | **Survivorship to start of year** | **Interest discount to end of 2028** | **Mortality rate during year** | **Discounted additional benefits within year** |
| 2028 | | | | |
| 2029 | 1.00000 | .97590 | .03321 | $17,843 |

| Table 4 to Paragraph (m)(4)(ii)(A) | | | | | |
|---|---|---|---|---|---|
| **Year** | **Death benefit during year** | **End-of-year notional account balance before withdrawal** | **Average notional account balance** | **Withdrawal at end of year** | **End-of-year notional account balance after withdrawal** |
| 2030 | .96679 | .92943 | .03739 | 17,349 | |
| 2031 | .93064 | .88517 | .04198 | 16,701 | |
| 2032 | .89157 | .84302 | .04715 | 15,963 | |
| 2033 | .84953 | .80288 | .05305 | 15,150 | |
| 2034 | .80446 | .76464 | .05979 | 14,267 | |
| | | | | $97,273 | |

(B) *Conclusion.* Because the sum of the notional account balance and the actuarial present value of the additional death benefit is more than 120 percent of the notional account balance, the exclusion under paragraph (m)(3)(i) of this section does not apply for 2029. Therefore, for purposes of applying the rules in § 1.401(a)(9)-5, the entire interest under Contract S must include the actuarial present value of the additional death benefit.

(n) *Change in annuity payment period* —(1) *In general.* An annuity payment period may be changed in accordance with the reannuitization provisions set forth in paragraph (n)(2) of this section or in association with an annuity payment increase described in paragraph (o) of this section.

(2) *Reannuitization.* If, in a stream of annuity payments that otherwise satisfies section 401(a)(9), the annuity payment period is changed and the annuity payments are modified in association with that change, this modification will not cause the distributions to fail to satisfy section 401(a)(9) provided the conditions set forth in paragraph (n)(3) of this section are satisfied, and—

(i) The modification occurs at the time that the employee retires or in connection with a plan termination;

(ii) The annuity payments prior to modification are annuity payments paid over a period certain without life contingencies; or

(iii) The annuity payments after modification are paid under a qualified joint and survivor annuity over the joint lives of the employee and a designated beneficiary, the employee's spouse is the sole beneficiary, and the modification occurs in connection with the employee becoming married to that spouse.

(3) *Conditions.* In order to modify a stream of annuity payments in accordance with paragraph (n)(2) of this section, the following conditions must be satisfied—

(i) The future payments under the modified stream satisfy section 401(a)(9) and this section (determined by treating the date of the change as a new annuity starting date and the actuarial present value of the remaining payments prior to modification as the entire interest of the participant);

(ii) For purposes of sections 415 and 417, the modification is treated as a new annuity starting date;

(iii) After taking into account the modification, the annuity stream satisfies section 415 (determined at the original annuity starting date, using the interest rates and mortality tables applicable as of that date); and

(iv) The end point of the period certain, if any, for any modified payment period is not later than the end point available under section 401(a)(9) to the employee at the original annuity starting date.

(4) *Examples.* For the purposes of the examples in this paragraph (n)(4), assume that the applicable segment rates under section 417(e)(3) are 5.00 percent, 5.50 percent, and 6.00 percent, and the applicable mortality table under section 417(e)(3) is the mortality table provided in Notice 2023-73, 2023-45 IRB 232. In addition, assume that the section 415 limit at age 72 for a straight life annuity is $306,667 (which is the lesser of the annual benefit under section 415(b)(1)(A), as adjusted pursuant to section 415(d) and further adjusted for age 72 in accordance with § 1.415(b)-1(e)(1)(i), and 100 percent of the participant's average compensation for the participant's high 3 years):

(i) *Example 1* —(A) *Facts* —( *1*) *Background.* Participant D has 10 years of participation in a frozen defined benefit plan (Plan W). D is not retired and elects to receive distributions from Plan W in the form of a straight life annuity with annual payments of $310,000 per year beginning in 2025 at a date when D has an attained age of 72. Plan W offers non-retired employees in pay status the opportunity to modify their annuity payments due to an associated change in the payment period at retirement. Plan W treats the date of the change in payment period as a new annuity starting date for purposes of sections 415 and 417. Thus, for example, the plan provides a new qualified and joint survivor annuity election and obtains spousal consent. Plan W determines modifications of annuity payment amounts at retirement so that the present value of future new annuity payment amounts (taking into account the new associated payment period) is actuarially equivalent to the present value of future pre-modification annuity payments (taking into account the pre-modification annuity payment period). Actuarial equivalency for this purpose is determined using the applicable segment rates under section 417(e)(3)(C) and the applicable mortality table as of the date of modification.

( *2*) *Payment of retirement benefits to Participant D.* D retires in 2029 at the age of 76 and, after receiving four annual payments of $310,000, elects to receive the remaining distributions from Plan W in the form of an immediate final lump sum payment of $2,795,732. Because payment of retirement benefits in the form of an immediate final lump sum payment satisfies (in terms of form) section 401(a)(9), the condition under paragraph (n)(3)(i) of this section is met.

(B) *Analysis.* Because Plan W treats a modification of an annuity payment stream at retirement as a new annuity starting date for purposes of sections 415 and 417, the condition under paragraph (n)(3)(ii) of this section is met. After taking into account the modification, the annuity stream determined as of the original annuity starting date consists of annual payments beginning at age 72 of $310,000, $310,000, $310,000, $310,000, and $2,795,732. This benefit stream is actuarially equivalent to a straight life annuity at age 72 of $315,145, calculated in accordance with section 415(b)(2)(E)(ii), which is an amount less than the section 415 limit determined at the original annuity starting date. Thus, the condition under paragraph (n)(3)(iii) of this section is met.

In addition, because the modified payment period does not include a period certain, paragraph (n)(3)(iv) of this section does not apply.

(C) *Conclusion.* Because a stream of annuity payments in the form of a straight life annuity satisfies section 401(a)(9), and because each of the conditions under paragraph (n)(3) of this section are satisfied, the modification of annuity payments to D described in this example meets the requirements of this paragraph (n).

(ii) *Example 2* —(A) *Facts.* The facts are the same as in paragraph (n)(4)(i) of this section ( *Example 1*), except that the straight life annuity payments are paid at a rate of $330,000 per year and, after D retires, the lump sum payment at age 76 is $2,976,102. Thus, after taking into account the modification, the annuity stream determined as of the original annuity starting date consists of annual payments beginning at age 72 of $330,000, $330,000, $330,000, $330,000, and $2,976,102.

(B) *Conclusion.* The benefit stream described in paragraph (n)(4)(ii)(A) of this section is actuarially equivalent to a straight life annuity at age 72 of $335,477, calculated in accordance with section 415(b)(2)(E)(ii), which exceeds the section 415 limit determined at the original annuity starting date. Thus, the lump sum payment to D fails to satisfy the condition under paragraph (n)(3)(iii) of this section. Therefore, the lump sum payment to D fails to meet the requirements of this paragraph (n) and fails to satisfy the requirements of section 401(a)(9).

(iii) *Example 3* —(A) *Facts* —( *1*) *Background.* Participant E has 10 years of participation in Plan X, a frozen defined benefit plan. E retires in 2025 at a date when E's attained age is 72. E elects to receive annual distributions from Plan X in the form of a 27-year period certain annuity (that is, a 27-year annuity payment period without a life contingency) paid at a rate of $37,000 per year beginning in 2025 with future payments increasing at a rate of 4.00 percent per year (that is, the 2026 payment will be $38,480, the 2027 payment will be $40,019 and so on). Plan X offers participants in pay status whose annuity payments are in the form of a term-certain annuity the opportunity to modify their payment period at any time and treats the modifications as a new annuity starting date for the purposes of sections 415 and 417. Thus, for example, the plan provides a new qualified and joint survivor annuity election and obtains spousal consent.

( *2*) *Plan provisions for determination of actuarial equivalence.* Plan X determines modifications of annuity payment amounts so that the present value of future new annuity payment amounts (taking into account the new associated payment period) is actuarially equivalent to the present value of future pre-modification annuity payments (taking into account the pre-modification annuity payment period). Actuarial equivalency for this purpose is determined using 5.00 percent and the applicable mortality table as of the date of modification.

( *3*) *Modification of retirement benefits paid to Participant E.* In 2028, E, after receiving annual payments of $37,000, $38,480, and $40,019, elects to receive the remaining distributions from Plan W in the form of a straight life annuity paid with annual payments of $92,133 per year.

(B) *Analysis.* Because payment of retirement benefits in the form of a straight life annuity satisfies (in terms of form) section 401(a)(9), the condition under paragraph (n)(3)(i) of this section is met. Because Plan X treats a modification of an annuity payment stream at retirement as a new annuity starting date for purposes of sections 415 and 417, the condition under paragraph (n)(3)(ii) of this section is met. After taking into account the modification, the annuity stream determined as of the original annuity starting date consists of annual payments beginning at age 72 of $37,000,

$38,480, and $40,019, and a straight life annuity beginning at age 75 of $92,133. This benefit stream is actuarially equivalent to a straight life annuity at age 72 of $81,924, calculated in accordance with section 415(b)(2)(E)(i), which is an amount less than the section 415 limit determined at the original annuity starting date. Thus, the condition under paragraph (n)(3)(iii) of this section is met. In addition, because the modified payment period does not include a period certain, paragraph (n)(3)(iv) of this section does not apply.

(C) *Conclusion.* Because a stream of annuity payments in the form of a straight life annuity satisfies section 401(a)(9), and each of the conditions under paragraph (n)(3) of this section are satisfied, the modification of annuity payments to E meets the requirements of this paragraph (n).

(o) *Increase in annuity payments* —(1) *General rules.* Notwithstanding the general rule under paragraph (a)(1) of this section prohibiting increases in annuity payments, the following increases in annuity payments are permitted—

(i) An annual percentage increase that does not exceed the percentage increase in an eligible cost-of-living index (as defined in paragraph (o)(2) of this section) for a 12-month period ending in the year during which the increase occurs or the prior year;

(ii) A percentage increase that occurs at specified times (for example, at specified ages) and does not exceed the cumulative total of annual percentage increases in an eligible cost-of-living index (as defined in paragraph (o)(2) of this section) after the annuity starting date, or if later, the date of the most recent percentage increase;

(iii) An increase by a constant percentage, applied not less frequently than annually, at a rate that is less than 5 percent per year;

(iv) An increase eliminating some or all of the reduction in the amount of the employee's payments to provide for a survivor benefit, but only if there is no longer a survivor benefit because the beneficiary whose life was being used to determine the period described in section 401(a)(9)(A)(ii) over which payments were being made dies or is no longer the employee's beneficiary pursuant to a qualified domestic relations order within the meaning of section 414(p);

(v) An increase to pay increased benefits that result from a plan amendment;

(vi) An increase to allow a beneficiary to convert the survivor portion of a joint and survivor annuity into a single-sum distribution upon the employee's death;

(vii) An increase to the extent permitted in accordance with paragraph (o)(3) or (4); or

(viii) An increase resulting from the resumption of benefits that were suspended pursuant to section 411(a)(3)(B), 418E, or 432(e)(9).

(2) *Eligible cost of living index* —(i) *In general.* For purposes of this paragraph (o), an eligible cost-of-living index means an index described in paragraph (o)(2)(ii), (iii), or (iv) of this section.

(ii) *Consumer price index.* An index is described in this paragraph (o)(2)(ii) if it is a consumer price index that is based on prices of all items (or all items excluding food and energy) and issued by the Bureau of Labor Statistics, including an index for a specific population (for example, urban

consumers or urban wage earners and clerical workers) and an index for a geographic area or areas (for example, a metropolitan area or State).

(iii) *Consumer price index with banking.* An index is described in this paragraph (o)(2)(iii) if it is a percentage adjustment based on a cost-of-living index described in paragraph (o)(2)(ii) of this section, or a fixed percentage if less. In any year when the cost-of-living index is lower than the fixed percentage, the fixed percentage may be treated as an increase in an eligible cost-of-living index, provided it does not exceed the sum of—

(A) The cost-of-living index for that year, and

(B) The accumulated excess of the annual cost-of-living index from each prior year over the fixed annual percentage used in that year (reduced by any amount previously utilized under this paragraph (o)(2)(iii)(B)).

(iv) *Adjustment based on compensation for position.* An index is described in this paragraph (o)(2)(iv) if it is a percentage adjustment based on the increase in compensation for the position held by the employee at the time of retirement, and provided under either—

(A) The terms of a governmental plan (within the meaning of section 414(d)), or

(B) The terms of a nongovernmental plan, as in effect on April 17, 2002.

(3) *Additional permitted increases for annuity contracts purchased from insurance companies.* Payments made from an annuity contract purchased from an insurance company will not fail to satisfy the nonincreasing payment requirement in paragraph (a)(1) of this section merely because the payments are increased in accordance with one or more of the following—

(i) As a result of dividend payments or other payments that result from actuarial gains (within the meaning of paragraph (o)(5) of this section), but only if—

(A) Actuarial gain is measured no less frequently than annually;

(B) The resulting dividend payments or other payments are either paid no later than the year following the year for which the actuarial experience is measured or paid in the same form as the payment of the annuity over the remaining period of the annuity (beginning no later than the year following the year for which the actuarial experience is measured); and

(C) The issuer of the contract uses reasonable actuarial methods and assumptions, as determined in good faith, when calculating the initial annuity payments, the issuer's experience with respect to those factors, and the amount of the dividend payments or other payments;

(ii) As a result of a shortening of the payment period with respect to the annuity or a full or partial commutation of the future annuity payments, provided that the amount of the payment pursuant to the commutation is determined using reasonable actuarial methods and assumptions, as determined in good faith by the issuer of the contract.

(iii) To provide a final payment upon death that does not exceed the amount by which the total consideration paid for the contract exceeds the aggregate amount of prior distributions under the contract; or

(iv) To provide a short-term advance of payments under the annuity, under which annuity payments that would otherwise satisfy the requirements of this section are paid up to one year before the payments were scheduled to be made.

(4) *Additional permitted increases for annuity payments from a qualified trust.* Annuity payments made under a defined benefit plan qualified under section 401(a) (including payments under an annuity contract purchased from an insurance company that provides the same benefits that would have been payable under the defined benefit plan if an annuity contract had not been purchased, but not an annuity contract that provides other benefits) will not fail to satisfy the nonincreasing payment requirement in paragraph (a)(1) of this section merely because the payments are increased in accordance with one of the following—

(i) As a result of dividend payments or other payments that result from actuarial gains (within the meaning of paragraph (o)(5) of this section), but only if—

(A) The actuarial gain is measured no less frequently than annually;

(B) The resulting dividend payments or other payments are either paid no later than the year following the year for which the actuarial experience is measured or paid in the same form as the annuity over the remaining period of the annuity (beginning no later than the year following the year for which the actuarial experience is measured);

(C) The actuarial gain taken into account is limited to the actuarial gain from investment experience;

(D) The assumed interest used to calculate actuarial gains is not less than 3 percent; and

(E) The payments are not increasing by a constant percentage as described in paragraph (o)(1)(iii) of this section; or

(ii) To provide a final payment upon the death of the employee that does not exceed the excess of the actuarial present value of the employee's accrued benefit (within the meaning of section 411(a)(7)) calculated as of the annuity starting date using the applicable interest rate and the applicable mortality table under section 417(e) (or, if greater, the total amount of employee contributions plus interest) over the total of payments before the death of the employee.

(5) *Actuarial gain defined.* For purposes of this paragraph (o), actuarial gain means the difference between an amount determined using the actuarial assumptions (that is, investment return, mortality, expense, and other similar assumptions) used to calculate the initial payments before adjustment for any increases and the amount determined under the actual experience with respect to those factors. Actuarial gain also includes differences between the amount determined using actuarial assumptions when an annuity was purchased or commenced, and the amount determined using actuarial assumptions used in calculating payments at the time the actuarial gain is determined.

(6) *Examples.* This paragraph (o) is illustrated by the following examples.

(i) *Example 1. Variable annuity* —(A) *Facts.* A retired participant Z1 in Plan X, a defined contribution plan, attains age 72 in 2021. Z1 elects to purchase Contract Y1 from Insurance Company W in 2025. Contract Y1 is a single life annuity contract with a 10-year period certain. Contract Y1 provides for an initial annual payment calculated with an assumed interest rate (AIR) of 3 percent, which is assumed for purposes of this example to be a reasonable interest rate selected in good faith. Subsequent payments are determined by multiplying the prior year's payment by a fraction, the numerator of which is 1 plus the actual return on the separate account assets underlying Contract Y1 since the preceding payment (which is reasonably determined in good faith) and the denominator of which is 1 plus the AIR during that period.

(B) *Analysis.* Under paragraph (o)(3)(i) of this section, payments made from an annuity contract purchased from an insurance company will not fail to satisfy the nonincreasing payment requirement on account of payment increases that result from actuarial gains (within the meaning of paragraph (o)(5) of this section), if the conditions set forth in paragraphs (o)(3)(i)(A) through (C) of this section are satisfied. The payment increases under Contract Y1 are the result of actuarial gain within the meaning of paragraph (o)(5) of this section because they are the result of the difference between investment experience and the 3 percent interest rate used to calculate the initial payments under Contract Y1. Contract Y1 satisfies the requirement of paragraph (o)(3)(i)(A) of this section because actuarial gain under Contract Y1 is measured annually. Contract Y1 satisfies the requirement of paragraph (o)(3)(i)(B) of this section because the actuarial gains are paid over the remaining period of the annuity beginning in the year following the year for which the actuarial experience is measured. Contract Y1 satisfies the requirement of paragraph (o)(3)(i)(C) of this section because the issuer of Contract Y1 used reasonable actuarial methods and assumptions, as determined in good faith, when calculating the initial annuity payments, the issuer's experience with respect to those factors, and the amount of adjustments under Contract Y1.

(C) *Conclusion.* Because payments under Contract Y1 increase only as a result of actuarial gain, and those increases satisfy the conditions set forth in paragraphs (o)(3)(i)(A) through (C) of this section, those increases are described in paragraph (o)(3)(i) of this section and therefore are excepted from the nonincreasing payment requirement of paragraph (a)(1) of this section pursuant to the exception under paragraph (o)(1)(vii) of this section.

(ii) *Example 2. Participating annuity* —(A) *Facts.* A retired participant Z2 in Plan X, a defined contribution plan, attains age 73 in 2025. Z2 elects to purchase Contract Y2 from Insurance Company W in 2025. Contract Y2 is a participating single life annuity contract with a 10-year period certain. Contract Y2 provides for level annual payments with dividends paid in a lump sum in the year after the year for which the actuarial experience is measured or paid out levelly beginning in the year after the year for which the actuarial gain is measured over the remaining lifetime and period certain (that is, the period certain ends at the same time as the original period certain). Dividends are determined annually by the Board of Directors of Company W based upon a comparison of actual actuarial experience to expected actuarial experience in the past year, with those amounts determined on a reasonable basis in good faith. The initial payment was determined in good faith using reasonable actuarial assumptions and methods.

(B) *Analysis.* Under paragraph (o)(3)(i) of this section, payments made from an annuity contract purchased from an insurance company will not fail to satisfy the nonincreasing payment requirement on account of payment increases that result from actuarial gains (within the meaning of paragraph (o)(5) of this section), if the conditions set forth in paragraphs (o)(3)(i)(A) through (C) of this section are satisfied. The payment increases under Contract Y2 are the result of

actuarial gain within the meaning of paragraph (o)(5) of this section. Contract Y2 satisfies the requirement of paragraph (o)(3)(i)(A) of this section because actuarial gain under Contract Y2 is measured annually. Contract Y2 satisfies the requirement of paragraph (o)(3)(i)(B) of this section because the resulting increases are paid either in the form of a lump sum or over the remaining period of the annuity beginning in the year following the year for which the actuarial experience is measured. Contract Y2 satisfies the requirement of paragraph (o)(3)(i)(C) of this section because the issuer of Contract Y2 used reasonable actuarial methods and assumptions, as determined in good faith, when calculating the initial annuity payments, the issuer's experience with respect to those factors, and the amount of adjustments under Contract Y2.

(C) *Conclusion.* Because payments under Contract Y2 increase only as a result of actuarial gain, and those increases satisfy the conditions set forth in paragraphs (o)(3)(i)(A) through (C) of this section, those increases are described in paragraph (o)(3)(i) of this section and therefore are excepted from the nonincreasing payment requirement of paragraph (a)(1) of this section pursuant to the exception under paragraph (o)(1)(vii) of this section.

(iii) *Example 3. Participating annuity with dividend accumulation* —(A) *Facts.* The facts are the same as in paragraph (o)(6)(ii) of this section ( *Example 2*), except that the annuity provides a dividend accumulation option under which Z2 may defer receipt of the dividends to a time selected by Z2.

(B) *Conclusion.* Because the dividend accumulation option permits dividends to be paid commencing later than the end of the year following the year for which the actuarial experience is measured, the dividend accumulation option does not meet the requirements of paragraph (o)(3)(i)(B) of this section. Neither does the dividend accumulation option fit within any of the other permissible increases described in paragraph (o)(3) of this section. Accordingly, payment increases pursuant to the dividend accumulation option are not excepted from the nonincreasing payment requirement of paragraph (a)(1) of this section pursuant to the exception under paragraph (o)(1)(vii) of this section. Thus, Contract Y2, and consequently any distributions from the contract, fail to meet the requirements of this paragraph (o) and thus to fail to satisfy the requirements of section 401(a)(9).

(iv) *Example 4. Participating annuity with dividends used to purchase additional death benefits* — (A) *Facts.* The facts are the same as in paragraph (o)(6)(ii) of this section ( *Example 2*), except that the annuity provides an option under which actuarial gain under the contract is used to provide additional death benefit protection for Z2.

(B) *Conclusion.* Because this option permits payments as a result of actuarial gain to be paid commencing later than the end of the year following the year for which the actuarial experience is measured, the option does not meet the requirements of paragraph (o)(3)(i)(B) of this section. Neither does the option fit within any of the other permissible increases described in paragraph (o)(3) of this section. Accordingly, payment increases pursuant to the dividend accumulation option are not excepted from the nonincreasing payment requirement of paragraph (a)(1) of this section pursuant to the exception under paragraph (o)(1)(vii) of this section. Thus, Contract Y2, and consequently any distributions from the contract, fail to meet the requirements of this paragraph (o) and thus to fail to satisfy the requirements of section 401(a)(9).

(p) *Payments to children* —(1) *In general.* Payments under a defined benefit plan or annuity contract that are made to an employee's child until the child reaches the age of majority as provided in paragraph (p)(2) of this section (or dies, if earlier) may be treated, for purposes of

section 401(a)(9), as if the payments under the defined benefit plan or annuity contract were made to the surviving spouse to the extent they become payable to the surviving spouse upon cessation of the payments to the child. Thus, when payments described in this paragraph (p)(1) become payable to the surviving spouse because the child attains the age of majority, there is not an increase in benefits under paragraph (a) of this section. Likewise, the age of the child receiving the payments described in this paragraph (p)(1) is not taken into consideration for purposes of the MDIB requirement of paragraph (b) of this section.

(2) *Age of majority* —(i) *General rule.* Except as provided in paragraph (p)(2)(ii) of this section, the determination of when an employee's child attains the age of majority is made under the rules of § 1.401(a)(9)-4(e)(3).

(ii) *Exception for preexisting plan terms.* A defined benefit plan may apply a definition of the age of majority other than the definition in paragraph (p)(2)(i) of this section, but only if the plan terms regarding the age of majority—

(A) Were adopted on or before February 24, 2022; and

(B) Met the requirements of A-15 of 26 CFR 1.401(a)(9)-6 (as it appeared in the April 1, 2021, edition of 26 CFR part 1).

(q) *Qualifying longevity annuity contract* —(1) *Definition of qualifying longevity annuity contract.* A qualifying longevity annuity contract (QLAC) is an annuity contract described in paragraph (d) of this section that is purchased from an insurance company for an employee and that, in accordance with the rules of application of paragraph (q)(4) of this section, satisfies each of the following requirements—

(i) Premiums for the contract satisfy the limitations of paragraph (q)(2) of this section;

(ii) The contract provides that distributions under the contract must commence not later than a specified annuity starting date that is no later than the first day of the month next following the 85th anniversary of the employee's birth;

(iii) The contract provides that, after distributions under the contract commence, those distributions must satisfy the requirements of this section (other than the requirement in paragraph (a)(3) of this section that annuity payments commence on or before the required beginning date);

(iv) After the required beginning date, the contract does not make available any commutation benefit, cash surrender right, or other similar feature (other than a right to rescind the contract within a period not exceeding 90 days from the date of purchase);

(v) No benefits are provided under the contract after the death of the employee other than the benefits described in paragraph (q)(3) of this section;

(vi) When the contract is issued (or December 31, 2016, if later), the contract (or a rider or endorsement with respect to that contract) states that the contract is intended to be a QLAC; and

(vii) The contract is not a variable contract under section 817, an indexed contract, or a similar contract, except to the extent provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter).

(2) *Limitation on premiums* —(i) *In general.* The premiums paid with respect to the contract on a date (premium payment date) satisfy the limitation of this paragraph (q)(2) if they do not exceed the dollar limitation of paragraph (q)(2)(ii) of this section.

(ii) *Dollar limitation.* The dollar limitation as of a premium payment date is an amount by which $200,000 (as adjusted under paragraph (q)(4)(ii)(A) of this section), exceeds the sum of—

(A) The premiums paid before that date with respect to the contract, and

(B) The premiums paid on or before that date with respect to any other contract that is intended to be a QLAC and that is purchased for the employee under the plan, or any other plan, annuity, or account described in section 401(a), 403(a), 403(b), or 408 or eligible governmental plan under section 457(b).

(iii) *Exchange of insurance contract for QLAC.* For purposes of this paragraph (q)(2), if an insurance contract is exchanged for a contract intended to be a QLAC, the fair market value of the exchanged contract will be treated as a premium paid for the QLAC. However, if an insurance contract is surrendered for its cash value, the surrender extinguishes all benefits and other characteristics of the contract, and the cash is used to purchase a QLAC, then only the cash from the surrendered contract is treated as a premium paid for the QLAC.

(3) *Payments after death of the employee* —(i) *Surviving spouse is sole beneficiary* —(A) *Death on or after annuity starting date.* If the employee dies on or after the annuity starting date for the contract and the employee's surviving spouse is the sole beneficiary under the contract then, except as provided in paragraph (q)(3)(iv) of this section, the only benefit permitted to be paid after the employee's death is a life annuity payable to the surviving spouse under which the periodic annuity payment does not exceed 100 percent of the periodic annuity payment that was payable to the employee.

(B) *Death before annuity starting date.* If the employee dies before the annuity starting date and the employee's surviving spouse is the sole beneficiary under the contract, then, except as provided in paragraph (q)(3)(iv) of this section, the only benefit permitted to be paid after the employee's death is a life annuity payable to the surviving spouse under which the periodic annuity payment does not exceed 100 percent of the periodic annuity payment that would have been payable to the employee as of the date that benefits to the surviving spouse commence. However, the annuity is permitted to exceed 100 percent of the periodic annuity payment that would have been payable to the employee to the extent necessary to satisfy the requirement to provide a qualified preretirement survivor annuity (as defined under section 417(c)(2) of the Code or section 205(e)(2) of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 88 Stat. 829, as amended (ERISA), pursuant to section 401(a)(11)(A)(ii) of the Code or section 205(a)(2) of ERISA). Any life annuity payable to the surviving spouse under this paragraph (q)(3)(i)(B) must commence no later than the date on which the annuity payable to the employee would have commenced under the contract if the employee had not died.

(ii) *Surviving spouse is not sole beneficiary* —(A) *Death on or after annuity starting date.* If the employee dies on or after the annuity starting date for the contract and the employee's surviving

spouse is not the sole beneficiary under the contract then, except as provided in paragraph (q)(3)(iv) of this section, the only benefit permitted to be paid after the employee's death is a life annuity payable to the designated beneficiary under which the periodic annuity payment does not exceed the applicable percentage (determined under paragraph (q)(3)(iii) of this section) of the periodic annuity payment that is payable to the employee.

(B) *Death before annuity starting date.* If the employee dies before the annuity starting date and the employee's surviving spouse is not the sole beneficiary under the contract, then, except as provided in paragraph (q)(3)(iv) of this section, the only benefit permitted to be paid after the employee's death is a life annuity payable to the designated beneficiary under which the periodic annuity payment is not in excess of the applicable percentage (determined under paragraph (q)(3)(iii) of this section) of the periodic annuity payment that would have been payable to the employee as of the date that benefits to the designated beneficiary commence under this paragraph (q)(3)(ii)(B). In any case in which the employee dies before the annuity starting date, any life annuity payable to a designated beneficiary under this paragraph (q)(3)(ii)(B) must commence by the last day of the calendar year following the calendar year of the employee's death.

(C) *Designated beneficiary who is not an eligible designated beneficiary.* Benefits paid to a designated beneficiary under this paragraph (q)(3)(ii) must satisfy the rules of section 401(a)(9)(H) and paragraph (d)(2) of this section.

(iii) *Applicable percentage* —(A) *Contracts without pre-annuity starting date death benefits.* If, as described in paragraph (q)(3)(iii)(E) of this section, the contract does not provide for a pre-annuity starting date non-spousal death benefit, the applicable percentage is the percentage described in the table in paragraph (b)(3) of this section.

(B) *Contracts with set beneficiary designation.* If the contract provides for a set non-spousal beneficiary designation as described in paragraph (q)(3)(iii)(F) of this section (and is not a contract described in paragraph (q)(3)(iii)(E) of this section), the applicable percentage is the percentage described in table 6 to paragraph (q)(3)(iii)(D).

(C) *Contracts providing for return of premium.* If the contract provides for a return of premium as described in paragraph (q)(3)(v) of this section, the applicable percentage is 0.

(D) *Applicable percentage table.* The applicable percentage is the percentage specified in following table for the adjusted employee/beneficiary age difference, determined in the same manner as in paragraph (b)(2)(iii) of this section.

Table 6 to Paragraph (q)(3)(iii)(D)

| Adjusted employee/beneficiary age difference | Applicable percentage |
|---|---|
| 2 years or less | 100 |
| 3 | 88 |
| 4 | 78 |
| 5 | 70 |
| 6 | 63 |
| 7 | 57 |
| 8 | 52 |

| Table 6 to Paragraph (q)(3)(iii)(D) | |
|---|---|
| **Adjusted employee/beneficiary age difference** | **Applicable percentage** |
| 9 | 48 |
| 10 | 44 |
| 11 | 41 |
| 12 | 38 |
| 13 | 36 |
| 14 | 34 |
| 15 | 32 |
| 16 | 30 |
| 17 | 28 |
| 18 | 27 |
| 19 | 26 |
| 20 | 25 |
| 21 | 24 |
| 22 | 23 |
| 23 | 22 |
| 24 | 21 |
| 25 and greater | 20 |

(E) *No pre-annuity starting date non-spousal death benefit.* A contract is described in this paragraph (q)(3)(iii)(E) if the contract provides that no benefit may be paid to a beneficiary other than the employee's surviving spouse after the employee's death—

( *1*) In any case in which the employee dies before the annuity starting date under the contract; and

( *2*) In any case in which the employee selects an annuity starting date that is earlier than the specified annuity starting date under the contract and the employee dies less than 90 days after making that election.

(F) *Contracts permitting set non-spousal beneficiary designation.* A contract provides for a set non-spousal beneficiary designation as described in this paragraph (q)(3)(iii)(F) if the contract provides that, if the beneficiary under the contract is not the employee's surviving spouse, then benefits are payable to the beneficiary only if the beneficiary was irrevocably designated on or before the later of the date of purchase and the employee's required beginning date. A contract does not fail to be described in the preceding sentence merely because the surviving spouse becomes the sole beneficiary before the annuity starting date. In those circumstances, the requirements of paragraph (q)(3)(i) of this section apply and not the requirements of this paragraph (q)(3)(iii).

(iv) *Calculation of early annuity payments.* For purposes of paragraphs (q)(3)(i)(B) and (ii)(B) of this section, to the extent the contract does not provide an option for the employee to select an annuity starting date that is earlier than the date on which the annuity payable to the employee would have commenced under the contract if the employee had not died, the contract must

provide a way to determine the periodic annuity payment that would have been payable if the employee were to have an option to accelerate the payments and the payments had commenced to the employee immediately prior to the date that benefit payments to the surviving spouse or designated beneficiary commence.

(v) *Return of premiums* —(A) *In general.* In lieu of a life annuity payable to a designated beneficiary under paragraph (q)(3)(i) or (ii) of this section, a QLAC may provide for a benefit to be paid to a beneficiary after the death of the employee up to the amount by which the premium payments made with respect to the QLAC exceed the payments already made under the QLAC.

(B) *Payments after death of surviving spouse.* If a QLAC is providing a life annuity to a surviving spouse (or will provide a life annuity to a surviving spouse) under paragraph (q)(3)(i) of this section, it may also provide for a benefit payable to a beneficiary after the death of both the employee and the spouse up to the amount by which the premium payments made with respect to the QLAC exceed the payments already made under the QLAC.

(C) *Timing of return of premium payment and other rules.* A return of premium payment under this paragraph (q)(3)(v) must be paid no later than the end of the calendar year following the calendar year in which the employee dies. If the employee's death is after the required beginning date, the return of premium payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover. If the return of premium payment is paid after the death of a surviving spouse who is receiving a life annuity (or after the death of a surviving spouse who has not yet commenced receiving a life annuity after the death of the employee), the return of premium payment under this paragraph (q)(3)(v) must be made no later than the end of the calendar year following the calendar year in which the surviving spouse dies. If the surviving spouse's death is after the required beginning date for the surviving spouse, then the return of premium payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover.

(vi) *Multiple beneficiaries.* If an employee has more than one designated beneficiary under a QLAC, the rules in § 1.401(a)(9)-8(a) apply for purposes of paragraphs (q)(3)(i) and (ii) of this section.

(vii) *Treatment of former spouses* —(A) *In general.* The payment of survivor benefits to the employee's former spouse under an annuity contract will not cause the contract to fail to satisfy the requirements of this paragraph (q)(3) merely because the divorce between the employee and that former spouse occurred after the contract is purchased, provided that a qualified domestic relations order described in section 414(p) (or, to the extent provided in paragraph (q)(3)(vii)(B) of this section, a divorce or separation instrument) satisfying the requirements of paragraph (q)(3)(vii)(C) of this section has been issued in connection with the divorce.

(B) [Reserved]

(C) *Applicable requirements.* This paragraph (q)(3)(vii)(C) is satisfied if the qualified domestic relations order (or divorce or separation instrument) issued in connection with the divorce—

( *1*) Provides that the former spouse is entitled to the survivor benefits under the contract;

( *2*) Provides that the former spouse is treated as a surviving spouse for purposes of the contract;

( *3*) Does not modify the treatment of the former spouse as the beneficiary under the contract who is entitled to the survivor benefits; or

( *4*) Does not modify the treatment of the former spouse as the measuring life for the survivor benefits under the contract.

(4) *Rules of application* —(i) *Rules relating to premiums* —(A) *Reliance on representations.* For purposes of the limitation on premiums described in paragraph (q)(2) of this section, unless the plan administrator has actual knowledge to the contrary, the plan administrator may rely on an employee's representation (made in writing or such other form as may be prescribed by the Commissioner) of the amount of the premiums described in paragraph (q)(2)(ii)(B) of this section, but only with respect to premiums that are not paid under a plan, annuity, or contract that is maintained by the employer or an entity that is treated as a single employer with the employer under section 414(b), (c), (m), or (o).

(B) *Consequences of excess premiums and correction.* If an annuity contract fails to be a QLAC solely because a premium for the contract exceeds the limits under paragraph (q)(2) of this section, then the contract is not a QLAC beginning on the date on which the premium is paid and the value of the contract may not be disregarded under § 1.401(a)(9)-5(b)(4) as of the date on which the contract ceases to be a QLAC (unless the excess premium is returned to the non-QLAC portion of the employee's account in accordance with the next sentence). However, if the excess premium is returned (either in cash or in the form of a contract that is not intended to be a QLAC) to the non-QLAC portion of the employee's account by the end of the calendar year following the calendar year in which the excess premium was originally paid, then the contract will not be treated as exceeding the limits under paragraph (q)(2) of this section at any time, and the value of the contract will not be included in the employee's account balance under § 1.401(a)(9)-5(b)(4). If the excess premium (including the fair market value of an annuity contract that is not intended to be a QLAC, if applicable) is returned to the non-QLAC portion of the employee's account after the last valuation date for the calendar year in which the excess premium was originally paid, then the employee's account balance for that calendar year must be increased to reflect that excess premium in the same manner as an employee's account balance is increased under § 1.401(a)(9)-7(b) to reflect a rollover received after the last valuation date. If the excess premium is returned to the non-QLAC portion of the employee's account as described in paragraph (q)(4)(ii)(B) of this section, it will not be treated as a violation of the requirement in paragraph (q)(1)(iv) of this section that the contract not provide a commutation benefit.

(ii) *Dollar and age limitations subject to adjustments* —(A) *Dollar limitation.* The $200,000 amount under paragraph (q)(2)(ii) of this section will be adjusted at the same time and in the same manner as the limits are adjusted under section 415(d), except that—

( *1*) The base period is the calendar quarter beginning July 1, 2022; and

( *2*) The amount of any increment to the limit that is not a multiple of $10,000 will be rounded to the next lowest multiple of $10,000.

(B) *Age limitation.* The maximum age set forth in paragraph (q)(1)(ii) of this section may be adjusted to reflect changes in mortality, with any adjusted age to be prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

(C) *Prospective application of adjustments.* If a contract fails to be a QLAC because it does not satisfy the dollar limitation in paragraph (q)(2)(ii) of this section or the age limitation in paragraph (q)(1)(ii) of this section, any subsequent adjustment that is made pursuant to this paragraph (q)(4)(ii) will not cause the contract to become a QLAC.

(iii) *Determination of whether contract is intended to be a QLAC* —(A) *Structural deficiency.* If a contract fails to be a QLAC at any time for a reason other than an excess premium described in paragraph (q)(4)(i)(B) of this section, then, as of the date of purchase, the contract will not be treated as a QLAC (for purposes of § 1.401(a)(9)-5(b)(4)) or as a contract that is intended to be a QLAC (for purposes of paragraph (q)(2) of this section).

(B) *Roth IRAs.* A contract that is purchased under a Roth IRA is not treated as a contract that is intended to be a QLAC for purposes of applying the dollar limitation rule in paragraph (q)(2)(ii) of this section. See A-14(d) of § 1.408A-6. If a QLAC is purchased or held under a plan, annuity, account, or traditional IRA, and that contract is later rolled over or converted to a Roth IRA, the contract is not treated as a contract that is intended to be a QLAC after the date of the rollover or conversion. Thus, premiums paid with respect to the contract will not be taken into account under paragraph (q)(2)(ii) of this section after the date of the rollover or conversion.

(iv) *Certain contract features permitted for QLACs* —(A) *Participating annuity contract.* An annuity contract does not fail to satisfy the requirement of paragraph (q)(1)(vii) of this section merely because it provides for the payment of dividends described in paragraph (n)(3)(iii) of this section.

(B) *Contracts with cost-of-living adjustments.* An annuity contract does not fail to satisfy the requirement of paragraph (q)(1)(vii) of this section merely because it provides for a cost-of-living adjustment as described in paragraph (o)(2) of this section.

(v) *Group annuity contract certificates.* The requirement under paragraph (q)(1)(vi) of this section that the contract state that it is intended to be a QLAC when issued is satisfied if a certificate is issued under a group annuity contract and the certificate, when issued, states that the employee's interest under the group annuity contract is intended to be a QLAC.

§ 1.401(a)(9)-7
Rollovers and transfers.

(a) *Treatment of rollover from distributing plan.* If an amount is distributed by a plan, then the amount distributed is still taken into account by the distributing plan for purposes of satisfying the requirements of section 401(a)(9), even if part of the distribution is rolled over into another eligible retirement plan described in section 402(c)(8). However, an amount that is a required minimum distribution under section 401(a)(9) is not eligible to be rolled over (and is therefore includible in the taxpayer's gross income under section 402). For this purpose, the amount that constitutes a required minimum distribution for a calendar year is determined in accordance with § 1.402(c)-2(f) for a distribution to an employee and § 1.402(c)-2(j) for a distribution to a beneficiary.

(b) *Treatment of rollover by receiving plan.* If an amount is distributed by one plan (distributing plan) and is rolled over to another plan (receiving plan), the benefit of the employee under the receiving plan is increased by the amount rolled over for purposes of determining the required minimum distribution for the calendar year following the calendar year in which the amount rolled over was distributed. If the amount rolled over is received after the last valuation date in the calendar year under the receiving plan, the benefit of the employee as of that valuation date,

adjusted in accordance with § 1.401(a)(9)-5(b), is increased by the rollover amount valued as of the date of receipt. In addition, if the amount rolled over is received in a different calendar year from the calendar year in which it is distributed, the amount rolled over is deemed to have been received by the receiving plan on the last day of the calendar year in which it was distributed.

(c) *Treatment of transfer under transferor plan* —(1) *Generally not treated as distribution.* In the case of a transfer of an amount of an employee's benefit from one plan (transferor plan) to another plan (transferee plan), the transfer is not treated as a distribution by the transferor plan for purposes of section 401(a)(9). Instead, the benefit of the employee under the transferor plan is decreased by the amount transferred. However, if any portion of an employee's benefit is transferred in a distribution calendar year with respect to that employee, in order to satisfy the requirements of section 401(a)(9), the transferor plan must determine the amount of the required minimum distribution with respect to that employee for the calendar year of the transfer using the employee's benefit under the transferor plan before the transfer. Additionally, if any portion of an employee's benefit is transferred in the employee's second distribution calendar year, but on or before the employee's required beginning date, in order to satisfy section 401(a)(9), the transferor plan must determine the amount of the required minimum distribution for the employee's first distribution calendar year based on the employee's benefit under the transferor plan before the transfer. The transferor plan may satisfy the minimum distribution requirement for the calendar year of the transfer (and the prior year if applicable) by segregating the amount that must be distributed from the employee's benefit and not transferring that amount. That amount may be retained by the transferor plan and must be distributed on or before the date required under section 401(a)(9).

(2) *Account balance decreased after transfer.* For purposes of determining any required minimum distribution for the calendar year following the calendar year in which the transfer occurs, in the case of a transfer after the last valuation date for the calendar year of the transfer under the transferor plan, the benefit of the employee as of that valuation date, adjusted in accordance with § 1.401(a)(9)-5(b), is decreased by the amount transferred, valued as of the date of the transfer.

(d) *Treatment of transfer under transferee plan.* In the case of a transfer from a transferor plan to a transferee plan, the benefit of the employee under the transferee plan is increased by the amount transferred in the same manner as if it were a plan receiving a rollover contribution under paragraph (b) of this section.

(e) *Treatment of spinoff or merger.* For purposes of determining an employee's benefit and required minimum distribution under section 401(a)(9), a spinoff, a merger, or a consolidation (as defined in § 1.414(l)-1(b)) is treated as a transfer of the benefits of the employees involved. Consequently, the benefit and required minimum distribution with respect to each employee whose benefits are transferred will be determined in accordance with paragraphs (c) and (d) of this section.

§ 1.401(a)(9)-8
Special rules.

(a) *Use of separate accounts* —(1) *Separate application of section 401(a)(9) for each beneficiary* —(i) *In general.* Except as otherwise provided in this paragraph (a)(1), for calendar years beginning after the calendar year in which the employee dies, section 401(a)(9) is applied separately with respect to the separate interests of each of the employee's beneficiaries under

the plan provided that those interests are held in separate accounts that satisfy the separate accounting requirements of paragraphs (a)(2)(i) and (ii) of this section.

(ii) *Separate accounting requirements not timely satisfied.* If the separate accounts that satisfy the separate accounting requirements of paragraph (a)(2) of this section are not established until after the end of the calendar year following the calendar year of the employee's death, then for distribution calendar years after those requirements are satisfied—

(A) The aggregate required distribution for a distribution calendar year is determined without regard to the separate account rule in paragraph (a)(1)(i) of this section;

(B) The amount of the aggregate required distribution determined in accordance with paragraph (a)(1)(ii)(A) of this section is allocated among the beneficiaries based on each respective beneficiary's share of the total remaining balance of the employee's interest in the plan; and

(C) The allocated share for each beneficiary determined under paragraph (a)(2)(ii)(B) of this section is required to be distributed to that beneficiary.

(iii) *Separate application of section 401(a)(9) for trust beneficiaries* —(A) *General prohibition.* Except as provided in paragraph (a)(1)(iii)(B) of this section, section 401(a)(9) may not be applied separately to the separate interests of each of the beneficiaries of a see-through trust described in § 1.401(a)(9)-4(f)(1)(i). For purposes of the excise tax under section 4974, unless the exception in paragraph (a)(1)(iii)(B) of this section applies, the trust is the payee with respect to the required distribution of the employee's interest in the plan.

(B) *Exception for certain trusts divided upon the death of the employee.* Section 401(a)(9) is applied separately with respect to the separate interests of the beneficiaries of a see-through trust if the terms of the trust provide that it is to be divided immediately upon the death of the employee, provided that the requirements in paragraph (a)(1)(iii)(C) of this section are satisfied. The preceding sentence applies only if the separate interests are held in separate see-through trusts (in which case the rules of §§ 1.401(a)(9)-4(f) and 1.401(a)(9)-5 will apply separately to each separate trust).

(C) *Immediately divided defined.* For purposes of paragraph (a)(1)(iii)(B) of this section, a trust is immediately divided upon the death of the employee only if, as of the date of death, the trust is terminated and there is no discretion as to the extent to which of the separate trusts post-death distributions attributable to the employee's interest in the plan are allocated. A trust does not fail to be immediately divided upon the death of the employee merely because there are administrative delays between the date of the employee's death and the date on which the trust is divided and terminated, provided that any amounts received by the trust during this period are allocated as if the trust had been divided on the date of the employee's death.

(2) *Separate accounting requirements* —(i) *Allocation of post-death distributions required.* A separate accounting satisfies the requirements of this paragraph (a)(2)(i) only if all post-death distributions with respect to a beneficiary's interest are allocated to the separate account of the beneficiary receiving the distributions.

(ii) *Allocation of other items.* A separate accounting satisfies the requirements of this paragraph (a)(2)(ii) if all post-death investment gains and losses, contributions, forfeitures, and expenses for the period prior to the establishment of the separate accounts are allocated on a pro rata basis in

a reasonable and consistent manner among the separate accounts. The separate accounting does not fail to satisfy the requirements of this paragraph (a)(2)(ii) merely because, in lieu of a pro rata allocation of investment gains and losses—

(A) Separate accounts are established that have separate investments; and

(B) The investment gains and losses attributable to assets held in each of those separate accounts are allocated only to that separate account.

(b) *Application of consent requirements.* Section 411(a)(11) and section 417(e) require employee and spousal consent to certain distributions of plan benefits while those benefits are immediately distributable. If an employee's normal retirement age is later than the employee's required beginning date and, therefore, benefits are still immediately distributable (within the meaning of § 1.411(a)-11(c)(4)), distributions must be made to the employee (or, if applicable, to the employee's spouse) in a manner that satisfies the requirements of section 401(a)(9) even though the employee (or, if applicable, the employee's spouse) fails to consent to the distribution. In that case, the benefit may be distributed in the form of a qualified joint and survivor annuity (QJSA) or in the form of a qualified preretirement survivor annuity (QPSA), as applicable, and the consent requirements of sections 411(a)(11) and 417(e) are deemed to be satisfied if the plan has made reasonable efforts to obtain consent from the employee (or, if applicable, the employee's spouse) and if the distribution otherwise meets the requirements of section 417. If the distribution is not required to be in the form of a QJSA to an employee or a QPSA to a surviving spouse, the required minimum distribution amount may be paid to satisfy section 401(a)(9), and the consent requirements of sections 411(a)(11) and 417(e) are deemed to be satisfied if the plan has made reasonable efforts to obtain consent from the employee (or, if applicable, the employee's spouse) and the distribution otherwise meets the requirements of section 417.

(c) *Definition of spouse.* Except as otherwise provided in paragraph (d)(1) of this section (in the case of distributions of a portion of an employee's benefit payable to a former spouse of an employee pursuant to a qualified domestic relations order), for purposes of satisfying the requirements of section 401(a)(9), an individual is the spouse or surviving spouse of an employee if the marriage of the employee and individual is recognized for Federal tax purposes under the rules of § 301.7701-18. In the case of distributions after the death of an employee, for purposes of section 401(a)(9), the spouse of the employee is determined as of the date of death of the employee.

(d) *Treatment of QDROs* —(1) *Continued treatment of spouse.* A former spouse to whom all or a portion of the employee's benefit is payable pursuant to a qualified domestic relations order described in section 414(p) (QDRO) is treated as a spouse (including a surviving spouse) of the employee for purposes of satisfying the requirements of section 401(a)(9), including the minimum distribution incidental benefit requirement under section 401(a)(9)(G), regardless of whether the QDRO specifically provides that the former spouse is treated as the spouse for purposes of sections 401(a)(11) and 417.

(2) *Separate accounts* —(i) *In general* —(A) *Separate accounts while the employee is alive.* If a QDRO provides that an employee's benefit is to be divided and a portion is to be allocated to an alternate payee, that portion will be treated as a separate account (or segregated share) that separately must satisfy the requirements of section 401(a)(9) and may not be aggregated with other separate accounts (or segregated shares) of the employee for purposes of satisfying section 401(a)(9). Except as otherwise provided in paragraph (f)(2)(ii) of this section, distribution of a

separate account allocated to an alternate payee pursuant to a QDRO must be made in accordance with section 401(a)(9). For example, distributions of the separate account will satisfy section 401(a)(9)(A) if required minimum distributions from the separate account during the employee's lifetime begin no later than the employee's required beginning date and the required minimum distribution is determined in accordance with § 1.401(a)(9)-5 for each distribution calendar year using an applicable denominator determined under § 1.401(a)(9)-5(c) (determined by treating the spousal alternate payee as the employee's spouse).

(B) *Separate accounts after the death of the employee.* The determination of whether distributions from the separate account after the death of the employee to the alternate payee will be made in accordance with section 401(a)(9)(B)(i), or in accordance with section 401(a)(9)(B)(ii) or (iii) and (iv), will depend on whether distributions have begun as determined under § 1.401(a)(9)-2(a)(3) (which provides, in general, that distributions are not treated as having begun until the employee's required beginning date even though payments may actually have begun before that date). For example, if the alternate payee dies before the employee, and if distributions of the separate account allocated to the alternate payee pursuant to the QDRO are to be made to the alternate payee's beneficiary, then that beneficiary may be treated as a designated beneficiary for purposes of determining the required minimum distribution from the separate account after the death of the employee, provided that the beneficiary of the alternate payee is an individual who is a beneficiary under the plan or specified to or in the plan. Specification in or pursuant to the QDRO is treated as specification to the plan.

(ii) *Satisfaction of section 401(a)(9) requirements.* Distribution of the separate account allocated to an alternate payee pursuant to a QDRO satisfies the requirements of section 401(a)(9)(A)(ii) if the separate account is distributed, beginning no later than the employee's required beginning date, over the life of the alternate payee (or over a period not extending beyond the life expectancy of the alternate payee). Also, if, pursuant to § 1.401(a)(9)-3(b)(4)(iii) or (c)(5)(iii), the plan permits the employee to elect the distribution method that will apply upon the death of the employee, that election is to be made only by the alternate payee for purposes of distributing the alternate payee's separate account. If the alternate payee dies after distribution of the alternate payee's separate account has begun (determined under § 1.401(a)(9)-2(a)(3)) but before the employee dies, distribution of the remaining portion of that portion of the benefit allocated to the alternate payee must be made in accordance with the rules in § 1.401(a)(9)-5(c) or § 1.401(a)(9)-6(a) for distributions during the life of the employee. Only after the death of the employee is the amount of the required minimum distribution determined in accordance with the rules in § 1.401(a)(9)-5(d) or § 1.401(a)(9)-6(b).

(3) *Other situations.* If a QDRO does not provide that an employee's benefit is to be divided but provides that a portion of an employee's benefit (otherwise payable to the employee) is to be paid to an alternate payee, that portion is not treated as a separate account (or segregated share) of the employee. Instead, that portion is aggregated with any amount distributed to the employee and treated as having been distributed to the employee for purposes of determining whether section 401(a)(9) has been satisfied with respect to that employee.

(e) *Application of section 401(a)(9) pending determination of whether a domestic relations order is a QDRO is being made.* A plan does not fail to satisfy the requirements of section 401(a)(9) merely because it fails to distribute an amount otherwise required to be distributed by section 401(a)(9) during the period in which the issue of whether a domestic relations order is a QDRO is being determined pursuant to section 414(p)(7), provided that the period does not extend beyond the 18-month period described in section 414(p)(7)(E). To the extent that a distribution

otherwise required under section 401(a)(9) is not made during this period, any segregated amounts, as defined in section 414(p)(7)(A), are treated as though the amounts are not vested during the period and any distributions with respect to those amounts must be made under the relevant rules for nonvested benefits described in either § 1.401(a)(9)-5(g)(1) or § 1.401(a)(9)-6(f), as applicable.

(f) *Application of section 401(a)(9) when insurer is in State delinquency proceedings.* A plan does not fail to satisfy the requirements of section 401(a)(9) merely because an individual's distribution from the plan is less than the amount otherwise required to satisfy section 401(a)(9) because distributions were being paid under an annuity contract issued by a life insurance company in State insurer delinquency proceedings and have been reduced or suspended by reason of those State proceedings. To the extent that a distribution otherwise required under section 401(a)(9) is not made during the State insurer delinquency proceedings, that amount and any additional amount accrued during that period are treated as though those amounts are not vested during that period and any distributions with respect to those amounts must be made under the relevant rules for nonvested benefits described in either § 1.401(a)(9)-5(g)(1) or § 1.401(a)(9)-6(f), as applicable.

(g) *In-service distributions required to satisfy section 401(a)(9).* A plan does not fail to qualify as a pension plan within the meaning of section 401(a) solely because the plan permits distributions to commence to an employee on or after the employee's required beginning date (as determined in accordance with § 1.401(a)(9)-2(b)) even though the employee has not retired or attained the normal retirement age under the plan as of the date on which the distributions commence. This rule applies without regard to whether the employee is a 5-percent owner with respect to the plan year ending in the calendar year in which distributions commence.

(h) *TEFRA section 242(b) elections* —(1) *In general.* Even though the distribution requirements added by the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97-248, 96 Stat. 324 (1982) (TEFRA), were retroactively repealed in 1984, the transitional election rule in section 242(b) of TEFRA (referred to as a section 242(b)(2) election in this paragraph (h)) was preserved. While sections 401(a)(11) and 417 must be satisfied with respect to any distribution subject to those requirements, satisfaction of those requirements is not considered a revocation of the section 242(b) election.

(2) *Application of section 242(b) election after transfer* —(i) *Section 242(b)(2) election made under transferor plan.* If an amount is transferred from one plan (transferor plan) to another plan (transferee plan), the amount transferred may be distributed in accordance with a section 242(b)(2) election made under the transferor plan if the employee did not elect to have the amount transferred and if the transferee plan separately accounts for the amount transferred. However, only the benefit attributable to the amount transferred, plus earnings thereon, may be distributed in accordance with the section 242(b)(2) election made under the transferor plan. If the employee elected to have the amount transferred or the transferee plan does not separately account for the amount transferred, the transfer is treated as a distribution and rollover of the amount transferred for purposes of this section.

(ii) *Section 242(b)(2) election made under transferee plan.* If an amount is transferred from one plan to another plan, the amount transferred may not be distributed in accordance with a section 242(b)(2) election made under the transferee plan. If a section 242(b)(2) election was made under the transferee plan, the transferee plan must separately account for the amount transferred. If the transferee plan does not separately account for the amount transferred, the section 242(b)(2)

election under the transferee plan is revoked, and subsequent distributions by the transferee plan must satisfy section 401(a)(9).

(iii) *Spinoff, merger, or consolidation treated as transfer.* A spinoff, merger, or consolidation, as defined in § 1.414(l)-1(b), is treated as a transfer for purposes of the section 242(b)(2) election.

(3) *Application of section 242(b) election after rollover.* If an amount is distributed from one plan (distributing plan) and rolled over into another plan (receiving plan), the amount rolled over must be distributed from the receiving plan in accordance with section 401(a)(9) whether or not the employee made a section 242(b)(2) election under the distributing plan. Further, if the amount rolled over was not distributed in accordance with the election, the election under the distributing plan is revoked and all subsequent distributions by the distributing plan must satisfy section 401(a)(9). Finally, if the employee made a section 242(b)(2) election under the receiving plan and the election is still in effect, the receiving plan must separately account for the amount rolled over and distribute that amount in accordance with section 401(a)(9). If the receiving plan does not separately account for the amounts rolled over, any section 242(b)(2) election under the receiving plan is revoked and subsequent distributions under the receiving plan must satisfy section 401(a)(9).

(4) *Revocation of section 242(b) election* —(i) *In general.* A section 242(b)(2) election may be revoked after the required beginning date under section 401(a)(9)(C). However, if the section 242(b)(2) election is revoked after the required beginning date, and the total amount of the distributions that would have been required prior to the date of the revocation in order to satisfy section 401(a)(9), but for the section 242(b)(2) election, have not been made, then—

(A) The catch-up distribution described in paragraph (h)(4)(ii) of this section must be made by the end of the calendar year following the calendar year in which the revocation occurs; and

(B) Distributions must continue in accordance with section 401(a)(9).

(ii) *Catch-up distribution.* The catch-up distribution must be equal to the total amount not yet distributed that would have been required to be distributed to satisfy the requirements of section 401(a)(9).

**Par. 4.** Amend § 1.401(a)(9)-9 as follows:

a. Amend the title by removing the phrase “distribution period” and adding in its place the phrase “Uniform Lifetime”;

b. Amend paragraph (a) by removing the phrase “applicable distribution period” and adding in its place the phrase “Uniform Lifetime”;

c. Amend paragraph (c) by removing the phrase “distribution period” and adding in its place the phrase “applicable denominator”;

d. Revise the heading of the second column of Table 2 to paragraph (c) by removing the phrase “Distribution period” and adding in its place the phrase “Applicable denominator”; and

e. Revise and republish paragraph (f)(2).

The revisions and republications read as follows:

§ 1.401(a)(9)-9
Life expectancy and Uniform Lifetime tables.
* * * * *

(f) * * *

(2) *Application to life expectancies that may not be recalculated* —(i) *Redetermination of initial life expectancy using current tables.* If an employee died before January 1, 2022, and, under the rules of § 1.401(a)(9)-5, the applicable denominator for a calendar year following the calendar year of the employee's death is equal to a single life expectancy calculated as of the calendar year of the employee's death (or, if applicable, the following calendar year), reduced by 1 for each subsequent year, then that life expectancy is reset as provided in paragraph (f)(2)(ii) of this section. Similarly, if an employee's sole beneficiary is the employee's surviving spouse, and the spouse dies before January 1, 2022, then the spouse's life expectancy for the calendar year of the spouse's death (which is used to determine the applicable denominator for later years) is reset as provided in paragraph (f)(2)(ii) of this section.

(ii) *Determination of applicable denominator* —(A) *Applicable denominator based on new life expectancy.* With respect to a life expectancy described in paragraph (f)(2)(i) of this section, the applicable denominator for a distribution calendar year beginning on or after January 1, 2022, is determined by using the Single Life Table in paragraph (b) of this section to determine the initial life expectancy for the age of the relevant individual in the relevant calendar year and then reducing the resulting applicable denominator by 1 for each subsequent year.

(B) *Example of redetermination.* Assume that an employee died at age 80 in 2019 and the employee's designated beneficiary (who was not the employee's spouse) was age 75 in the year of the employee's death. For 2020, the denominator that would have applied for the beneficiary was 12.7 years (the life expectancy for a 76-year-old under the Single Life Table in formerly applicable § 1.401(a)(9)-9), and for 2021, it would have been 11.7 years (the original life expectancy, reduced by 1 year). For 2022, if the designated beneficiary is still alive, then the applicable denominator would be 12.1 years (the 14.1-year life expectancy for a 76-year-old under the Single Life Table in paragraph (b) of this section, reduced by 2 years).

**Par. 5.** Revise and republish § 1.402(c)-2 to read as follows:

§ 1.402(c)-2
Eligible rollover distributions.

(a) *Overview of rollover and related statutory provisions* —(1) *General rule*— (i) *Rollover of distribution paid to employee.* Under section 402(c), any portion of a distribution paid to an employee from a qualified plan that is an eligible rollover distribution described in section 402(c)(4) may be rolled over to an eligible retirement plan described in section 402(c)(8)(B). See paragraph (j) of this section for rules relating to distributions paid to a surviving spouse or a non-spousal beneficiary.

(ii) *Exclusion from income.* Except as otherwise provided in this section, if an eligible rollover distribution is paid to an employee, then the amount distributed is not currently includible in gross income, provided that it is contributed to an eligible retirement plan no later than the 60th day

following the day on which the employee received the distribution. However, if all or any portion of the amount distributed (including any amount withheld as income tax under section 3405(c)) is not contributed as a rollover, it is included in the employee's gross income to the extent required under section 402(a), and also may be subject to the 10-percent additional income tax under section 72(t).

(iii) *Definition of eligible retirement plan* —(A) *In general.* An eligible retirement plan means an IRA described in paragraph (a)(1)(iii)(B)( *1*) of this section or a qualified plan described in paragraph (a)(1)(iii)(B)( *2*) of this section. In addition, an eligible deferred compensation plan described in section 457(b) that is maintained by an employer described in section 457(e)(1)(A) is treated as an eligible retirement plan, but only if the plan separately accounts for the amount of the rollover.

(B) *Definitions of IRA and qualified plan.* For purposes of section 402(c) and this section—

( *1*) An IRA is an individual retirement account described in section 408(a) or an individual retirement annuity (other than an endowment contract) described in section 408(b); and

( *2*) A qualified plan is an employees' trust described in section 401(a) that is exempt from tax under section 501(a), an annuity plan described in section 403(a), or an annuity contract described in section 403(b).

(iv) *Multiple distributions.* If more than one distribution is received by an employee from a qualified plan during a taxable year, the 60-day deadline applies separately to each distribution. Because the amount withheld as income tax under section 3405(c) is considered an amount distributed under section 402(c), an amount equal to all or any portion of the amount withheld may be contributed as a rollover to an eligible retirement plan within the 60-day period in addition to the net amount of the eligible rollover distribution actually received by the employee.

(v) *Definition of rollover.* For purposes of section 402(c) and this section, a rollover is—

(A) A direct rollover as described in § 1.401(a)(31)-1, Q&A-3;

(B) A contribution of an eligible rollover distribution to an eligible retirement plan that, except as provided in paragraph (b)(2) of this section, satisfies the time period requirement in paragraph (a)(1)(ii) of this section and the designation requirement described in paragraph (k)(1) of this section; or

(C) A repayment of a distribution that is treated as a rollover, as described in paragraph (a)(1)(vi) of this section.

(vi) *Certain repayments treated as rollovers.* The repayment of a distribution is treated as a rollover if that treatment is prescribed under another statutory provision. For example, the repayment of a qualified disaster recovery distribution under section 72(t)(11)(C) is treated as a rollover for purposes of this section.

(2) *Related Internal Revenue Code provisions* —(i) *Direct rollover option.* Section 401(a)(31) requires qualified plans to provide a distributee of an eligible rollover distribution the option to elect to have the distribution paid directly to an eligible retirement plan in a direct rollover. See § 1.401(a)(31)-1 for further guidance concerning this direct rollover option.

(ii) *Notice requirement.* Section 402(f) requires the plan administrator of a qualified plan to provide, within a reasonable time before making an eligible rollover distribution, a written explanation to the distributee of the distributee's right to elect a direct rollover and the withholding consequences of not making that election. The explanation also is required to provide certain other relevant information relating to the taxation of distributions. See § 1.402(f)-1 for guidance concerning the written explanation required under section 402(f).

(iii) *Mandatory income tax withholding.* If a distributee of an eligible rollover distribution does not elect to have the eligible rollover distribution paid directly from the plan to an eligible retirement plan in a direct rollover under section 401(a)(31), the eligible rollover distribution is subject to mandatory income tax withholding under section 3405(c). See § 31.3405(c)-1 of this chapter for provisions relating to the withholding requirements applicable to eligible rollover distributions.

(iv) *Section 403(b) annuities.* See § 1.403(b)-7(b) for guidance concerning the direct rollover requirements for distributions from annuities described in section 403(b).

(3) *Applicability date* —(i) *In general.* The rules provided in this section apply to any distribution made on or after January 1, 2025.

(ii) *Distributions prior to January 1, 2025.* For any distribution made before January 1, 2025, the rules of 26 CFR 1.402(c)-2 and 26 CFR 1.402(c)-3 (as they appeared in the April 1, 2023, edition of 26 CFR part 1) apply. Alternatively, the rules provided in this section may be applied to those distributions.

(b) *Special rules* —(1) *Rules related to Roth accounts* —(i) *Treatment of Roth conversions.* If all or any portion of an eligible rollover distribution that is rolled over to a Roth IRA is not from a designated Roth account described in section 402A, then the amount rolled over to the Roth IRA is included in the employee's gross income to the extent required under section 402(a). However, the amount rolled over to a Roth IRA generally is not subject to the 10-percent additional income tax under section 72(t).

(ii) *Treatment of distributions from designated Roth accounts.* A distribution from a designated Roth account may be rolled over only to another designated Roth account or to a Roth IRA. See § 1.402A-1, Q&A-5 for rules that apply to such a rollover.

(2) *Extensions of and exceptions to 60-day deadline* —(i) *Waiver of 60-day deadline.* The Commissioner may waive the 60-day deadline described in paragraph (a)(1)(ii) of this section if the failure to waive that requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual with respect to such requirement. See section 402(c)(3)(B).

(ii) *Frozen deposits.* The 60-day period described in paragraph (a)(1)(ii) of this section does not include any period during which the amount transferred to the employee is a frozen deposit described in section 402(c)(7)(B). The 60-day period also does not end earlier than 10 days after that amount ceases to be a frozen deposit.

(iii) *Exception for qualified plan loan offsets.* See paragraph (g) of this section for the timing requirements related to the rollover of a qualified plan loan offset amount.

(iv) *Other distributions treated as rollovers.* In the case of a repayment of a distribution treated as a rollover as described in paragraph (a)(1)(vi) of this section, see the applicable statutory provision and accompanying regulations, if any, for the timing requirements relating to the repayment.

(3) *Special rules for distribution that includes basis*— (i) *Rollover of basis to IRA.* If an eligible rollover distribution includes some or all of an employee's basis (that is, the employee's investment in the contract), then the portion of the distribution that is allocable to the employee's basis may be rolled over to an IRA.

(ii) *Rollover of basis to qualified trust must be done through direct trustee-to-trustee transfer.* If an eligible rollover distribution includes some or all of an employee's basis, then the portion of an eligible rollover distribution that is allocable to the employee's basis may be rolled over to a qualified plan only through a direct trustee-to-trustee transfer. In that case, the qualified trust or annuity contract must provide for separate accounting of the amount transferred (and earnings on that amount) including separately accounting for the portion of the distribution that includes an employee's basis and the portion of the distribution that does not include basis.

(iii) *Rollover of basis to section 457(b) plans not permitted.* The portion of an eligible rollover distribution that is allocable to an employee's basis may not be rolled over to an eligible deferred compensation plan described in section 457(b).

(iv) *Rollover of portion of distribution.* If an eligible rollover distribution includes some or all of an employee's basis and less than the entire distribution is being rolled over, then the amount rolled over is treated as consisting first of the portion of the distribution that is not allocable to the employee's basis.

(4) *Special rules for distributions that include property* —(i) *In general.* Except as provided in paragraph (b)(4)(ii) of this section, if an eligible rollover distribution consists of property other than money, then, only that property may be rolled over to an eligible retirement plan.

(ii) *Rollover of proceeds permitted.* In the case of an eligible rollover distribution that consists of property other than money, the proceeds of the sale of that property may be rolled over to an eligible retirement plan. However, to the extent those proceeds exceed the property's fair market value at the time of the sale, that excess may not be rolled over. See section 402(c)(6)(C) and (D) for other rules relating to the sale of distributed property.

(c) *Definition of eligible rollover distribution* —(1) *General rule.* Unless specifically excluded, an eligible rollover distribution means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan. Thus, except as specifically provided in paragraph (c)(2) or (3) of this section, any amount distributed to an employee from a qualified plan is an eligible rollover distribution, regardless of whether it is a distribution of a benefit that is protected under section 411(d)(6).

(2) *Exceptions.* An eligible rollover distribution does not include the following:

(i) Any distribution that is one of a series of substantially equal periodic payments made (not less frequently than annually) over any one of the following periods—

(A) The life of the employee (or the joint lives of the employee and the employee's designated beneficiary);

(B) The life expectancy of the employee (or the joint life and last survivor expectancy of the employee and the employee's designated beneficiary); or

(C) A specified period of ten years or more;

(ii) Any distribution to the extent the distribution is a required minimum distribution under section 401(a)(9); or

(iii) Any distribution that is made on account of hardship.

(3) *Other amounts not treated as eligible rollover distributions.* The following amounts are not treated as eligible rollover distributions:

(i) Elective deferrals (as defined in section 402(g)(3)) and employee contributions that, pursuant to rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter), are returned to the employee (together with the income allocable thereto) in order to comply with the section 415 limitations;

(ii) Corrective distributions of excess deferrals as described in § 1.402(g)-1(e)(3), together with the income allocable to these corrective distributions;

(iii) Corrective distributions of excess contributions under a qualified cash or deferred arrangement described in § 1.401(k)-2(b)(2) and excess aggregate contributions described in § 1.401(m)-2(b)(2), together with the income allocable to these distributions;

(iv) Loans that are treated as deemed distributions pursuant to section 72(p);

(v) Subject to the rules of paragraph (c)(4) of this section, dividends paid on employer securities as described in section 404(k);

(vi) The costs of life insurance coverage includible in the employee's income under section 72(m)(3)(B);

(vii) Prohibited allocations that are treated as deemed distributions pursuant to section 409(p);

(viii) Distributions that are permissible withdrawals from an eligible automatic contribution arrangement within the meaning of section 414(w);

(ix) Distributions of premiums for accident or health insurance under § 1.402(a)-1(e)(1)(i) (other than distributions subject to section 402(l), as described in § 1.402(a)-1(e)(3));

(x) Amounts treated as distributed as a result of the purchase of a collectible pursuant to section 408(m); and

(xi) Similar items designated by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. *See* § 601.601(d) of this chapter.

(4) *Dividends reinvested in employer securities.* Dividends paid to an employee stock ownership plan (as defined in section 4975(e)(7)) that are reinvested in employer securities pursuant to a

participant election under section 404(k)(2)(A)(iii)(II) are included in the participant's account balance and lose their character as dividends when subsequently distributed from the account. As a result, these amounts are eligible rollover distributions if they otherwise meet the requirements of this paragraph (c).

(d) *Determination of substantially equal periodic payments* —(1) *General rule.* For purposes of paragraph (c)(2)(i) of this section, and except as provided in this paragraph (d) or paragraph (e) of this section, whether a series of payments is a series of substantially equal periodic payments over a specified period is determined at the time payments begin, and by following the principles of section 72(t)(2)(A)(iv), without regard to contingencies or modifications that have not yet occurred. Thus, for example, a joint and 50-percent survivor annuity will be treated as a series of substantially equal periodic payments at the time payments commence, as will a joint and survivor annuity that provides for increased payments to the employee if the employee's beneficiary dies before the employee. Similarly, for purposes of determining if a disability benefit payment is part of a series of substantially equal periodic payments for a period described in section 402(c)(4)(A), any contingency under which payments cease upon recovery from the disability may be disregarded.

(2) *Certain supplements disregarded.* For purposes of determining whether a distribution is one of a series of periodic payments that are substantially equal, social security supplements described in section 411(a)(9) are disregarded. For example, if a distributee receives a life annuity of $500 per month, plus a social security supplement consisting of payments of $200 per month until the distributee reaches the age at which social security benefits of not less than $200 a month begin, the $200 supplemental payments are disregarded and, therefore, each monthly payment of $700 made before the social security age and each monthly payment of $500 made after the social security age is treated as one of a series of substantially equal periodic payments for life. A series of periodic payments that are not substantially equal solely because the amount of each payment is reduced upon attainment of social security retirement age (or, alternatively, upon commencement of social security early retirement, survivor, or disability benefits) is also treated as substantially equal as long as the reduction in the actual payments is level and does not exceed the applicable social security benefit.

(3) *Changes in the amount of payments or the distributee.* If the amount (or, if applicable, the method of calculating the amount) of the payments changes so that subsequent payments are not substantially equal to prior payments, then a new determination must be made as to whether the remaining payments are a series of substantially equal periodic payments over a period specified in paragraph (c)(2)(i) of this section. This determination is made without taking into account payments made or the years of payment that elapsed prior to the change. However, a new determination is not made merely because, upon the death of the employee, the employee's beneficiary becomes the distributee. Thus, if distributions commence over a period that is at least as long as either the first annuitant's life or 10 years, then substantially equal payments to the survivor are not eligible rollover distributions even though the payment period remaining after the death of the employee is or may be less than the period described in section 402(c)(4)(A). For example, substantially equal periodic payments made under a life annuity with a five-year term certain would not be an eligible rollover distribution even when paid after the death of the employee with three years remaining under the term certain.

(4) *Defined contribution plans.* The following rules apply in determining whether a series of payments from a defined contribution plan constitutes a series of substantially equal periodic payments for a period described in section 402(c)(4)(A)—

(i) *Declining balance of years.* A series of payments from an account balance under a defined contribution plan over a period is considered a series of substantially equal periodic payments over that period if, for each year, the amount of the distribution is calculated by dividing the account balance by the number of years remaining in the period. For example, a series of payments is considered substantially equal payments over 10 years if the series is determined as follows. In year 1, the annual payment is the account balance divided by 10; in year 2, the annual payment is the remaining account balance divided by 9; and so on until year 10 when the entire remaining balance is distributed.

(ii) *Reasonable actuarial assumptions.* If an employee's account balance under a defined contribution plan is to be distributed in annual installments of a specified amount until the account balance is exhausted, then, for purposes of determining if the period of distribution is a period described in section 402(c)(4)(A), the period of years over which the installments will be distributed must be determined using reasonable actuarial assumptions. For example, if an employee has an account balance of $100,000, the employee elects distributions of $12,000 per year until the account balance is exhausted, and the future rate of return is assumed to be 5 percent per year, the account balance will be exhausted in approximately 12 years. Similarly, if the same employee elects a fixed annual distribution amount and the fixed annual amount is less than or equal to $10,000, it is reasonable to assume that the future rate of return will be greater than 0 percent and, thus, the account will not be exhausted in less than 10 years.

(e) *Determination of whether a payment is an independent payment* —(1) *Definition of independent payments.* Except as provided in paragraphs (e)(2) and (3) of this section, a payment is treated as independent of the payments in a series of substantially equal payments, and thus not part of the series described in paragraph (c)(2)(i) of this section, if the payment is substantially larger or smaller than the other payments in the series. An independent payment is an eligible rollover distribution if it is not otherwise excepted from the definition of eligible rollover distribution. This rule applies regardless of whether the payment is made before, with, or after payments in the series. For example, if an employee elects a single payment of half of the account balance with the remainder of the account balance paid over the life expectancy of the distributee, the single payment is treated as independent of the payments in the series and is an eligible rollover distribution unless otherwise excepted. Similarly, if an employee's surviving spouse receives a survivor life annuity of $1,000 per month plus a single payment on account of death of $7,500, the single payment is treated as independent of the payments in the annuity and is an eligible rollover distribution unless otherwise excepted.

(2) *Special rules* —(i) *Administrative error or delay.* If, due solely to reasonable administrative error or delay in payment, there is an adjustment after the annuity starting date to the amount of any payment in a series of payments that otherwise would constitute a series of substantially equal payments described in section 402(c)(4)(A) and this section, the adjusted payment or payments are treated as part of the series of substantially equal periodic payments and are not treated as independent of the payments in the series. For example, if, due solely to reasonable administrative delay, the first payment of a life annuity is delayed by two months and reflects an additional two months' worth of benefits, that payment is treated as a substantially equal payment in the series rather than as an independent payment. The result does not change merely because the amount of the adjustment is paid in a separate supplemental payment.

(ii) *Supplemental payments for annuitants.* A supplemental payment from a defined benefit plan to an annuitant (that is, a retiree or beneficiary) is treated as part of a series of substantially equal

payments, rather than as an independent payment, provided that the following conditions are met—

(A) The supplement is a benefit increase for annuitants;

(B) The amount of the supplement is determined in a consistent manner for all similarly situated annuitants;

(C) The supplement is paid to annuitants who are otherwise receiving payments that would constitute substantially equal periodic payments; and

(D) The aggregate supplement is less than or equal to the greater of 10 percent of the annual rate of payment for the annuity, or $750.

(iii) *Final payment in a series.* If a payment in a series of periodic payments from an account balance under a defined contribution plan is equal to the remaining balance in the account and is substantially less than the other payments in the series, the final payment must nevertheless be treated as a payment in the series of substantially equal periodic payments and may not be treated as an independent payment if the other payments in the series are substantially equal and the payments are for a period described in section 402(c)(4)(A) based on the rules provided in paragraph (d)(4)(ii) of this section. Thus, the final payment will not be an eligible rollover distribution.

(3) *Additional guidance.* The Commissioner, in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin, may provide additional rules for determining what is an independent payment under paragraph (e)(1) of this section and may prescribe a higher amount than the $750 amount in paragraph (e)(2)(ii)(D) of this section. See § 601.601(d) of this chapter.

(f) *Determination of whether a distribution is a required minimum distribution* —(1) *Determination for calendar year of distribution.* Except as provided in paragraphs (f)(2) and (3) of this section, if a minimum distribution is required for a calendar year, then the amounts distributed during that calendar year are treated as required minimum distributions under section 401(a)(9) to the extent that the total minimum distribution required under section 401(a)(9) for the calendar year has not been satisfied (and accordingly, those amounts are not eligible rollover distributions). For example, if an employee is required under section 401(a)(9) to receive a minimum distribution for a calendar year of $5,000 and the employee receives a total of $7,200 in that year, the first $5,000 distributed will be treated as the required minimum distribution and will not be an eligible rollover distribution, and the remaining $2,200 will be an eligible rollover distribution if it otherwise qualifies. If the total section 401(a)(9) required minimum distribution for a calendar year prior to the calendar year of the distribution is not distributed in that calendar year (for example, when the distribution for the calendar year in which the employee reaches the applicable age is made on April 1 of the following calendar year), then the amount that was required to be distributed, but not distributed, is added to the amount required to be distributed for the next calendar year in determining the portion of any distribution in the next calendar year that is a required minimum distribution (and, thus, is not an eligible rollover distribution).

(2) *Distribution before first distribution calendar year.* Any amount that is paid to an employee before January 1 of the first distribution calendar year for the employee (as described in

§ 1.401(a)(9)-5(a)(2)(ii)) is not treated as required under section 401(a)(9) and, thus, is an eligible rollover distribution if it otherwise qualifies.

(3) *Special rule for annuities.* In the case of annuity payments from a defined benefit plan, or under an annuity contract purchased from an insurance company (including a qualified plan distributed annuity contract (as defined in paragraph (h) of this section)), the entire amount of any annuity payment made on or after January 1 of the first distribution calendar year for the employee (as described in § 1.401(a)(9)-5(a)(2)(ii)) is treated as an amount required under section 401(a)(9) and, thus, is not an eligible rollover distribution.

(g) *Treatment of plan loan offset amounts* —(1) *General rule.* A distribution of a plan loan offset amount, as defined in paragraph (g)(3)(i) of this section (including a qualified plan loan offset amount, a type of plan loan offset amount defined in paragraph (g)(3)(ii) of this section), is an eligible rollover distribution if it is described in paragraph (c) of this section. See § 1.401(a)(31)-1, Q&A-16, for guidance concerning the offering of a direct rollover of a plan loan offset amount. See also § 31.3405(c)-1, Q&A-11, of this chapter for guidance concerning special withholding rules with respect to plan loan offset amounts.

(2) *Rollover period for a plan loan offset amount* —(i) *Plan loan offset amount that is not a qualified plan loan offset amount.* A distribution of a plan loan offset amount that is an eligible rollover distribution and that is not a qualified plan loan offset amount may be rolled over by the employee to an eligible retirement plan within the 60-day period set forth in section 402(c)(3)(A), as described in paragraph (a)(1)(ii) of this section.

(ii) *Plan loan offset amount that is a qualified plan loan offset amount.* A distribution of a plan loan offset amount that is an eligible rollover distribution and that is a qualified plan loan offset amount may be rolled over by the employee to an eligible retirement plan within the period set forth in section 402(c)(3)(C), which is the individual's tax filing due date (including extensions) for the taxable year in which the offset is treated as distributed from a qualified employer plan.

(3) *Definitions* —(i) *Plan loan offset amount.* For purposes of section 402(c), a plan loan offset amount is the amount by which, under the plan terms governing a plan loan, an employee's accrued benefit is reduced (offset) in order to repay the loan (including the enforcement of the plan's security interest in an employee's accrued benefit). A distribution of a plan loan offset amount can occur in a variety of circumstances, for example, when the terms governing a plan loan require that, in the event of the employee's termination of employment or request for a distribution, the loan be repaid immediately or treated as in default. A distribution of a plan loan offset amount also occurs when, under the terms governing the plan loan, the loan is cancelled, accelerated, or treated as if it were in default (for example, when the plan treats a loan as in default upon an employee's termination of employment or within a specified period thereafter). A distribution of a plan loan offset amount is an actual distribution, not a deemed distribution under section 72(p).

(ii) *Qualified plan loan offset amount.* For purposes of section 402(c), a qualified plan loan offset amount is a plan loan offset amount that satisfies the following requirements:

(A) The plan loan offset amount is treated as distributed from a qualified employer plan to an employee or beneficiary solely by reason of the termination of the qualified employer plan, or the failure to meet the repayment terms of the loan because of the severance from employment of the employee; and

(B) The plan loan offset amount relates to a plan loan that met the requirements of section 72(p)(2) immediately prior to the termination of the qualified employer plan or the severance from employment of the employee, as applicable.

(iii) *Qualified employer plan.* For purposes of section 402(c) and this section, a qualified employer plan is a qualified employer plan as defined in section 72(p)(4).

(4) *Special rules for qualified plan loan offset amounts* —(i) *Definition of severance from employment.* For purposes of paragraph (g)(3)(ii)(A) of this section, whether an employee has a severance from employment with the employer that maintains the qualified employer plan is determined in the same manner as under § 1.401(k)-1(d)(2). Thus, an employee has a severance from employment when the employee ceases to be an employee of the employer maintaining the plan.

(ii) *Offset because of severance from employment.* A plan loan offset amount is treated as distributed from a qualified employer plan to an employee or beneficiary solely by reason of the failure to meet the repayment terms of a plan loan because of severance from employment of the employee if the plan loan offset:

(A) Relates to a failure to meet the repayment terms of the plan loan, and

(B) Occurs within the period beginning on the date of the employee's severance from employment and ending on the first anniversary of that date.

(5) *Examples.* The following examples illustrate the rules with respect to plan loan offset amounts, including qualified plan loan offset amounts, in this paragraph (g) and in §§ 1.401(a)(31)-1, Q&A-16, and 31.3405(c)-1, Q&A-11, of this chapter. For purposes of these examples, each reference to a plan refers to a qualified employer plan as described in section 72(p)(4).

(i) *Example 1* —(A) In 2025, Employee A has an account balance of $10,000 in Plan Y, of which $3,000 is invested in a plan loan to Employee A that is secured by Employee A's account balance in Plan Y. Employee A has made no after-tax employee contributions to Plan Y. The plan loan meets the requirements of section 72(p)(2). Plan Y does not provide any direct rollover option with respect to plan loans. Employee A severs from employment on June 15, 2025. After severance from employment, Plan Y accelerates the plan loan and provides Employee A 90 days to repay the remaining balance of the plan loan. Employee A, who is under the age set forth in section 401(a)(9)(C)(i)(I), does not repay the loan within the 90 days and instead elects a direct rollover of Employee A's entire account balance in Plan Y. On September 18, 2025 (within the 12-month period beginning on the date that Employee A severed from employment), Employee A's outstanding loan is offset against the account balance.

(B) In order to satisfy section 401(a)(31), Plan Y must make a direct rollover by paying $7,000 directly to the eligible retirement plan chosen by Employee A. When Employee A's account balance was offset by the amount of the $3,000 unpaid loan balance, Employee A received a plan loan offset amount (equivalent to $3,000) that is an eligible rollover distribution. However, under § 1.401(a)(31)-1, Q&A-16, Plan Y satisfies section 401(a)(31), even though a direct rollover option was not provided with respect to the $3,000 plan loan offset amount.

(C) No withholding is required under section 3405(c) on account of the distribution of the $3,000 plan loan offset amount because no cash or other property (other than the plan loan offset amount) is received by Employee A from which to satisfy the withholding.

(D) The $3,000 plan loan offset amount is a qualified plan loan offset amount within the meaning of paragraph (g)(3)(ii) of this section. Accordingly, Employee A may roll over up to the $3,000 qualified plan loan offset amount to an eligible retirement plan within the period that ends on the employee's tax filing due date (including extensions) for the taxable year in which the offset occurs.

(ii) *Example 2* —(A) The facts are the same as in paragraph (g)(5)(i) of this section ( *Example 1*), except that, rather than accelerating the plan loan, Plan Y permits Employee A to continue making loan installment payments after severance from employment. Employee A continues making loan installment payments until January 1, 2026, at which time Employee A does not make the loan installment payment due on January 1, 2026. In accordance with § 1.72(p)-1, Q&A-10, Plan Y allows a cure period that continues until the last day of the calendar quarter following the quarter in which the required installment payment was due. Employee A does not make a plan loan installment payment during the cure period. Plan Y offsets the unpaid $3,000 loan balance against Employee A's account balance on July 1, 2026 (which is after the 12-month period beginning on the date that Employee A severed from employment).

(B) The conclusion is the same as in paragraph (g)(5)(i) of this section ( *Example 1*), except that the $3,000 plan loan offset amount is not a qualified plan loan offset amount (because the offset did not occur within the 12-month period beginning on the date that Employee A severed from employment). Accordingly, Employee A may roll over up to the $3,000 plan loan offset amount to an eligible retirement plan within the 60-day period provided in section 402(c)(3)(A) (rather than within the period that ends on Employee A's tax filing due date (including extensions) for the taxable year in which the offset occurs).

(iii) *Example 3* —(A) The facts are the same as in paragraph (g)(5)(i) of this section ( *Example 1*), except that the terms governing the plan loan to Employee A provide that, upon severance from employment, Employee A's account balance is automatically offset by the amount of any unpaid loan balance to repay the loan. Employee A severs from employment but does not request a distribution from Plan Y. Nevertheless, pursuant to the terms governing the plan loan, Employee A's account balance is automatically offset on June 15, 2025, by the amount of the $3,000 unpaid loan balance.

(B) The $3,000 plan loan offset amount is a qualified plan loan offset amount within the meaning of paragraph (g)(3)(ii) of this section. Accordingly, Employee A may roll over up to the $3,000 qualified plan loan offset amount to an eligible retirement plan within the period that ends on Employee A's tax filing due date (including extensions) for the taxable year in which the offset occurs.

(iv) *Example 4* —(A) The facts are the same as in paragraph (g)(5)(i) of this section ( *Example 1*), except that Employee A elects to receive a cash distribution of the account balance that remains after the $3,000 plan loan offset amount, instead of electing a direct rollover of the remaining account balance.

(B) The amount of the distribution received by Employee A is $10,000 ($3,000 relating to the plan loan offset and $7,000 relating to the cash distribution). Because the amount of the $3,000 plan

loan offset amount attributable to the loan is included in determining the amount of the eligible rollover distribution to which withholding applies, withholding in the amount of $2,000 (20 percent of $10,000) is required under section 3405(c). The $2,000 is required to be withheld from the $7,000 to be distributed to Employee A in cash, so that Employee A actually receives a cash amount of $5,000.

(C) The $3,000 plan loan offset amount is a qualified plan loan offset amount within the meaning of paragraph (g)(3)(ii) of this section. Accordingly, Employee A may roll over up to the $3,000 qualified plan loan offset to an eligible retirement plan within the period that ends on Employee A's tax filing due date (including extensions) for the taxable year in which the offset occurs. In addition, Employee A may roll over up to $7,000 (the portion of the distribution that is not related to the offset) within the 60-day period provided in section 402(c)(3).

(v) *Example 5* —(A) The facts are the same as in paragraph (g)(5)(iv) of this section ( *Example 4*), except that the $7,000 distribution to Employee A after the offset consists solely of employer securities within the meaning of section 402(e)(4)(E).

(B) No withholding is required under section 3405(c) because the distribution consists solely of the $3,000 plan loan offset amount and the $7,000 distribution of employer securities. This is the result because the total amount required to be withheld does not exceed the sum of the cash and the fair market value of other property distributed, excluding plan loan offset amounts and employer securities.

(C) Employee A may roll over up to the $7,000 of employer securities to an eligible retirement plan within the 60-day period provided in section 402(c)(3). The $3,000 plan loan offset amount is a qualified plan loan offset amount within the meaning of paragraph (g)(3)(ii) of this section. Accordingly, Employee A may roll over up to the $3,000 qualified plan loan offset amount to an eligible retirement plan within the period that ends on Employee A's tax filing due date (including extensions) for the taxable year in which the offset occurs.

(vi) *Example 6* —(A) Employee B, who is age 40, has an account balance in Plan Z. Plan Z does not provide for after-tax employee contributions. In 2025, Employee B receives a loan from Plan Z, the terms of which satisfy section 72(p)(2). The loan is secured by elective contributions subject to the distribution restrictions in section 401(k)(2)(B).

(B) Employee B fails to make an installment payment due on April 1, 2026, or any other monthly payments thereafter. In accordance with § 1.72(p)-1, Q&A-10, Plan Z allows a cure period that continues until the last day of the calendar quarter following the quarter in which the required installment payment was due (September 30, 2026). Employee B does not make a plan loan installment payment during the cure period. On September 30, 2026, pursuant to section 72(p)(1), Employee B is taxed on a deemed distribution equal to the amount of the unpaid loan balance. Pursuant to paragraph (c)(3)(iv) of this section, the deemed distribution is not an eligible rollover distribution.

(C) Because Employee B has not severed from employment or experienced any other event that permits the distribution under section 401(k)(2)(B) of the elective contributions that secure the loan, Plan Z is prohibited from executing on the loan. Accordingly, Employee B's account balance is not offset by the amount of the unpaid loan balance at the time of the deemed distribution. Thus, there is no distribution of an offset amount that is an eligible rollover distribution on September 30, 2026.

(vii) *Example 7* —(A) The facts are the same as in paragraph (g)(5)(vi) of this section ( *Example 6*), except that Employee B has a severance from employment on November 1, 2026. On that date, Employee B's unpaid loan balance is offset against the account balance on distribution.

(B) The plan loan offset amount is not a qualified plan loan offset amount. Although the offset occurred within 12 months after Employee B severed from employment, the plan loan does not meet the requirement in paragraph (g)(3)(ii)(B) of this section (that the plan loan meet the requirements of section 72(p)(2) immediately prior to Employee B's severance from employment). Instead, the loan was taxable on September 30, 2026 (prior to Employee B's severance from employment on November 1, 2026), because of the failure to meet the level amortization requirement in section 72(p)(2)(C). Accordingly, Employee B may roll over the plan loan offset amount to an eligible retirement plan within the 60-day period provided in section 402(c)(3)(A) (rather than within the period that ends on Employee B's tax filing due date (including extensions) for the taxable year in which the offset occurs).

(h) *Qualified plan distributed annuity contract* —(1) *Definition of a qualified plan distributed annuity contract.* A qualified plan distributed annuity contract is an annuity contract purchased for a participant, and distributed to the participant, by a qualified plan.

(2) *Treatment of amounts paid as eligible rollover distributions.* Amounts paid under a qualified plan distributed annuity contract are payments of the balance to the credit of the employee for purposes of section 402(c) and are eligible rollover distributions if they otherwise qualify. Thus, for example, if the employee surrenders the contract for a single sum payment of its cash surrender value, the payment would be an eligible rollover distribution to the extent it is not a required minimum distribution under section 401(a)(9). This rule applies even if the annuity contract is distributed in connection with a plan termination. See § 1.401(a)(31)-1, Q&A-17 and § 31.3405(c)-1, Q&A-13 of this chapter concerning the direct rollover requirements and 20-percent withholding requirements, respectively, that apply to eligible rollover distributions from such an annuity contract.

(i) [Reserved]

(j) *Treatment of distributions to beneficiary* —(1) *Spousal distributee* —(i) *In general.* Pursuant to section 402(c)(9), if any distribution attributable to an employee is paid to the employee's surviving spouse, section 402(c) applies to the distribution in the same manner as if the spouse were the employee. The same rule applies if any distribution attributable to an employee is paid in accordance with a qualified domestic relations order (as defined in section 414(p)) (QDRO) to the employee's spouse or former spouse who is an alternate payee. Therefore, a distribution to the surviving spouse of an employee (or to a spouse or former spouse who is an alternate payee under a QDRO), including a distribution of ancillary death benefits attributable to the employee, is an eligible rollover distribution if it would be described in paragraph (c) of this section had it been paid to the employee. For this purpose, the amount excluded from the definition of eligible rollover distribution under paragraph (c)(2)(ii) of this section as a required minimum distribution is determined under the rules of paragraph (j)(3) of this section (or paragraph (j)(4) of this section, if applicable).

(ii) *Rollovers to qualified plans must be in capacity of employee.* If a surviving spouse rolls over a distribution to a qualified plan described in paragraph (a)(1)(iii)(B)( *2*) of this section or to an eligible deferred compensation plan described in section 457(b) that is maintained by an employer described in section 457(e)(1)(A), then, with respect to the amount rolled over, that amount is

treated as the spouse's own interest under the receiving plan and not the interest of the decedent under the distributing plan. Thus, for example, in determining the required minimum distribution from the receiving plan with respect to the amount rolled over, distributions must satisfy section 401(a)(9)(A) and not section 401(a)(9)(B).

(2) *Non-spousal distributee* —(i) *Eligibility for rollover.* A distributee other than the employee or the employee's surviving spouse (or a spouse or former spouse who is an alternate payee under a QDRO) is not permitted to roll over a distribution from a qualified plan. Therefore, a distribution to a non-spousal distributee does not constitute an eligible rollover distribution under section 402(c)(4).

(ii) *Direct transfer permitted.* Although a non-spousal distributee may not roll over a distribution, pursuant to section 402(c)(11), if the distributee is a designated beneficiary (as determined under § 1.401(a)(9)-4) who is not described in paragraph (j)(1) of this section and the distribution would be an eligible rollover distribution had it been paid to the employee, then the distributee may elect that the distribution be made in the form of a direct trustee-to-trustee transfer to an IRA established for the purpose of receiving that distribution. If a direct trustee-to-trustee transfer is made pursuant to section 402(c)(11) then—

(A) The transfer is treated as an eligible rollover distribution;

(B) The IRA is an inherited IRA described in section 408(d)(3)(ii); and

(C) Section 401(a)(9)(B) (other than section 401(a)(9)(B)(iv)) will apply to the IRA.

(iii) *Applicability to see-through trusts.* If a distributee described in paragraph (j)(2)(ii) of this section is a see-through trust described in § 1.401(a)(9)-4(f)(1)(i), then the beneficiaries of the trust that are treated as designated beneficiaries under § 1.401(a)(9)-4(f)(3) are also treated as designated beneficiaries for purposes of section 402(c)(11)(A).

(iv) *Applicability of withholding rules.* An amount that could have been transferred to a beneficiary IRA in accordance with section 402(c)(11), but instead, was paid directly to a non-spouse beneficiary, is treated as an eligible rollover distribution for purposes of section 3405(c). Thus, 20-percent withholding under section 3405(c) applies to a distribution made directly to a non-spouse beneficiary.

(3) *Determination of amounts that constitute required minimum distributions for distributions to beneficiaries* —(i) *In general* —(A) *First portion of a distribution is treated as a required minimum distribution.* If a minimum distribution is required to be made to a beneficiary in a calendar year, then the amounts distributed during that calendar year are treated as required minimum distributions under section 401(a)(9), to the extent that the total required minimum distribution under section 401(a)(9) for the calendar year has not been satisfied. Accordingly, those amounts are not eligible rollover distributions. If the employee dies before the employee's required beginning date (within the meaning of § 1.401(a)(9)-2(b)), then no amount is a required minimum distribution for the year in which the employee dies.

(B) *Determination of required minimum distribution based on distribution method.* Except as otherwise provided in paragraphs (j)(3)(ii) and (4) of this section, if an employee dies before the employee's required beginning date, then the amount that is not an eligible rollover distribution because it is a required minimum distribution for the calendar year is determined under paragraph

(j)(3)(i)(C), (D), or (E) of this section, whichever applies to the beneficiary. See § 1.401(a)(9)-3(b)(4) and (c)(5) to determine which rule applies. If an employee dies on or after the employee's required beginning date, then the amount that is not an eligible rollover distribution because it is a required minimum distribution for a calendar year is determined under paragraph (j)(3)(i)(F) of this section.

(C) *Five-year rule in the case of death before required beginning date.* If the 5-year rule described in § 1.401(a)(9)-3(b)(2) or (c)(2) applies to the beneficiary, then no amount is required to be distributed until the end of the calendar year that includes the fifth anniversary of the date of the employee's death. In that year, the entire amount to which the beneficiary is entitled under the plan must be distributed, and because it is a required minimum distribution, it is not an eligible rollover distribution. Thus, if the 5-year rule applies with respect to a designated beneficiary, then any distribution made before the calendar year that includes the fifth anniversary of the date of the employee's death is eligible for rollover if it otherwise meets the requirements of this section.

(D) *Ten-year rule in the case of death before required beginning date.* If the 10-year rule described in § 1.401(a)(9)-3(c)(3) applies to the beneficiary, then no amount is required to be distributed until the end of the calendar year that includes the tenth anniversary of the date of the employee's death. In that year, the entire amount to which the beneficiary is entitled under the plan must be distributed, and because it is treated as a required minimum distribution, it is not an eligible rollover distribution. Thus, if the 10-year rule applies with respect to a designated beneficiary, then any distribution made before the calendar year that includes the tenth anniversary of the date of the employee's death is eligible for rollover if it otherwise meets the requirements of this section.

(E) *Life expectancy rule.* If the life expectancy rule described in § 1.401(a)(9)-3(c)(4) (or, in the case of a defined benefit plan, the annuity payment rule described in § 1.401(a)(9)-3(b)(3)) applies to the designated beneficiary, then, in the first distribution calendar year for the beneficiary (as defined in § 1.401(a)(9)-5(a)(2)(iii)) and in each subsequent calendar year, the amount treated as a required minimum distribution and not eligible to be rolled over is determined in accordance in with § 1.401(a)(9)-5(d) and (e) (or, in the case of a defined benefit plan, § 1.401(a)(9)-6).

(F) *Employee dies on or after required beginning date.* If the employee dies on or after the employee's required beginning date, then, in the calendar year of the employee's death, the amount treated as a required minimum distribution and not eligible to be rolled over is determined in accordance with § 1.401(a)(9)-5(c) (or, in the case of a defined benefit plan, § 1.401(a)(9)-6). For each subsequent calendar year, the amount treated as a required minimum distribution and not eligible to be rolled over is determined in accordance with § 1.401(a)(9)-5(d) and (e) (or, in the case of a defined benefit plan, § 1.401(a)(9)-6).

(ii) *Exception allowing beneficiary to change distribution method.* If the 5-year rule or 10-year rule described in § 1.401(a)(9)-3(b)(2), (c)(2) or (c)(3) applies to a designated beneficiary under the plan, and the eligible designated beneficiary is using the exception under § 1.408-8(d)(2)(ii) to switch to the use of the life expectancy rule under the IRA to which the distribution is rolled over or transferred, then the designated beneficiary must determine the portion of the distribution that is a required minimum distribution that is not eligible for rollover using the life expectancy rule described in § 1.401(a)(9)-3(c)(4) (or, in the case of a defined benefit plan, the annuity payment rule described in § 1.401(a)(9)-3(b)(3)).

(4) *Special rule applicable to a spouse beneficiary* —(i) *In general.* This paragraph (j)(4) provides a special rule relating to the determination of amounts treated as a required minimum distribution

for distributions to an employee's surviving spouse to whom the 10-year rule described in § 1.401(a)(9)-3(c)(3) applies. This rule, which treats a portion of a distribution made before the last year of the 10-year period as a required minimum distribution, applies if—

(A) The distribution is made in or after the calendar year the surviving spouse attains the applicable age described in § 1.401(a)(9)-2(b)(2); and

(B) The surviving spouse rolls over a portion of that distribution to an eligible retirement plan under which the surviving spouse is not treated as the beneficiary of the employee.

(ii) *Catch-up of missed required minimum distributions.* If this paragraph (j)(4) applies to a distribution then, notwithstanding paragraph (j)(3)(i)(D) of this section, the portion of the distribution that is treated as a required minimum distribution, and thus is not an eligible rollover distribution, is the excess (if any) of—

(A) The sum of the hypothetical required minimum distributions determined under paragraph (j)(4)(iii) of this section for each year during the catch-up period with respect to that distribution (determined under paragraph (j)(4)(v) of this section), over

(B) The actual distributions made to the surviving spouse during those calendar years (other than the calendar year in which that distribution is made).

(iii) *Calculation of hypothetical required minimum distributions for the catch-up period.* This paragraph (j)(4)(iii) provides rules for determining the calculation of the hypothetical required minimum distribution for each calendar year during the catch-up period with respect to a distribution (determination year). The hypothetical required minimum distribution for a determination year is the amount that would have been the required minimum distribution for that year had the election under § 1.401(a)(9)-5(g)(3)(i) been in effect for the spouse. Thus, the hypothetical required minimum distribution is calculated using the applicable denominator determined under § 1.401(a)(9)-5(g)(3). However, in lieu of the account balance that would otherwise be used to determine the required minimum distribution for the determination year, an adjusted account balance is used for this purpose. The adjusted account balance for a determination year is calculated by reducing the account balance that would otherwise be used to determine the required minimum distribution for the calendar year in which the distribution is made by the excess (if any) of—

(A) The sum of the hypothetical required minimum distributions determined under this paragraph (j)(4)(iii) beginning with the first applicable year and ending with the calendar year preceding the determination year; over

(B) The actual distributions made to the surviving spouse during those calendar years.

(iv) *Definition of first applicable year.* The first applicable year is the later of—

(A) The calendar year in which the surviving spouse attains the applicable age, and

(B) The calendar year in which the employee would have attained the applicable age.

(v) *Definition of catch-up period.* The catch-up period with respect to a distribution is the period that—

(A) Begins with first applicable year, and

(B) Ends in the calendar year in which the distribution is made.

(vi) *Reasonable assumptions by plan administrator.* For purposes of section 402(f)(2)(A), a plan administrator is permitted to assume that a surviving spouse to whom this paragraph (j)(4) applies will roll over (to the extent permitted under the rules of this paragraph (j)(4)) the entire distribution to an eligible retirement plan under which that spouse is not treated as the beneficiary of the employee. Thus, a plan administrator may assume that the catch-up of missed required minimum distributions described in paragraph (j)(4)(ii) of this section applies to the distribution and treat only the remaining portion of the distribution as an eligible rollover distribution for purposes of sections 401(a)(31) and 3405(c). See paragraph (k)(2) of this section concerning the effect of this assumption for purposes of section 402(c).

(vii) [Reserved]

(k) *Other rules* —(1) *Designation must be irrevocable*— (i) *Indirect rollover.* In order for a contribution of an eligible rollover distribution to an individual retirement plan to constitute a rollover and, thus, to qualify for exclusion from gross income under section 402(c), a distributee must elect, at the time the contribution is made, to treat the contribution as a rollover contribution. An election is made by designating to the trustee, issuer, or custodian of the eligible retirement plan that the contribution is a rollover contribution. This election is irrevocable. Once any portion of an eligible rollover distribution has been contributed to an individual retirement plan and designated as a rollover distribution, taxation of the withdrawal of the contribution from the individual retirement plan is determined under section 408(d) rather than under section 402 or 403. Therefore, the eligible rollover distribution is not eligible for capital gains treatment, five-year or ten-year averaging, or the exclusion from gross income for net unrealized appreciation on employer stock.

(ii) *Direct rollover.* If an eligible rollover distribution is paid to an eligible retirement plan in a direct rollover at the election of the distributee, the distributee is deemed to have irrevocably designated that the direct rollover is a rollover contribution.

(2) *Use of actual minimum required distribution calculation.* The portion of any distribution that an employee (or spousal distributee) may roll over as an eligible rollover distribution under section 402(c) is determined based on the actual application of section 402 and other relevant provisions of the Internal Revenue Code. The actual application of these provisions may produce different results than any assumption described in paragraph (j)(4)(vi) of this section or § 1.401(a)(31)-1, Q&A-18, that is used by the plan administrator. Thus, for example, if the plan administrator assumes there is no designated beneficiary and calculates the portion of a distribution that is a required minimum distribution using the Uniform Lifetime Table under § 1.401(a)(9)-9(c), but the portion of the distribution that is actually a required minimum distribution and thus not an eligible rollover distribution is determined by taking into account a spousal designated beneficiary who is more than 10 years younger than the employee, then a greater portion of the distribution is actually an eligible rollover distribution and the distributee may roll over the additional amount.

(3 ) *Plan rollover not counted towards one rollover per year limitation.* A distribution from a qualified plan that is rolled over to an individual retirement account or individual retirement annuity is not treated for purposes of section 408(d)(3)(B) as an amount received by an individual from an individual retirement account or individual retirement annuity that is not includible in gross income because of the application of section 408(d)(3).

§ 1.402(c)-3
[Removed]

**Par. 6.** Section 1.402(c)-3 is removed.

**Par. 7.** Amend § 1.403(b)-6 by revising and republishing paragraph (e).

The revision and republication read as follows:

§ 1.403(b)-6
Timing of distributions and benefits.
* * * * *

(e) *Minimum required distributions for eligible plans* —(1) *In general.* Under section 403(b)(10), a section 403(b) contract must meet the minimum distribution requirements of section 401(a)(9) (in both form and operation). See section 401(a)(9) for these requirements.

(2) *Generally treated as IRAs.* For purposes of applying the minimum distribution requirements of section 401(a)(9) to section 403(b) contracts, the minimum distribution requirements applicable to individual retirement annuities described in section 408(b) and individual retirement accounts described in section 408(a) apply to section 403(b) contracts. Consequently, except as otherwise provided in this paragraph (e), the minimum distribution requirements of section 401(a)(9) are applied to section 403(b) contracts in accordance with the provisions in § 1.408-8 that apply to an IRA that is not a Roth IRA.

(3) *Exceptions under which qualified plan rules will apply* —(i) *Required beginning date.* The required beginning date for purposes of section 403(b)(10) is determined in accordance with § 1.401(a)(9)-2(b) (rather than § 1.408-8(b)(1)).

(ii) *Amounts not taken into account.* The amounts not taken into account in determining whether the minimum distribution requirement of section 401(a)(9) has been satisfied for a calendar year are the amounts described in § 1.402(c)-2(c)(3) (rather than the amounts described in § 1.408-8(g)(2)).

(iii) *Designated Roth account.* The rules of § 1.401(a)(9)-3(a)(2) (which provides that if an employee's entire interest under a defined contribution plan is in a designated Roth account, then no distributions are required during the employee's lifetime and, upon death, the employee is treated as having died before the required beginning date), § 1.401(a)(9)-5(b)(3) (which excludes amounts held in a designated Roth account from the employee's account balance), and § 1.401(a)(9)-5(g)(2)(iii) (regarding distributions from designated Roth accounts) apply to a designated Roth account in a section 403(b) contract (rather than the rules of § 1.408-8(b)(1)(ii) that apply to a Roth IRA).

(iv) *Qualifying longevity annuity contracts.* The rules in § 1.401(a)(9)-6(q)(2)(i) (relating to the limitation on premiums for a qualifying longevity annuity contract (QLAC), as defined in § 1.401(a)(9)-6(q)(1)) and § 1.401(a)(9)-6(q)(4)(i)(A) (relating to reliance on representations with respect to a QLAC) apply to the purchase of a QLAC under a section 403(b) plan (rather than the rules in § 1.408-8(h)(2) and (3)).

(4) *Surviving spouse rule does not apply.* The rule in § 1.408-8(c) (under which the surviving spouse of an IRA owner is permitted to treat an IRA of the decedent as the spouse's own IRA) does not apply to a section 403(b) contract. Thus, the surviving spouse of a participant is not permitted to treat a section 403(b) contract as the spouse's own section 403(b) contract, even if the spouse is the sole beneficiary.

(5) *Retirement income accounts.* For purposes of § 1.401(a)(9)-6(d) (relating to annuity contracts purchased under a defined contribution plan), annuity payments provided with respect to retirement income accounts do not fail to satisfy the requirements of section 401(a)(9) merely because the payments are not made under an annuity contract purchased from an insurance company that is licensed to do business under the laws of a State, provided that the relationship between the annuity payments and the retirement income accounts is not inconsistent with any rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter). See also § 1.403(b)-9(a)(5) for additional rules relating to annuities payable from a retirement income account.

(6) *Special rules for benefits accruing before December 31, 1986* —(i) *Non-applicability of section 401(a)(9) to pre-'87 account balance.* The minimum distribution requirements of section 401(a)(9) do not apply to the undistributed portion of the account balance under a section 403(b) contract valued as of December 31, 1986, exclusive of subsequent earnings (pre-'87 account balance). The minimum distribution requirements of section 401(a)(9) apply to all benefits under any section 403(b) contract accruing after December 31, 1986 (post-'86 account balance), including earnings after December 31, 1986. Consequently, the post-'86 account balance includes earnings after December 31, 1986, on contributions made before January 1, 1987, in addition to the contributions made after December 31, 1986, and earnings thereon.

(ii) *Recordkeeping required.* The issuer or custodian of the section 403(b) contract must keep records that enable it to identify the pre-'87 account balance and subsequent changes as set forth in paragraph (e)(6)(iii) of this section and provide that information upon request to the relevant employee or beneficiaries with respect to the contract. If the issuer or custodian does not keep those records, the entire account balance is treated as subject to section 401(a)(9).

(iii) *Applicability of section 401(a)(9) to post-'86 account balance.* In applying the minimum distribution requirements of section 401(a)(9), only the post-'86 account balance is used to calculate the required minimum distribution for a calendar year. The amount of any distribution from a contract is treated as being paid from the post-'86 account balance to the extent the distribution is required to satisfy the minimum distribution requirement with respect to that contract for a calendar year. Any amount distributed in a calendar year from a contract in excess of the required minimum distribution for a calendar year with respect to that contract is treated as paid from the pre-'87 account balance, if any, of that contract.

(iv) *Rollover of amounts from pre-'87 account balance.* If an amount is distributed from the pre-'87 account balance and rolled over to another section 403(b) contract, the amount is treated as part of the post-'86 account balance in that second contract. However, if the pre-'87 account

balance under a section 403(b) contract is directly transferred to another section 403(b) contract (as permitted under § 1.403(b)-10(b)), the amount transferred retains its character as a pre-'87 account balance, provided the issuer of the transferee contract satisfies the recordkeeping requirements of paragraph (e)(6)(ii) of this section.

(v) *Relevance of distinction between pre-'87 and post-'86 account balance for purposes of section 72.* The distinction between the pre-'87 account balance and the post-'86 account balance provided for under this paragraph (e)(6) has no relevance for purposes of determining the portion of a distribution that is includible in income under section 72.

(vi) *Pre-'87 account balance distributions must satisfy incidental benefit requirement.* The pre-'87 account balance must be distributed in accordance with the incidental benefit requirement of § 1.401-1(b)(1)(i). Distributions attributable to the pre-'87 account balance are treated as satisfying this requirement if all distributions from the section 403(b) contract (including distributions attributable to the post-'86 account balance) satisfy the requirements of § 1.401-1(b)(1)(i) without regard to this section, and distributions attributable to the post-'86 account balance satisfy the rules of this paragraph (e) (without regard to this paragraph (e)(6)). Distributions attributable to the pre-'87 account balance are treated as satisfying the incidental benefit requirement if all distributions from the section 403(b) contract (including distributions attributable to both the pre-'87 account balance and the post-'86 account balance) satisfy the rules of this paragraph (e) (without regard to this paragraph (e)(6)).

(7) *Application to multiple contracts for an employee.* The required minimum distribution must be determined separately for each section 403(b) contract of an employee. However, because, as provided in paragraph (e)(2) of this section, the minimum distribution requirements of section 401(a)(9) apply to section 403(b) contracts in accordance with the provisions in § 1.408-8, the required minimum distribution from one section 403(b) contract of an employee is permitted to be distributed from another section 403(b) contract in order to satisfy the minimum distribution requirements of section 401(a)(9). Thus, as provided in § 1.408-8(e), with respect to IRAs, the required minimum distribution amount from each contract is then totaled and the total minimum distribution taken from any one or more of the individual section 403(b) contracts. However, consistent with the rules in § 1.408-8(e), only amounts in section 403(b) contracts that an individual holds as an employee may be aggregated. In addition, amounts in section 403(b) contracts that a person holds as a beneficiary of a decedent may be aggregated, but those amounts may not be aggregated with amounts held in section 403(b) contracts that the person holds as the employee or as the beneficiary of another decedent. Distributions from section 403(b) contracts do not satisfy the minimum distribution requirements for IRAs, nor do distributions from IRAs satisfy the minimum distribution requirements for section 403(b) contracts.

(8) *Governmental plans.* A section 403(b) contract that is part of a governmental plan (within the meaning of section 414(d)) is treated as having complied with section 401(a)(9) for all years to which section 401(a)(9) applies to the contract, if the terms of the contract reflect a reasonable, good faith interpretation of section 401(a)(9).

(9) *Effective date.* This paragraph (e) applies for purposes of determining required minimum distributions for calendar years beginning on or after January 1, 2025. For earlier calendar years, the rules of 26 CFR 1.403(b)-6(e) (as it appeared in the April 1, 2023, edition of 26 CFR part 1) apply.

* * * * *

**Par. 8.** Revise and republish § 1.408-8 to read as follows:

§ 1.408-8
Distribution requirements for individual retirement plans.

(a) *Applicability of section 401(a)(9)* —(1) *In general.* An IRA is subject to the required minimum distribution requirements of section 401(a)(9). In order to satisfy section 401(a)(9), the rules of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9 must be applied, except as otherwise provided in this section. For example, if the owner of an individual retirement account dies before the IRA owner's required beginning date, whether the 10-year rule or the life expectancy rule applies to distributions after the IRA owner's death is determined in accordance with § 1.401(a)(9)-3(c), and the rules of § 1.401(a)(9)-4 apply for purposes of determining an IRA owner's designated beneficiary. The amount of the minimum distribution required for each calendar year from an individual retirement account is determined in accordance with § 1.401(a)(9)-5 and the minimum distribution required for each calendar year from an individual retirement annuity described in section 408(b) is determined in accordance with § 1.401(a)(9)-6 (including § 1.401(a)(9)-6(d)(2)).

(2) *Definition of IRA and IRA owner.* For purposes of this section, an IRA is an individual retirement account or annuity described in section 408(a) or (b), and the IRA owner is the individual for whom an IRA is originally established by contributions for the benefit of that individual and that individual's beneficiaries.

(3) *Substitution of specific terms.* For purposes of applying the required minimum distribution rules of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9, the IRA trustee, custodian, or issuer is treated as the plan administrator, and the IRA owner is substituted for the employee.

(4) *Treatment of SEPs and SIMPLE IRA Plans.* IRAs that receive employer contributions under a SEP arrangement (within the meaning of section 408(k)) or a SIMPLE IRA plan (within the meaning of section 408(p)) are treated as IRAs, rather than employer plans, for purposes of section 401(a)(9) and are, therefore, subject to the distribution rules in this section.

(b) *Different rules for IRAs and qualified plans* —(1) *Determination of required beginning date* —(i) *In general.* An IRA owner's required beginning date is determined using the rules for employees who are 5-percent owners under § 1.401(a)(9)-2(b)(3). Thus, the IRA owner's required beginning date is April 1 of the calendar year following the calendar year in which the individual attains the applicable age.

(ii) *Special rules for Roth IRAs.* No minimum distributions are required to be made from a Roth IRA while the owner is alive. After the Roth IRA owner dies, the required minimum distribution rules apply to the Roth IRA as though the Roth IRA owner died before his or her required beginning date. In accordance with section 401(a)(9)(B)(iv)(II), if the sole beneficiary is the Roth IRA owner's surviving spouse, then the surviving spouse may delay distributions until the Roth IRA owner would have attained the applicable age.

(2) *Account balance determination.* For purposes of determining the required minimum distribution from an IRA for any calendar year, the account balance of the IRA as of December 31 of the calendar year preceding the calendar year for which distributions are required to be made is substituted for the account balance of the employee under § 1.401(a)(9)-5(b). Except as provided in paragraph (d) of this section, no adjustments are made for contributions or distributions after that date.

(3) *Determination of portion of distribution that is a required minimum distribution.* The portion of a distribution from an IRA that is a required minimum distribution and thus not eligible for rollover is determined in the same manner as provided in § 1.402(c)-2(f) and (j) for a distribution from a qualified plan. For example, if a minimum distribution to an IRA owner is required under section 401(a)(9)(A)(ii) for a calendar year, any amount distributed during a calendar year from an IRA of that IRA owner is treated as a required minimum distribution under section 401(a)(9) to the extent that the total required minimum distribution for the year under section 401(a)(9) from all of that IRA owner's IRAs has not been satisfied (either by a distribution from the IRA or, as permitted under paragraph (e) of this section, from another IRA).

(4) *Documentation requirements* —(i) *Disabled or chronically ill beneficiaries.* In determining whether an IRA owner's designated beneficiary is disabled or chronically ill for purposes of § 1.401(a)(9)-4(e), the required documentation described in § 1.401(a)(9)-4(e)(7) need not be provided to the IRA trustee, custodian, or issuer.

(ii) *Trust documentation.* In determining whether the requirements of § 1.401(a)(9)-4(f)(2) are met (to determine whether a trust is a see-through trust), the trust documentation described in § 1.401(a)(9)-4(h) need not be provided to the IRA trustee, custodian, or issuer.

(c) *Surviving spouse treating IRA as own* —(1) *Election generally permitted* —(i) *In general.* The surviving spouse of an individual may elect, in the manner described in paragraph (c)(2) of this section, to treat the surviving spouse's entire interest as a beneficiary in the individual's IRA (or the remaining part of that interest if distributions have begun) as the surviving spouse's own IRA.

(ii) *Eligibility to make election.* In order to make the election described in this paragraph (c)(1), the surviving spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts from the IRA. If a trust is named as beneficiary of the IRA, this requirement is not satisfied even if the surviving spouse is the sole beneficiary of the trust.

(iii) *Timing of election.* If § 1.402(c)-2(j)(4) (the special rule for catch-up distributions after a surviving spouse reaches the applicable age) would apply to the IRA owner's surviving spouse had a distribution been made directly to the surviving spouse in a calendar year, then, except as provided in paragraph (c)(1)(iv) of this section, the election described in this paragraph (c)(1) may not be made in that calendar year.

(iv) *Exception for late elections.* In the case of a surviving spouse who, pursuant to the timing rule in paragraph (c)(1)(iii) of this section, may not make the election described in paragraph (c)(1)(i) of this section in a calendar year, the spouse may nevertheless make the election in that calendar year provided that the election does not apply to amounts in the IRA that would be treated as required minimum distributions under § 1.402(c)-2(j)(4)(ii) had they been distributed in that calendar year. Thus, the election can be made in a calendar year only after the amounts treated as required minimum distributions under § 1.402(c)-2(j)(4)(ii) for that calendar year have been distributed from the IRA.

(2) *Election procedures.* The election described in paragraph (c)(1) of this section is made by the surviving spouse redesignating the account as an account in the name of the surviving spouse as IRA owner rather than as beneficiary. Alternatively, a surviving spouse eligible to make the election is deemed to have made the election if, at any time, either of the following occurs—

(i) Any amount in the IRA that would be required to be distributed to the surviving spouse as beneficiary under section 401(a)(9)(B) for a calendar year following the calendar year of the IRA owner's death is not distributed within the time period required under section 401(a)(9)(B); or

(ii) A contribution (other than a rollover of a distribution from an eligible retirement plan of the decedent) is made to the IRA.

(3) *Effect of election.* Following an election described in paragraph (c)(1) of this section, the surviving spouse is considered the IRA owner for whose benefit the trust is maintained for all purposes under the Internal Revenue Code (including section 72(t)). Thus, for example, the required minimum distribution for the calendar year of the election and each subsequent calendar year is determined under section 401(a)(9)(A) with the spouse as IRA owner and not section 401(a)(9)(B) with the surviving spouse as the deceased IRA owner's beneficiary. However, if the election is made in the calendar year that includes the date of the IRA owner's death, the spouse is not required to take a required minimum distribution as the IRA owner for that calendar year. Instead, the spouse is required to take a required minimum distribution for that year, determined with respect to the deceased IRA owner under the rules of § 1.401(a)(9)-5(c), to the extent the distribution was not made to the IRA owner before death.

(d) *Treatment of rollovers and transfers* —(1) *Treatment of rollovers* —(i) *In general.* If a distribution is rolled over to an IRA, then the rules in § 1.401(a)(9)-7 apply for purposes of determining the account balance and the required minimum distribution for that IRA. However, because the value of the account balance is determined as of December 31 of the year preceding the year for which the required minimum distribution is being determined, and not as of a valuation date in the preceding year, the account balance of the IRA is adjusted only if the amount rolled over is not received in the calendar year in which the amount was distributed. If the amount rolled over is received in the calendar year following the calendar year in which the amount was distributed, then, for purposes of determining the required minimum distribution for that following calendar year, the account balance of the IRA as of December 31 of the calendar year in which the distribution was made must be adjusted by the amount received in accordance with § 1.401(a)(9)-7(b).

(ii) *Spousal rollovers.* A surviving spouse is permitted to roll over a distribution to an IRA as the beneficiary of the deceased employee or IRA owner, and the rules of paragraph (d)(1)(i) of this section apply to that IRA. A surviving spouse may also elect to treat that IRA as the spouse's own IRA in accordance with paragraph (c) of this section.

(2) *Special rules for death before required beginning date* —(i) *Carryover of election under qualified plan or IRA.* If an employee or IRA owner dies before the required beginning date and the surviving spouse rolls over a distribution of the employee's or IRA owner's interest to an IRA in the spouse's capacity as a beneficiary of the deceased employee or IRA owner, then, except as provided in paragraph (d)(2)(ii) of this section, the method for determining required minimum distributions that applied to that surviving spouse under the distributing plan or IRA (such as when a beneficiary makes an election described in § 1.401(a)(9)-3(c)(5)(iii)) also applies to the receiving IRA. Thus, for example, if an employee who died before the required beginning date designated the employee's surviving spouse as a beneficiary of the employee's interest in the plan and the plan provides that the surviving spouse is subject to the 10-year rule described in § 1.401(a)(9)-3(c)(4), then the 10-year rule also applies to any IRA in the name of the decedent that receives a rollover of the employee's interest.

(ii) *Change from 5-year rule or 10-year rule to life expectancy payments.* If the 5-year rule or 10-year rule described in § 1.401(a)(9)-3(b)(2), (c)(2), or (c)(3), respectively, applies to a distributing plan or IRA and a distribution is made to the employee's surviving spouse before the deadline described in § 1.401(a)(9)-3(b)(4)(iii) or (c)(5)(iii) that would have applied had the distributing plan or IRA permitted the surviving spouse to make an election between the 5-year rule or 10-year rule and the life expectancy rule (or, in the case of a defined benefit plan, the annuity payment rule), then the surviving spouse may elect to have the life expectancy rule described in § 1.401(a)(9)-3(c)(4) or the annuity payment rule described in § 1.401(a)(9)-3(b)(3) apply to any IRA to which any portion of that distribution is rolled over. However, see § 1.402(c)-2(j)(4)(ii) to determine the portion of that distribution that is treated as a required minimum distribution in the calendar year of the distribution and thus is not eligible for rollover.

(iii) *Spousal rollover to spouse's own IRA.* If an employee or IRA owner dies before the required beginning date and the surviving spouse rolls over a distribution described in paragraph (d)(2)(i) of this section from the surviving spouse's IRA in the capacity as the beneficiary of the decedent to the surviving spouse's own IRA, then, in determining the amount that is treated as a required minimum distribution under section 401(a)(9) and thus is not eligible for rollover, the rules of § 1.402(c)-2(j)(4) are applied as if the distribution was made directly from the decedent's interest in the plan or IRA to the surviving spouse's own IRA.

(3) *Applicability of rollover rules to non-spouse beneficiary.* The rules of paragraphs (d)(1)(i), (2)(i) and (ii) of this section apply to a non-spouse beneficiary who makes an election to have a distribution made in the form of a direct trustee-to-trustee transfer as described in section 402(c)(11) in the same manner as a rollover of a distribution made by a surviving spouse.

(4) *Treatment of transfers.* In the case of a trustee-to-trustee transfer from one IRA to another IRA that is not a distribution and rollover, the transfer is not treated as a distribution by the transferor IRA for purposes of section 401(a)(9). Accordingly, the minimum distribution requirement with respect to the transferor IRA must still be satisfied. After the transfer, the employee's account balance and the required minimum distribution under the transferee IRA are determined in the same manner that an account balance and required minimum distribution are determined under an IRA receiving a rollover contribution under paragraph (d)(1) of this section.

(e) *Application of section 401(a)(9) for multiple IRAs* —(1) *Distribution from one IRA to satisfy total required minimum distribution* —(i) *In general.* The required minimum distribution from one IRA is permitted to be distributed from another IRA in order to satisfy section 401(a)(9), subject to the limitations of paragraphs (e)(2) and (3) of this section. Except as provided in paragraph (e)(1)(ii) of this section, the required minimum distribution must be calculated separately for each IRA and the sum of those separately calculated required minimum distributions may be distributed from any one or more of the IRAs under the rules set forth in this paragraph (e).

(ii) *Permitted aggregation of annuity contract and account balance.* Subject to the limitations of paragraphs (e)(2) and (3) of this section, an individual who holds an IRA that is an annuity contract described in section 408(b) may elect to aggregate that IRA with one or more IRAs with account balances that the individual holds and apply the optional aggregation rule of § 1.401(a)(9)-5(a)(5)(iv) with respect to the annuity contract and the account balances under those IRAs as if the account balances were the remaining account balances following the purchase of the annuity contract with a portion of those account balances.

(2) *IRAs eligible for aggregate treatment* —(i) *IRA owners.* Generally, only amounts in IRAs that an individual holds as the IRA owner are aggregated for purposes of paragraph (e)(1) of this section. Except in the case of a surviving spouse electing to treat a decedent's IRA as the spouse's own IRA, an IRA that a beneficiary acquires as a result of the death of an individual is not treated as an IRA of the beneficiary but rather as an IRA of the decedent for purposes of this paragraph (e). Thus, for example, for purposes of satisfying the minimum distribution requirements with respect to one IRA by making distributions from another IRA, IRAs for which the individual is the IRA owner are not aggregated with IRAs for which the individual is a beneficiary.

(ii) *IRA beneficiaries.* IRAs that a person holds as a beneficiary of a decedent are aggregated for purposes of paragraph (e)(1) of this section, but those amounts are not aggregated with IRAs that the person holds as the owner or as the beneficiary of a different decedent.

(3) *Non-Roth IRAs are treated separately from section 403(b) contracts and Roth IRAs.* Distributions from an IRA that is not a Roth IRA may not be used to satisfy the required minimum distribution requirements with respect to a Roth IRA, or a section 403(b) contract (as defined in § 1.403(b)-2(b)(16)(i)). Similarly, distributions from a Roth IRA do not satisfy the required minimum distribution requirements with respect to a section 403(b) contract or an IRA that is not a Roth IRA. In addition, distributions from a section 403(b) contract do not satisfy the required minimum distribution requirements with respect to an IRA.

(4) *Allocation rule for partial distributions in year of death* —(i) *Distribution required in year of IRA owner's death.* This paragraph (e)(4) provides a special rule that applies if an IRA owner has multiple IRAs (which do not all have identical beneficiary designations) that are aggregated in accordance with paragraph (e)(1) of this section and that IRA owner dies before taking the total required minimum distribution for the calendar year of the IRA owner's death (that is, there is a shortfall). In that case, each of the owner's IRAs is subject to a requirement to distribute a proportionate share of the shortfall for the calendar year to a beneficiary of that IRA, with the proportions based on the account balances determined under paragraph (b)(2) of this section. This allocation of the shortfall to a particular IRA is made without regard to whether some of the required minimum distribution for the calendar year was already made to the IRA owner from that IRA.

(ii) *Distribution requirement in the year of beneficiary's death.* Rules similar to the rules of paragraph (e)(4)(i) of this section apply in the case of a beneficiary of multiple IRAs that are aggregated under paragraph (e)(1) of this section if a required minimum distribution is due for that beneficiary in the calendar year of the beneficiary's death, to the extent that the amount was not distributed to the beneficiary.

(iii) *Example.* Assume IRA owner X died on December 31, 2024, at the age of 75. At the time of X's death, X owned two separate IRAs, IRA Y and IRA Z, neither of which is a Roth IRA. The balance of IRA Y as of December 31, 2023, was $100,000 and the balance of IRA Z as of December 31, 2023, was $50,000. X died after X's required beginning date and under the rules of paragraph (e)(1) of this section, the total of the 2024 required minimum distributions for IRA Y and IRA Z is $6,097.56 ($150,000/24.6). X designated A as his beneficiary under IRA Y and B as his beneficiary under IRA Z. Prior to X's death, X had taken a $3,000 distribution from IRA Z in 2024. Under the rules of paragraph (e)(4)(i) of this section, the remaining portion of the 2024 required minimum distribution ($3,097.56) is allocated two-thirds to IRA Y and one-third to IRA Z. Thus, in the calendar year of X's death A is required to take a required minimum distribution of

$2,065.04 from IRA Y and B is required to take a required minimum distribution of $1,032.52 from IRA Z.

(f) *Reporting requirements.* The trustee, custodian, or issuer of an IRA is required to report information with respect to the minimum amount required to be distributed from the IRA for each calendar year to individuals or entities, at the time, and in the manner, prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter), as well as the applicable Federal tax forms and accompanying instructions.

(g) *Distributions taken into account* —(1) *General rule.* Except as provided in paragraph (g)(2) of this section, all amounts distributed from an IRA are taken into account in determining whether section 401(a)(9) is satisfied, regardless of whether the amount is includible in income. Thus, for example, a qualified charitable distribution made pursuant to section 408(d)(8) is taken into account in determining whether section 401(a)(9) is satisfied.

(2) *Amounts not taken into account.* The following amounts are not taken into account in determining whether the required minimum distribution with respect to an IRA for a calendar year has been made—

(i) Contributions returned pursuant to section 408(d)(4), together with the income allocable to these contributions;

(ii) Contributions returned pursuant to section 408(d)(5);

(iii) Corrective distributions of excess simplified employee pension contributions under section 408(k)(6)(C), together with the income allocable to these distributions;

(iv) Amounts that are treated as distributed pursuant to section 408(e);

(v) Amounts that are treated as distributed as a result of the purchase of a collectible pursuant to section 408(m);

(vi) Corrective distributions of excess deferrals as described in § 1.402(g)-1(e), together with the income allocable to these corrective distributions; and

(vii) Similar items designated by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. See § 601.601(d) of this chapter.

(h) *Qualifying longevity annuity contracts* —(1) *General rule.* The special rule in § 1.401(a)(9)-5(b)(4) for a QLAC, defined in § 1.401(a)(9)-6(q), applies to an IRA, subject to the modifications set forth in this paragraph (h).

(2) *Reliance on representations.* For purposes of the limitation described in § 1.401(a)(9)-6(q)(2)(ii), unless the trustee, custodian, or issuer of an IRA has actual knowledge to the contrary, the trustee, custodian, or issuer may rely on the IRA owner's representation (made in writing or other form as may be prescribed by the Commissioner) of the amount of the premiums described in § 1.401(a)(9)-6(q)(2)(ii) that are not paid under the IRA.

(3) *Permitted delay in setting beneficiary designation.* In the case of a contract that is rolled over from a plan to an IRA before the required beginning date under the plan, the contract will not violate the rule in § 1.401(a)(9)-6(q)(3)(iii)(F) that a non-spouse beneficiary must be irrevocably selected on or before the later of the date of purchase and the required beginning date under the IRA, provided that the contract requires a beneficiary to be irrevocably selected by the end of the year following the year of the rollover.

(4) *Roth IRAs.* The rule in § 1.401(a)(9)-5(b)(4) does not apply to a Roth IRA. Accordingly, a contract that is purchased under a Roth IRA is not treated as a contract that is intended to be a QLAC for purposes of applying the dollar limitation rule in § 1.401(a)(9)-6(q)(2)(ii). If a QLAC is purchased or held under a plan, annuity, account, or traditional IRA, and that contract is later rolled over or converted to a Roth IRA, the contract is not treated as a contract that is intended to be a QLAC after the date of the rollover or conversion. Thus, premiums paid with respect to the contract will not be taken into account under § 1.401(a)(9)-6(q)(2)(ii) after the date of the rollover or conversion.

(i) [Reserved]

(j) *Applicability date.* This section applies for purposes of determining required minimum distributions for calendar years beginning on or after January 1, 2025. For earlier calendar years, the rules of 26 CFR 1.408-8 (as it appeared in the April 1, 2023, edition of 26 CFR part 1) apply.

**Par. 9.** Amend § 1.457-6 by revising and republishing paragraph (d).

The revision and republication read as follows:

§ 1.457-6
Timing of distributions under eligible plans.
* * * * *

(d) *Minimum required distributions for eligible plans.* In order to be an eligible plan, a plan must meet the distribution requirements of section 457(d)(1) and (2). Under section 457(d)(2), a plan must meet the minimum distribution requirements of section 401(a)(9). See section 401(a)(9) and the regulations thereunder for these requirements. For taxable years beginning on or after January 1, 2025, if an eligible plan is subject to the rules of § 1.401(a)(9)-5, then the plan must meet the requirements of section 401(a)(9)(H). The preceding sentence applies to an eligible plan maintained by any eligible employer (including an eligible plan of a tax-exempt entity).

* * * * *

**PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE**

**Par. 10.** The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805, unless otherwise noted.

**Par. 11.** For each section set forth below, revise the section by removing the text that appears in the column labeled “Remove” and replacing it with the text that appears in the column labeled “Insert”:

| Regulation section | Remove | Insert |
|---|---|---|
| § 31.3405(c)-1, Q&A-1(a) | "§ 1.402(c)-2, Q&A-2" | "§ 1.402(c)-2(a)(1)(iii)". |
| § 31.3405(c)-1, Q&A-1(b) | "§ 1.402(c)-2, Q&A-3 through Q&A-10 and Q&A-14" | "§ 1.402(c)-2". |
| § 31.3405(c)-1, Q&A-4 | "§ 1.402(c)-2, Q&A-10" | "§ 1.402(c)-2(h)". |
| § 31.3405(c)-1, Q&A-7(a) | "§ 1.402(c)-2, Q&A-2" | "§ 1.402(c)-2(a)(1)(iii)". |
| § 31.3405(c)-1, Q&A-10(a) | "§ 1.402(c)-2, Q&A-15" | "§ 1.402(c)-2(k)(2)". |
| § 31.3405(c)-1, Q&A-11 | "§ 1.402(c)-2, Q&A-9" | "§ 1.402(c)-2(g)". |
| § 31.3405(c)-1, Q&A-13 | "Q&A-10 of § 1.402(c)-2" | "§ 1.402(c)-2(h)". |
| § 31.3405(c)-1, Q&A-13 | "§ 1.402(c)-2, Q&A-10" | "§ 1.402(c)-2(h)". |

**PART 54—PENSION EXCISE TAXES**

**Par. 12.** The authority citation for part 54 continues to read in part as follows:

Authority: 26 U.S.C. 7805, unless otherwise noted.

**Par. 13.** Revise and republish § 54.4974-1 to read as follows:

§ 54.4974-1
Excise tax on accumulations in qualified retirement plans.

(a) *Imposition of excise tax* —(1) *In general.* If the amount distributed to a payee under any qualified retirement plan or any eligible deferred compensation plan (as defined in section 457(b)) for a calendar year is less than the required minimum distribution for that year, section 4974 imposes an excise tax on the payee for the taxable year beginning with or within the calendar year during which the amount is required to be distributed. Except as provided in paragraph (a)(2) of this section, the tax is equal to 25 percent of the amount by which the required minimum distribution for a calendar year exceeds the actual amount distributed during the calendar year.

(2) *Reduction of tax in certain cases* —(i) *In general.* In the case of a taxpayer who satisfies this paragraph (a)(2), the tax described in paragraph (a)(1) of this section is equal to 10 percent (in lieu of 25 percent) of the amount by which the required minimum distribution for a calendar year exceeds the actual amount distributed during the calendar year.

(ii) *Eligible taxpayers.* This paragraph (a)(2) is satisfied if, by the last day of the correction window described in paragraph (a)(2)(iii) of this section, the taxpayer—

(A) Receives a corrective distribution from the applicable plan described in paragraph (a)(2)(iv) of this section of the amount by which the required minimum distribution for a calendar year exceeds the actual amount distributed during the calendar year from that plan; and

(B) Files a return reflecting the tax described in this paragraph (a).

(iii) *Correction window.* For purposes of paragraph (a)(2) of this section, the correction window ends on the earliest of—

(A) The date a notice of deficiency under section 6212 with respect to the tax imposed by section 4974(a) is mailed;

(B) The date on which the tax imposed by section 4974(a) is assessed; or

(C) The last day of the second taxable year that begins after the end of the taxable year in which the tax under section 4974(a) is imposed.

(iv) *Applicable plan.* If the minimum distribution was required to be paid from a particular qualified retirement plan or eligible deferred compensation plan, then the applicable plan is that particular qualified retirement plan or eligible deferred compensation plan. However, if the requirement to take a minimum distribution could have been satisfied by a payment from any one of a number of qualified retirement plans (such as an individual retirement account under section 408(a) or a section 403(b) plan), then the corrective distribution may be taken from any one of those qualified retirement plans.

(3) *Definition of required minimum distribution.* For purposes of section 4974, the term required minimum distribution means the minimum amount required to be distributed pursuant to section 401(a)(9), 403(b)(10), 408(a)(6), 408(b)(3), or 457(d)(2), as the case may be. Except as otherwise provided in paragraph (f) of this section (which provides a special rule for amounts required to be distributed by an employee's, or an individual's, required beginning date), the required minimum distribution for a calendar year is the required minimum distribution amount required to be distributed during the calendar year.

(b) *Definition of qualified retirement plan.* For purposes of section 4974, each of the following is a qualified retirement plan—

(1) A plan described in section 401(a) that includes a trust exempt from tax under section 501(a);

(2) An annuity plan described in section 403(a);

(3) An annuity contract, custodial account, or retirement income account described in section 403(b);

(4) An individual retirement account described in section 408(a) (including a Roth IRA described in section 408A);

(5) An individual retirement annuity described in section 408(b) (including a Roth IRA described in section 408A); or

(6) Any other plan, contract, account, or annuity that, at any time, has been treated as a plan, account, or annuity described in paragraphs (b)(1) through (5) of this section but that no longer satisfies the applicable requirements for that treatment.

(c) *Determination of required minimum distribution for individual accounts*— (1) *General rule.* Except as otherwise provided in this paragraph (c), if a payee's interest under a qualified

retirement plan or any eligible deferred compensation plan is in the form of an individual account (and distribution of that account is not being made under an annuity contract purchased in accordance with § 1.401(a)(9)-5(a)(5) and § 1.401(a)(9)-6(d)), the amount of the required minimum distribution for any calendar year for purposes of section 4974 is the amount required to be distributed to that payee for that calendar year determined in accordance with § 1.401(a)(9)-5 as provided in the following (whichever applies)—

(i) Section 401(a)(9), §§ 1.401(a)(9)-1 through 1.401(a)(9)-5, and 1.401(a)(9)-7 through 1.401(a)(9)-9, in the case of a plan described in section 401(a) that includes a trust exempt under section 501(a) or an annuity plan described in section 403(a);

(ii) Section 403(b)(10) and § 1.403(b)-6(e) in the case of an annuity contract, custodial account, or retirement income account described in section 403(b);

(iii) Section 408(a)(6) or (b)(3) and § 1.408-8 in the case of an individual retirement account or annuity described in section 408(a) or (b); or

(iv) Section 457(d) and § 1.457-6(d) in the case of an eligible deferred compensation plan.

(2) *Distributions under 5-year rule or 10-year rule.* If an employee dies before the required beginning date and either § 1.401(a)(9)-3(c)(2) or (3) applies to the employee's beneficiary, there is no required minimum distribution until the end of the calendar year described in whichever of those paragraphs applies to the beneficiary (that is, the calendar year that includes the fifth anniversary or the tenth anniversary of the date of the employee's death, as applicable). The required minimum distribution due in that fifth or tenth calendar year is the employee's entire interest in the plan.

(3) *Default provisions.* Unless otherwise provided under the qualified retirement plan or eligible deferred compensation plan (or, if applicable, the governing instrument of the plan), the default provisions in § 1.401(a)(9)-3(c)(5)(i) apply in determining whether paragraph (c)(1) or (2) of this section applies.

(4) *Plans providing uniform required beginning date.* For purposes of this section, if the plan provides a uniform required beginning date for purposes of section 401(a)(9) for all employees in accordance with § 1.401(a)(9)-2(b)(4), then the required minimum distribution for each calendar year for an employee who is not a 5-percent owner is the lesser of the amount determined based on a required beginning date of April 1 of the calendar year following the calendar year in which the employee attains the applicable age or the amount determined based on the required beginning date under the plan. Thus, for example, if an employee who was not a 5-percent owner participated in a defined contribution plan with a uniform required beginning date (as described in the preceding sentence) and the employee died after the applicable age (but before April 1 of the calendar year following the calendar year in which the employee retired) without a designated beneficiary, then required minimum distributions for calendar years after the calendar year that includes the date of the employee's death are equal to the lesser of—

(i) The required minimum distribution determined by treating the employee as dying before the required beginning date (that is, the 5-year rule of § 1.401(a)(9)-3(c)(2)); or

(ii) The required minimum distribution determined by treating the employee as dying on or after the required beginning date (annual distributions over the employee's remaining life expectancy, as set forth in § 1.401(a)(9)-5(d)).

(d) *Determination of required minimum distribution under a defined benefit plan or annuity* —(1) *General rule.* If a payee's interest in a qualified retirement plan or eligible deferred compensation plan is being distributed in the form of an annuity (either directly from the plan, in the case of a defined benefit plan, or under an annuity contract purchased from an insurance company), then the amount of the required minimum distribution for purposes of section 4974 depends on whether the annuity is a permissible annuity distribution option or an impermissible annuity distribution option. For this purpose—

(i) A permissible annuity distribution option is an annuity contract (or, in the case of annuity distributions from a defined benefit plan, a distribution option) that specifically provides for distributions that, if made as provided, would for every calendar year equal or exceed the minimum distribution amount required to be distributed to satisfy the applicable section enumerated in paragraph (b) of this section for that calendar year; and

(ii) An impermissible annuity distribution option is any other annuity distribution option.

(2) *Permissible annuity distribution option.* If the annuity contract (or, in the case of annuity distributions from a defined benefit plan, a distribution option) under which distributions to the payee are being made is a permissible annuity distribution option, then the required minimum distribution for a given calendar year for purposes of section 4974 equals the amount that the annuity contract (or distribution option) provides is to be distributed for that calendar year.

(3) *Impermissible annuity distribution option* —(i) *General rule.* If the annuity contract (or, in the case of annuity distributions from a defined benefit plan, the distribution option) under which distributions to the payee are being made is an impermissible annuity distribution option, then the required minimum distribution for each calendar year for purposes of section 4974 is the amount that would be distributed under the applicable permissible annuity distribution option described in this paragraph (d)(3) (or the amount determined by the Commissioner if there is no option of this type). The determination of which permissible annuity distribution applies depends on whether distributions commenced before the death of the employee, whether the plan is a defined benefit or defined contribution plan, whether there is a designated beneficiary for purposes of section 401(a)(9), and whether the designated beneficiary is an eligible designated beneficiary under section 401(a)(9)(E)(ii). For this purpose, the determination of whether there is a designated beneficiary and whether that designated beneficiary is an eligible designated beneficiary is made in accordance with § 1.401(a)(9)-4, and the determination of which designated beneficiary's life is to be used in the case of multiple designated beneficiaries in made in accordance with § 1.401(a)(9)-5(f).

(ii) *Defined benefit plan* —(A) *Benefits commence before employee dies.* If the plan under which distributions are being made is a defined benefit plan, benefits commence before the employee dies, and there is a designated beneficiary, then the applicable permissible annuity distribution option is the joint and survivor annuity option under the plan for the lives of the employee and the designated beneficiary that is a permissible annuity distribution option and that provides for the greatest level amount payable to the employee determined on an annual basis. If the plan does not provide an option described in the preceding sentence (or there is no designated beneficiary under the impermissible annuity distribution option), then the applicable permissible annuity

distribution option is the life annuity option under the plan payable for the life of the employee in level amounts with no survivor benefit.

(B) *Employee dies before benefits commence.* If the plan under which distributions are being made is a defined benefit plan, the employee dies before benefits commence, there is a designated beneficiary, and the plan has a life annuity option payable for the life of the designated beneficiary in level amounts, then the applicable permissible annuity distribution option is that life annuity option. If there is no designated beneficiary, then the 5-year rule in section 401(a)(9)(B)(ii) applies in accordance with paragraph (d)(4)(i) of this section.

(iii) *Defined contribution plan* —(A) *In general.* If the plan under which distributions are being made is a defined contribution plan and the impermissible annuity distribution option is an annuity contract purchased from an insurance company, then the applicable permissible annuity distribution option is the applicable annuity described in paragraph (d)(3)(iii)(B) or (C) of this section that could have been purchased with the portion of the employee's or individual's account that was used to purchase the annuity contract that is the impermissible annuity distribution option. The amount of the payments under that annuity contract are determined using the interest rate prescribed under section 7520 determined as of the date the contract was purchased, the ages of the annuitants on that date, and the mortality rates in § 1.401(a)(9)-9(e).

(B) *Benefits commence before employee dies.* If the plan under which distributions are being made is a defined contribution plan, the benefits commence before the employee dies, and there is a designated beneficiary who is an eligible designated beneficiary within the meaning of section 401(a)(9)(E)(ii), then the applicable annuity is the joint and survivor annuity option providing level annual payments for the lives of the employee and the designated beneficiary, under which the amount of the periodic payment that would have been payable to the survivor is the applicable percentage under the table in § 1.401(a)(9)-6(b)(2) (taking into account the rules of § 1.401(a)(9)-6(k)(2)) of the amount of the periodic payment that would have been payable to the employee or individual. If there is no designated beneficiary, or if the designated beneficiary is not an eligible designated beneficiary under the impermissible distribution option, then the annuity described in this paragraph (d)(3)(iii)(B) is a life annuity for the life of the employee with no survivor benefit that provides level annual payments.

(C) *Employee dies before benefits commence.* If the plan under which distributions are being made is a defined contribution plan, the employee dies before benefits commence, and there is an eligible designated beneficiary under the impermissible annuity distribution option, then the applicable annuity is a life annuity for the life of the designated beneficiary that provides level annual payments and that would have been a permissible annuity distribution option. If there is no designated beneficiary, then section 401(a)(9)(B)(ii) applies in accordance with paragraph (d)(4)(i) of this section. If the designated beneficiary is not an eligible designated beneficiary, then section 401(a)(9)(B)(ii) applies in accordance with paragraph (d)(4)(ii) of this section.

(4) *Application of section 401(a)(9)(B)(ii)* —(i) *Application of 5-year rule.* If the 5-year rule in section 401(a)(9)(B)(ii) applies to the distribution to the payee under the contract (or distribution option), then no amount is required to be distributed to satisfy the applicable enumerated section in paragraph (b) of this section until the end of the calendar year that includes the fifth anniversary of the date of the employee's death. For the calendar year that includes the fifth anniversary of the date of the employee's death, the amount required to be distributed to satisfy the applicable enumerated section is the payee's entire remaining interest in the annuity contract (or under the

plan in the case of distributions from a defined benefit plan). However, see § 1.401(a)(9)-6(j) for rules regarding payments that are not permitted under section 436.

(ii) *Application of 10-year rule.* If the employee dies before distribution of the employee's entire interest, section 401(a)(9)(H) applies, and the designated beneficiary of the remaining interest is not an eligible designated beneficiary, then no amount is required to be distributed to satisfy the applicable enumerated section in paragraph (b) of this section until the end of the calendar year that includes the tenth anniversary of the date of the employee's death. For the calendar year that includes the tenth anniversary of the date of the employee's death, the amount required to be distributed to satisfy the applicable enumerated section is the payee's entire remaining interest in the annuity contract.

(5) *Plans providing uniform required beginning date.* Rules similar to the rules of paragraph (c)(4) of this section (relating to plans that have adopted a uniform required beginning date) apply in the case of a defined benefit plan.

(e) *Distribution of remaining benefit after deadline for required distribution.* If there is any remaining benefit with respect to an employee (or IRA owner) after the calendar year in which the entire remaining benefit is required to be distributed, the required minimum distribution for each calendar year subsequent to that calendar year is the entire remaining benefit. Thus, for example, if the designated beneficiary of the employee is not an eligible designated beneficiary, then, pursuant to § 1.401(a)(9)-5(e)(2), the entire interest of the employee must be distributed no later than the end of the calendar year that includes the tenth anniversary of the date of the employee's death, and the required minimum distribution for that calendar year and each subsequent calendar year is the remaining portion of the employee's interest in the plan.

(f) *Excise tax for first distribution calendar year.* If the amount not paid is an amount required to be paid by April 1 of a calendar year that includes the employee's required beginning date, the missed distribution is a required minimum distribution for the previous calendar year (that is, for the employee's or the individual's first distribution calendar year as determined in accordance with § 1.401(a)(9)-5(a)(2)(ii)). However, the excise tax under section 4974 is calculated with respect to the calendar year that includes the last day by which the amount is required to be distributed (that is, the calendar year that includes the employee's or individual's required beginning date) even though the preceding calendar year is the calendar year for which the amount is required to be distributed. There is also a required minimum distribution for the calendar year that includes the employee's or individual's required beginning date, and that distribution is also required to be made during the calendar year that includes the employee's or individual's required beginning date.

(g) *Waiver of excise tax* —(1) *General rule.* The tax under paragraph (a) of this section may be waived if the payee establishes to the satisfaction of the Commissioner that—

(i) The failure to distribute the required minimum distribution described in this section was due to reasonable error; and

(ii) Reasonable steps are being taken to remedy the failure.

(2) *Automatic waiver after election to distribute within 10 years of employee's death.* Unless the Commissioner determines otherwise, the tax under paragraph (a) of this section is waived automatically if—

(i) The employee's or individual's death is before the employee's or individual's required beginning date;

(ii) The payee is an individual—

(A) Who is an eligible designated beneficiary (as defined in § 1.401(a)(9)-4(e));

(B) Whose required minimum distribution amount for a calendar year is determined under the life expectancy rule described in § 1.401(a)(9)-3(c)(4); and

(C) Who did not make an affirmative election to have the life expectancy rule apply as described in § 1.401(a)(9)-3(c)(5)(iii);

(iii) The payee fails to satisfy the minimum distribution requirement; and

(iv) The payee elects the 10-year rule described in § 1.401(a)(9)-3(c)(3) by the end of the ninth calendar year following the calendar year of the employee's death.

(3) *Automatic waiver for failure to take required minimum distribution for the year of death.* Unless the Commissioner determines otherwise, the tax under paragraph (a) of this section is waived automatically if—

(i) A distribution is required to be made to an individual under § 1.401(a)(9)-3 or § 1.401(a)(9)-5 in a calendar year;

(ii) The individual who was required to take the distribution described in paragraph (g)(3)(i) of this section died in that calendar year without satisfying that distribution requirement; and

(iii) The beneficiary of the individual described in paragraph (g)(3)(ii) of this section takes a corrective distribution in the amount needed to satisfy that distribution requirement no later than the tax filing deadline (including extensions thereof) for the taxable year of that beneficiary that begins with or within that calendar year (or, if later, the last day of the calendar year following that calendar year).

(h) *Applicability date.* This section applies for taxable years beginning on or after January 1, 2025. For earlier taxable years, the rules of 26 CFR 54.4974-2 (as it appeared in the April 1, 2023, edition of 26 CFR part 54) apply.

§ 54.4974-2
[Removed]

**Par. 14.** Section 54.4974-2 is removed.

# *Connelly v. United States*

Supreme Court of the United States

March 27, 2024, Argued; June 6, 2024, Decided

No. 23-146.

**Reporter**
602 U.S. 257 *; 144 S. Ct. 1406 **; 219 L. Ed. 2d 31 ***; 2024 U.S. LEXIS 2485 ****; 30 Fla. L. Weekly Fed. S 227; 2024 WL 2859749

THOMAS A. ***CONNELLY***, AS EXECUTOR OF THE ESTATE OF MICHAEL P. ***CONNELLY***, SR., PETITIONER v. ***UNITED STATES***

**Notice:** The pagination of this document is subject to change pending release of the final published version.

**Prior History: [****1]** ON WRIT OF CERTIORARI TO THE ***UNITED STATES*** COURT OF APPEALS FOR THE EIGHTH CIRCUIT

***Connelly** v. **United States**, Dep't of Treasury, IRS, 70 F.4th 412, 2023 U.S. App. LEXIS 13629 (8th Cir. Mo., June 2, 2023)*

**Disposition:** *70 F. 4th 412*, affirmed.

## Case Summary

**Overview**
HOLDINGS: [1]-In a case involving brothers who were the sole shareholders in a closely held corporation, the corporation's contractual obligation to redeem the deceased brother's shares at fair market value was not a liability that decreased the value of those shares for purposes of the federal estate tax. For calculating the estate tax, the whole point was to assess how much the deceased brother's shares were worth at the time that he died—before the corporation spent $3 million on the redemption payment. A hypothetical buyer would thus treat life insurance proceeds that would be used to redeem the deceased brother's shares as a net asset. The brothers' arrangement guaranteed that the insurance proceeds would be available to fund the redemption. The arrangement also meant that the corporation would receive the proceeds and thereby increase the value of the deceased brother's shares.

**Outcome**
Judgment affirmed. Unanimous decision.

## Syllabus

**[**1407] [***33] [*257]** Michael and Thomas ***Connelly*** were the sole shareholders in Crown C Supply, a small building supply corporation. The brothers entered into an agreement to ensure that Crown would stay in the family if either brother died. Under that agreement, the surviving brother would have the option to purchase the deceased brother's shares. If he declined, Crown itself would be required to redeem (*i.e.*, purchase) the shares. To ensure that Crown would have enough money to redeem the shares if required, it obtained $3.5 million in life insurance on each brother. After Michael died, Thomas elected not to purchase Michael's shares, thus triggering Crown's obligation to do so. Michael's son and Thomas agreed that the value of Michael's shares was $3 million, and Crown paid the same amount to Michael's estate. As the executor of Michael's estate, Thomas then filed a federal tax return for the estate, which reported the value of Michael's shares as $3 million. The Internal Revenue Service (IRS) audited the return. During the audit, Thomas obtained a valuation from an outside accounting firm. That firm determined **[****2]** that Crown's fair market value at Michael's death was $3.86 million, an amount that excluded the $3 million in insurance proceeds used to redeem Michael's shares on the theory that their value was offset by the redemption obligation. Because Michael had held a 77.18% ownership interest in Crown, the analyst calculated the value of Michael's shares as approximately $3 million ($3.86 million x 0.7718). The IRS disagreed. It insisted that Crown's redemption obligation did not offset the life-insurance proceeds, and accordingly, assessed Crown's total value as $6.86 million ($3.86 million + $3 million). The IRS then calculated the value of Michael's shares as $5.3 million **[**1408]** ($6.86 million x 0.7718). Based on this higher valuation, the IRS determined that the estate owed an additional $889,914 in taxes. The estate paid the **[***34]** deficiency and Thomas, acting as executor, sued the ***United States*** for a refund. The District Court granted summary judgment to the Government. The court held that, to accurately value Michael's shares, the $3 million in life-insurance proceeds must be counted in Crown's valuation. The Eighth Circuit affirmed.

**[*258]** *Held:* A corporation's contractual obligation to redeem shares **[****3]** is not necessarily a liability that reduces a corporation's value for purposes of the federal estate tax.

When calculating the federal estate tax, the value of a decedent's shares in a closely held corporation must reflect the corporation's fair market value. And, life-insurance proceeds payable to a corporation are an asset that increases the corporation's fair market value. The question here is whether Crown's contractual obligation to redeem Michael's shares at fair market value offsets the value of life-insurance proceeds committed to funding that redemption.

The answer is no. Because a fair-market-value redemption has no effect on any shareholder's economic interest, no hypothetical buyer purchasing Michael's shares would have treated Crown's obligation to redeem Michael's shares at fair market value as a factor that reduced the value of those shares. At the time of Michael's death, Crown was worth $6.86 million—$3 million in life-insurance proceeds earmarked for the redemption plus $3.86 million in other assets and income-generating potential. Anyone purchasing


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Michael's shares would acquire a 77.18% stake in a company worth $6.86 million, along with Crown's obligation to redeem **[****4]** those shares at fair market value. A buyer would therefore pay up to $5.3 million for Michael's shares ($6.86 million x 0.7718)—*i.e.*, the value the buyer could expect to receive in exchange for Michael's shares when Crown redeemed them at fair market value. Crown's promise to redeem Michael's shares at fair market value did not reduce the value of those shares.

Thomas's efforts to resist this straightforward conclusion fail. He views the relevant inquiry as what a buyer would pay for shares that make up the same percentage of the less-valuable corporation that exists after the redemption. For calculating the estate tax, however, the whole point is to assess how much Michael's shares were worth at the time that he died—before Crown spent $3 million on the redemption payment. See *26 U. S. C. §2033* (defining the gross estate to "include the value of all property to the extent of the interest therein of the decedent at the time of his death"). A hypothetical buyer would treat the life-insurance proceeds that would be used to redeem Michael's shares as a net asset.

Thomas's argument that the redemption obligation was a liability also cannot be reconciled with the basic mechanics of a stock redemption. He **[****5]** argues that Crown was worth only $3.86 million before the redemption, and thus that Michael's shares were worth approximately $3 million ($3.86 million x 0.7718). But he also argues that Crown was worth $3.86 million *after* Michael's shares were redeemed. See Reply Brief 6. Both cannot be right: A corporation that pays out **[*259]** $3 million to redeem shares should be worth *less* than before the redemption.

**[***35]** Finally, Thomas asserts that affirming the decision below will make succession planning more difficult for closely held corporations. But the result here is simply a consequence of how the ***Connelly*** brothers chose to structure their agreement. Pp. 5-9.

**[**1409]** *70 F. 4th 412*, affirmed.

**Counsel: Kannon K. Shanmugam** argued the cause for petitioner.

**Yaira Dubin** argued the cause for respondent.

**Judges:** THOMAS, J., delivered the opinion for a unanimous Court.

**Opinion by:** THOMAS

## Opinion

JUSTICE THOMAS delivered the opinion of the Court.

Michael and Thomas ***Connelly*** owned a building supply corporation. The brothers entered into an agreement to ensure that the company would stay in the family if either brother died. Under that agreement, the corporation could be required to redeem (*i.e.*, purchase) the deceased brother's shares. To fund the possible share redemption, the corporation obtained life insurance on each brother. After Michael died, a narrow dispute **[****6]** arose over how to value his shares for calculating the estate tax. The central question is whether the corporation's obligation to redeem Michael's shares was a liability that decreased the value of those shares. We conclude that it was not and therefore affirm.

**[*260]** I

A

Congress has long imposed a tax "on the transfer of the taxable estate of every decedent who is a citizen or resident of the ***United States***." *26 U. S. C. §2001(a)*. [1] A decedent's "taxable estate" is the value of "all property, real or personal, tangible or intangible," owned by the decedent "at the time of his death," minus applicable deductions. *§§2031(a)*, *2051*. Imposing the estate tax thus requires calculating the value of the property in the decedent's estate. In general, the lodestar for that assessment is "fair market value," which "is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." *26 CFR §20.2031-1(b)* (2021).

A decedent's taxable estate includes his shares in a closely held corporation. *26 U. S. C. §2031(b)*. Closely held corporations ordinarily have only a few shareholders (often within the same family) and, unlike public corporations, **[****7]** those shareholders typically participate in the corporation's day-to-day management. 3 J. Cox & T. Hazen, Law of Corporations **[**1410]** §14.1 (3d ed. 2010) (Cox & Hazen). Given this close working relationship, shareholders sometimes enter into an agreement to restrict the transfer of shares to outside investors. 3 *id.*, §14.9. One such arrangement involves "giving the corporation or the other shareholders the right to purchase the shares of a holder on his death." *Ibid.* A related arrangement, called a share redemption agreement, contractually *requires* a corporation **[***36]** to repurchase a deceased shareholder's shares. Although such an agreement may delineate **[*261]** how to set a price for the shares, it is ordinarily not dispositive for valuing the decedent's shares for the estate tax. See *26 U. S. C. §2703*. As a general rule, the fair market value of the corporation determines the value of the shares, and one must therefore consider "the company's net worth, prospective earning power and dividend-paying capacity, and

[1] Not all estates are subject to the estate tax. Because certain credits are allowed against the estate tax, any estate valued below a certain threshold (today, about $13.6 million) is not subject to the tax. See *26 U. S. C. §2010(c)*.


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other relevant factors," "including proceeds of life insurance policies payable to . . . the company." *26 CFR §20.2031-2(f)(2)*.

B

Brothers Michael and Thomas ***Connelly*** were the sole shareholders in Crown C Supply, a small but successful **[****8]** building supply corporation in St. Louis, Missouri. Michael owned 77.18% of Crown's outstanding shares (385.9 out of 500 shares), and Thomas owned the remaining 22.82% (114.1 shares). The brothers entered into an agreement with Crown to ensure a smooth transition of ownership and keep Crown in the family in the event one of the brothers died. The agreement provided that if either Michael or Thomas died, the surviving brother would have the option to purchase the deceased brother's shares. And, if the surviving brother declined to do so, then Crown itself would be contractually required to redeem the shares. With an exception not relevant here, the agreement specified that the redemption price for each share would be based upon an outside appraisal of Crown's fair market value. App. 12-14. To ensure that Crown would have enough money to redeem the shares if required, Crown obtained $3.5 million in life insurance on each brother.

When Michael died in 2013, Thomas opted not to purchase Michael's shares. As a result, Crown was obligated under the agreement to redeem Michael's shares. Rather than secure an outside appraisal of the company's fair market value (as the agreement contemplated), **[****9]** Michael's son and Thomas agreed in an "amicable and expeditious manner" that the value of Michael's shares was $3 million. *Id.*, at 25-26. **[*262]** Crown then used $3 million of the life-insurance proceeds to redeem Michael's shares, leaving Thomas as Crown's sole shareholder.

As the executor of Michael's estate, Thomas then filed a federal tax return for the estate. The return reported the value of Michael's shares as $3 million, in accordance with the agreement between Michael's son and Thomas. The Internal Revenue Service (IRS) audited the return. During the audit, Thomas obtained a valuation from an accounting firm. The firm's analyst took as given the holding in *Estate of Blount v. Commissioner, 428 F. 3d 1338 (CA11 2005)*, which concluded that insurance proceeds should be "deduct[ed] . . . from the value" of a corporation when they are "offset by an obligation to pay those proceeds to the estate in a stock buyout." *Id., at 1345*. The analyst thus excluded the $3 million in insurance proceeds used to redeem Michael's shares, and determined that Crown's fair market value at Michael's death was $3.86 million. Because Michael held a 77.18% ownership interest, the analyst calculated the value of Michael's shares as approximately $3 million ($3.86 million x 0.7718). **[****10]**

**[**1411]** The IRS took a different view, insisting that Crown's redemption obligation did not offset the life-insurance **[***37]** proceeds. The IRS counted the $3 million in life-insurance proceeds excluded by the analyst and assessed Crown's total value as $6.86 million ($3.86 million + $3 million). And, the IRS


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thus calculated the value of Michael's shares as $5.3 million ($6.86 million x 0.7718). Based on this higher valuation, the IRS determined that the estate owed an additional $889,914 in taxes.

The estate paid the deficiency and Thomas, acting as executor, sued the ***United States*** for a refund. As relevant, Thomas argued that the $3 million in life-insurance proceeds used to redeem Michael's shares should not be counted when calculating the value of those shares. The District Court granted summary judgment to the Government, concluding that Michael's estate was not entitled to a refund. ***Connelly [*263]*** *v. Dep't of Treasury, IRS, 2021 U.S. Dist. LEXIS 179745, 2021 WL 4281288, *17 (ED Mo., Sept. 21, 2021)*. The court held that the $3 million in life-insurance proceeds must be counted to accurately value Michael's shares. It explained that, under customary valuation principles, Crown's obligation to redeem Michael's shares was not a liability that reduced the corporation's fair market value. *2021 U.S. Dist. LEXIS 179745, [WL] at *14*. The court therefore held **[****11]** that Crown's redemption obligation did not offset the life-insurance proceeds. *2021 U.S. Dist. LEXIS 179745, [WL] at *15-*17*. The Court of Appeals affirmed on the same basis. ***Connelly*** *v. Department of Treasury, IRS, 70 F. 4th 412 (CA8 2023)*.

We granted certiorari, *601 U. S. ___, 144 S. Ct. 536, 217 L. Ed. 2d 285 (2023)*, to address whether life-insurance proceeds that will be used to redeem a decedent's shares must be included when calculating the value of those shares for purposes of the federal estate tax. We now affirm.

II

The dispute in this case is narrow. All agree that, when calculating the federal estate tax, the value of a decedent's shares in a closely held corporation must reflect the corporation's fair market value. And, all agree that life insurance proceeds payable to a corporation are an asset that increases the corporation's fair market value. The only question is whether Crown's contractual obligation to redeem Michael's shares at fair market value offsets the value of life-insurance proceeds committed to funding that redemption.

Thomas argues that a contractual obligation to redeem shares is a liability that offsets the value of life-insurance proceeds used to fulfill that obligation. Brief for Petitioner 17. He accordingly contends that anyone purchasing "a subset of the corporation's shares would treat the two as canceling each other **[****12]** out." *Ibid.* By contrast, the Government argues that Crown's obligation to pay for Michael's shares did not reduce the value of those shares. It contends that "no real-world buyer or seller would have viewed the redemption **[*264]** obligation as an offsetting liability." Brief for ***United States*** 15. We agree with the Government.

An obligation to redeem shares at fair market value does not offset the value of life-insurance proceeds set aside for the redemption because a share redemption at fair market value does not affect any shareholder's economic interest. A simple example **[***38]** proves the point. Consider a corporation with one asset—


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$10 million in cash—and two shareholders, A and B, who own 80 and 20 shares respectively. Each individual share is worth $100,000 ($10 million ÷ 100 shares). So, A's shares are worth $8 million (80 shares x $100,000) and B's shares are worth $2 million (20 shares x $100,000). To redeem B's shares at fair market value, the corporation would thus **[**1412]** have to pay B $2 million. After the redemption, A would be the sole shareholder in a corporation worth $8 million and with 80 outstanding shares. A's shares would still be worth $100,000 each ($8 million ÷ 80 shares). Economically, **[****13]** the redemption would have no impact on either shareholder. The value of the shareholders' interests after the redemption—A's 80 shares and B's $2 million in cash—would be equal to the value of their respective interests in the corporation before the redemption. Thus, a corporation's contractual obligation to redeem shares at fair market value does not reduce the value of those shares in and of itself.

Because a fair-market-value redemption has no effect on any shareholder's economic interest, no willing buyer purchasing Michael's shares would have treated Crown's obligation to redeem Michael's shares at fair market value as a factor that reduced the value of those shares. At the time of Michael's death, Crown was worth $6.86 million—$3 million in life-insurance proceeds earmarked for the redemption plus $3.86 million in other assets and income-generating potential. Anyone purchasing Michael's shares would acquire a 77.18% stake in a company worth $6.86 million, along with Crown's obligation to redeem those shares at fair market value. A buyer would therefore pay up to $5.3 million for **[*265]** Michael's shares ($6.86 million x 0.7718)—*i.e.*, the value the buyer could expect to receive in exchange **[****14]** for Michael's shares when Crown redeemed them at fair market value. We thus conclude that Crown's promise to redeem Michael's shares at fair market value did not reduce the value of those shares.

Thomas resists this straightforward conclusion. He suggests that Crown's redemption obligation "would make it impossible" for a hypothetical buyer seeking to purchase 77.18% of Crown "to capture the full value of the insurance proceeds." Brief for Petitioner 26. That is so, according to Thomas, because the insurance proceeds would leave the company as soon as they arrived to complete the redemption. He argues that the "buyer would thus not consider proceeds that would be used for redemption as net assets." *Ibid.* In other words, Thomas views the relevant inquiry as what a buyer would pay for shares that make up the same percentage of the less-valuable corporation that exists after the redemption. See *Estate of Blount v. Commissioner, T.C. Memo 2004-116, 87 T.C.M. (CCH) 1303 (2004), ¶2004-116* RIA Memo TC, aff 'd in part and rev'd in part, *428 F. 3d 1338 (CA11 2005)*; see also *A. Chodorow, Valuing Corporations for Estate Tax Purposes, 3 Hastings Bus. L. J. 1, 25 (2006)* ("Any valuation that takes the redemption obligation into account effectively values the corporation on a 'post-redemption' basis, i.e., after the decedent's shares have been redeemed"). But, for calculating the estate tax, the whole point **[****15]** is to assess how much Michael's shares were worth at the **[***39]** time that he died—before Crown spent $3 million on the redemption payment. See *26 U. S. C. §2033* (defining the gross estate to "include the value of all property to the extent of the interest therein of the decedent at the time of his death"); *26 CFR §20.2031-1(b)* (the "value of every item of property includible in a decedent's gross estate . . . is *its* fair market value at the


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time of the decedent's death" (emphasis added)). A hypothetical buyer would thus treat the life-insurance proceeds that would be used to redeem Michael's shares as a net asset.

**[*266]** Moreover, Thomas's argument that the redemption obligation was a liability cannot be reconciled with the basic mechanics of a stock redemption. As the District Court explained, when a shareholder redeems his shares he "is essentially 'cashing out' his shares of ownership in the company and its assets." *2021 U.S. Dist. LEXIS 179745, 2021 WL 4281288, *16*. **[**1413]** That transaction necessarily reduces a corporation's total value. And, because there are fewer outstanding shares after the redemption, the remaining shareholders are left with a larger proportional ownership interest in the less-valuable corporation. Thomas's understanding, however, would turn this ordinary process **[****16]** upside down. In Thomas's view, Crown's redemption of Michael's shares left Thomas with a larger ownership stake in a company with the *same* value as before the redemption. Thomas argues that Crown was worth only $3.86 million before the redemption, and thus that Michael's shares were worth approximately $3 million ($3.86 million x 0.7718). But, he also argues that Crown was worth $3.86 million *after* Michael's shares were redeemed. See Reply Brief 6. That cannot be right: A corporation that pays out $3 million to redeem shares should be worth *less* than before the redemption. See Cox & Hazen §21.2. Thomas's argument thus cannot be reconciled with an elementary understanding of a stock redemption.

Finally, Thomas asserts that affirming the decision below will make succession planning more difficult for closely held corporations. He reasons that if life-insurance proceeds earmarked for a share redemption are a net asset for estate-tax purposes, then "Crown would have needed an insurance policy worth far more than $3 million in order to redeem Michael's shares at fair market value." Brief for Petitioner 33. True enough, but that is simply a consequence of how the ***Connelly*** brothers chose to **[****17]** structure their agreement. There were other options. For example, the brothers could have used a cross-purchase agreement—an arrangement in which shareholders agree to purchase each other's shares at **[*267]** death and purchase life-insurance policies on each other to fund the agreement. See S. Pratt, Valuing a Business 821 (6th ed. 2022). A cross-purchase agreement would have allowed Thomas to purchase Michael's shares and keep Crown in the family, while avoiding the risk that the insurance proceeds would increase the value of Michael's shares. The proceeds would have gone directly to Thomas—not to Crown. But, every arrangement has its own drawbacks. A cross-purchase agreement would have required each brother to pay the premiums for the insurance policy on the other brother, creating a risk that one of them would **[***40]** be unable to do so. And, it would have had its own tax consequences. By opting to have Crown purchase the life-insurance policies and pay the premiums, the ***Connelly*** brothers guaranteed that the policies would remain in force and that the insurance proceeds would be available to fund the redemption. As we have explained, however, this arrangement also meant that Crown would receive **[****18]** the proceeds and thereby increase the value of Michael's shares. Thomas' concerns about the implications of how he and Michael structured their agreement are therefore misplaced.

III


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We hold that Crown's contractual obligation to redeem Michael's shares did not diminish the value of those shares. [2] Because redemption obligations are not necessarily liabilities that reduce a corporation's value for purposes of the federal **[**1414]** estate tax, we affirm the judgment of the Court of Appeals.

*It is so ordered.*

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**End of Document**

[2] We do not hold that a redemption obligation can *never* decrease a corporation's value. A redemption obligation could, for instance, require a corporation to liquidate operating assets to pay for the shares, thereby decreasing its future earning capacity. We simply reject Thomas's position that all redemption obligations reduce a corporation's net value. Because that is all this case requires, we decide no more.


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# Buy-Sell Agreements After Connelly

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# *Connelly*

- Setting up the issue
- Parameters of the law
- Cross purchase using life insurance LLC

- Slides
- Newsletter articles, including article on *Connelly*
- Several thousand page PDF, which can be downloaded from the link in the yellow box in the middle of the newsletter

# Navigate between Slides and Big PDF

- Open both documents
- Highlight cross-reference in slides
- Ctrl-c to copy
- Go to FULL TABLE OF CONTENTS in big PDF
- Crtl-f to find
- Ctrl-v to paste
- Click ENTER to execute search (might need to specify “exact” or “whole word” search
- Warning: search works only for to the fifth level of the heading, not the sixth, which ends in parentheses. For the latter, use the fifth level of the heading and scroll down just a little.

# Example (II.Q.4.h.)

- Company worth $4M
- A owns 75%; B owns 25%
- Goal is to redeem A for $3M (75% of $4M) when A dies
- Company buys $3M insurance on A's life to fund buyout, so it could buy A's interest when A dies (if able to keep policy until then)

# Example (II.Q.4.h.)

- A dies
- Company has $7M assets ($4M original value plus $3M life insurance)
- Business deal was to buy out A for $3M
- But 75% of $7M equals $5.25M

# Example (II.Q.4.h.)

- Should A be bought out for $5.25M or $3M?
- If B is not related to A and it's a pure business deal, $3M is correct
- Note that B's interest in the company increased from $1M (25% of $4M) to $4M (100% of $4M after redemption)

# Example (II.Q.4.h.)

- What if B is A's adult child?
- A's estate is taxed on the $3M sale proceeds and A gets to pass a $3M (increased) business interest to B, free from estate tax
- A's estate (or B) should pay estate tax on this deemed bequest to B

# Example (II.Q.4.h.)

- Distinguishing between B as an unrelated business associate and B as a child receiving a bequest is what *Connelly* and other cases are all about
- What if B is A's child, but B grew the business and deserves more equity as compensation for B's efforts, rather than as a bequest?

# Buy-Sell Agreements (II.Q.4.h.)

- Reg. § 20.2031-2(h) prerequisites for respecting every buy-sell agreement to establish estate tax values
- IRC § 2703 adds a requirement to these prerequisites where at least 50% of business is, in the aggregate, owned by family members (III.B.7.e. and III.B.7.b.i.(b))

# Buy-Sell Agreements (II.Q.4.h.)

Reg. § 20.2031-2(h) provides:

> Another person may hold an option or a contract to purchase securities owned by a decedent at the time of his death. The effect, if any, that is given to the option or contract price in determining the value of the securities for estate tax purposes depends upon the circumstances of the particular case. Little weight will be accorded a price contained in an option or contract under which the decedent is free to dispose of the underlying securities at any price he chooses during his lifetime. Such is the effect, for example, of an agreement on the part of a shareholder to purchase whatever shares of stock the decedent may own at the time of his death....

# Buy-Sell Agreements (II.Q.4.h.)

Reg. § 20.2031-2(h) continues:

> Even if the decedent is not free to dispose of the underlying securities at other than the option or contract price, such price will be disregarded in determining the value of the securities unless it is determined under the circumstances of the particular case that the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth. See section 2703 and the regulations at § 25.2703 of this chapter for special rules involving options and agreements (including contracts to purchase) entered into (or substantially modified after) October 8, 1990.

# Buy-Sell Agreements (II.Q.4.h.)

IRC § 2703(a) values property without regard to:

- any option, agreement, or other right to acquire or use property at price less than fair market value of that property (without regard to such option, agreement, or right), or
- any restriction on right to sell or use that property

# Buy-Sell Agreements (II.Q.4.h.)

IRC § 2703(a) N/A if satisfy all of:

- Bona fide business arrangement
- Not device to transfer property to decedent's family for less than full and adequate consideration in money or money's worth
- Terms are comparable to similar arrangements entered into by persons in arms' length transaction



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# Buy-Sell Agreements (II.Q.4.h.)

- *Huffman v. Commissioner*, T.C. Memo. 2024-12: buy-sell agreement did not satisfy comparability test of IRC § 2703, leading to a higher estate tax value
- First quarter newsletter article and webinar
- Possible ways to prepare for comparability attack

# Buy-Sell Agreements (II.Q.4.h.)

- *Huffman* held that first two requirements were satisfied, but comparability test was not
- Explore comparability test

# Buy-Sell Agreements (II.Q.4.h.)

Reg. § 25.2703-1(b)(4)(i), "In general":

A right or restriction is treated as comparable to similar arrangements entered into by persons in an arm's length transaction if the right or restriction is one that could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm's length. A right or restriction is considered a fair bargain among unrelated parties in the same business if it conforms with the general practice of unrelated parties under negotiated agreements in the same business. This determination generally will entail consideration of such factors as the expected term of the agreement, the current fair market value of the property, anticipated changes in value during the term of the arrangement, and the adequacy of any consideration given in exchange for the rights granted.

# Buy-Sell Agreements (II.Q.4.h.)

Reg. § 25.2703-1(b)(4)(ii), "Evidence of general business practice":

> Evidence of general business practice is not met by showing isolated comparables. If more than one valuation method is commonly used in a business, a right or restriction does not fail to evidence general business practice merely because it uses only one of the recognized methods. It is not necessary that the terms of a right or restriction parallel the terms of any particular agreement. If comparables are difficult to find because the business is unique, comparables from similar businesses may be used.

# Buy-Sell Agreements (II.Q.4.h.)

*Estate of Amlie v. Commissioner*, T.C. Memo. 2006-76, held:

> For the reasons discussed below, we conclude that the estate has satisfied section 2703(b)(3). By its terms, the statute requires only a showing that the agreement's terms are "comparable" to similar arrangements entered at arm's length. While the regulations caution against using "isolated comparables," we believe that in context the regulations delineate more of a safe harbor than an absolute requirement that multiple comparables be shown.

# Buy-Sell Agreements (II.Q.4.h.)

After citing *Amlie*, *Huffman* noted that an isolated comparable may satisfy the comparability test, but not in this specific case:

> Petitioners argue that the final section 2703(b) requirement is satisfied by the Lloyd-Barneson agreement, which they claim is comparable to the RTP agreements and was entered into in an arm's-length transaction. Petitioners note that the Lloyd-Barneson agreement contained the following provisions, which are also included in the RTP agreements: (1) a right to purchase on the death of the grantor and by a right of first refusal; (2) a maximum purchase price; and (3) no specific termination or exercise date. Petitioners also point out that the Lloyd-Barneson agreement was entered into by unrelated parties - Lloyd and Mr. Barneson - and executed at arm's length.

# Buy-Sell Agreements (II.Q.4.h.)

*Huffman* continued:

Respondent counters that the Lloyd-Barneson agreement cannot serve as a good comparable because it was not submitted into evidence. Respondent notes that there are only two pieces of evidence which describe the Lloyd-Barneson agreement: a one-paragraph reference in the Assignment agreement and another in the Chet-Barneson agreement. Otherwise, the only information provided about the Lloyd-Barneson agreement comes from witnesses' testimony, which made vague references to the agreement.

# Buy-Sell Agreements (II.Q.4.h.)

*Huffman* continued further:

> Respondent contends that even if we are to find that the testimony regarding the Lloyd-Barneson agreement is credible, there are differences among it and the RTP agreements which render the Lloyd-Barneson agreement not a good comparable. The noted differences are that (1) Lloyd Huffman was allowed to freely transfer his rights whereas Chet had to obtain consent from the owners; (2) the right of first refusal in the RTP agreements exempted offers from Chet's brothers; (3) the RTP agreements had an addendum that granted Chet the right to purchase the shares at any time at his discretion; and (4) the stated purpose of the RTP agreements was to retain ownership of Dukes within the Huffman family.

# Buy-Sell Agreements (II.Q.4.h.)

*Huffman* agreed with IRS that evidentiary proof was thin:

> We agree with respondent. As we noted in *Estate of Amlie*, T.C. Memo. 2006-76, slip op. at 41, reliance on an isolated comparable is adequate given that the regulations "delineate more of a safe harbor than an absolute requirement that multiple comparables be shown." Use of the Lloyd-Barneson agreement then would be acceptable to show that the RTP agreements had terms similar to an agreement entered into at arm's-length. But as respondent notes, we do not have the Lloyd-Barneson agreement in evidence. We have only vague and incomplete references to it and testimony based on those references. We do not have an isolated comparable to undergo the section 2703(b)(3) analysis.

# Buy-Sell Agreements (II.Q.4.h.)

*Huffman* agreed with the IRS that the purported comparable agreement was too different from the one before the court:

> Even if we were to accept witnesses' testimony as sufficient evidence, we do not think that the Lloyd-Barneson agreement is sufficiently similar. Even though the three agreements purport to create rights to purchase Dukes shares for a maximum price, the differences among them are significant. For example, Chet had the unfettered right to purchase the Dukes shares at any time and at his sole discretion; Lloyd did not have this same right. Further, Lloyd was permitted to assign or otherwise transfer his purchase rights whereas Chet had to obtain consent to do the same. Chet then had rights superior to Lloyd's in purchasing the shares but inferior in transferring those rights. The terms of the agreements are therefore not comparable within the meaning of section 2703(b)(3).

# Buy-Sell Agreements (II.Q.4.h.)

*Huffman* concluded:

> On the basis of the foregoing, we do not think that petitioners have satisfied the final requirement of section 2703(b). See *Estate of Blount v. Commissioner*, T.C. Memo. 2004-116, slip op. at 48 (finding that solely testimony without production of comparable agreements was insufficient to satisfy section 2703(b)(3)), *aff'd* in part, *rev'd* in part and remanded, 428 F.3d 1338 (11th Cir. 2005). Section 2703(b) is therefore not satisfied, and so the RTP agreements must be disregarded for purposes of valuing the Dukes shares that Chet purchased in 2007. See § 2703(a).

# Buy-Sell Agreements (II.Q.4.h.)

- The citation to *Blount* in the last paragraph above is a little misleading. *Blount* said that:

  > Congress contemplated that business "comparables" that established "the general practice of unrelated parties" would constitute the evidence satisfying section 2703(b)(3), and that "expert testimony" could be used for this purpose.

- However, *Blount* did not find how expert applied comparables to be credible
- Unfortunately, taxpayer in *Huffman* relied almost exclusively on one comparable and did not have appraiser present evidence about other comparables beyond mere brief testimony

# Buy-Sell Agreements (II.Q.4.h.)

Bona fide and comparability tests are somewhat intertwined:

- Tax Court seems to be saying that, not only does agreement itself need to be intended to yield fair market value sale, but also comparable clauses need to be designed to reach fair market value result
- In *Blount*, a multiple of cashflow was reasonable approach, but Tax Court rejected multiple used and also cited inconsistency regarding the impact of nonoperating assets
- As to latter, buy-sell formula was based on sale of only operating assets, but actual sale was for operating and nonoperating assets

# Buy-Sell Agreements (II.Q.4.h.)

- Contemporaneous evidence tends to be most probative
- When drafting, reviewing, or revising a buy-sell agreement where trying to set estate tax values is important, consider gathering proof that its terms are comparable to similar arrangements entered into by persons in an arms' length transaction
- Following slides are some opportunities to consider in light of *Huffman* and may or may not be practical, depending on materiality of issue

# Buy-Sell Agreements (II.Q.4.h.)

Drafting agreement, focusing more on buy-sell provisions:

- Preserve original form - copy form into new document and save all edits to new versions of that new document, to see how varied from form
- Document the business reasons for any variations from the form

# Buy-Sell Agreements (II.Q.4.h.)

Drafting agreement:

- If the agreement is based on forms service:
  - Document who authors are
  - Document what authors say about provisions being used in commercial (non-estate-planning) settings and any objective support for those statements
- If agreement is based on internal forms, document whether form is used in agreements with third parties

# Buy-Sell Agreements (II.Q.4.h.)

Obtaining appraisals:

- Each time an appraiser values business interest, ask how buy-sell provisions compare to other buy-sell provisions appraiser has seen in agreements between unrelated third parties
- See whether appraiser is comfortable discussing in report how buy-sell provisions compare to other companies that size in same industry (which would be ideal but often is not practical), to other companies of that size with similar ownership structure among unrelated owners, or to anything else that may be reasonable and meaningful

# *Connelly* (II.Q.4.h.)

- Agreement violated Code § 2703
- Life insurance included in determining business value, according to E.D. Mo., 8th Cir., and unanimous Supreme Court
- Same result in *Blount* Tax Court, but 11 th Cir. held life insurance excluded from business value, because it was a liability of the business



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# *Connelly* (II.Q.4.h.)

Example from Supreme Court *Connelly* opinion:

- $10M corp owned 80% by A ($8M) and 20% by B ($2M)
- Corp redeems B for $2M
- $8M corp ($10M - $2M) owned 100% by A ($8M)
- Redemption did not reduce value of A's shares



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# *Connelly* (II.Q.4.h.)

- "We hold that [the company's] contractual obligation to redeem Michael's shares did not diminish the value of those shares.[2]"
- "[2]We do not hold that a redemption obligation can never decrease a corporation's value. A redemption obligation could, for instance, require a corporation to liquidate operating assets to pay for the shares, thereby decreasing its future earning capacity. We simply reject Thomas's position that all redemption obligations reduce a corporation's net value. Because that is all this case requires, we decide no more."

# *Connelly* (II.Q.4.h.)

Significance of footnote 2:

- Using nonoperating asset, such as buy-sell life insurance, for redemption does not decrease value of business to remaining owners
- Using an operating asset would tend to decrease value of business to remaining owners
- When key person dies, business' value may decrease, and key-person life insurance (not used for redemption) might merely restore that lost value – need to see whether death benefit is more or less than this decease

# *Connelly* (II.Q.4.h.)

- "…the brothers could have used a cross-purchase agreement - an arrangement in which shareholders agree to purchase each other's shares at death and purchase life-insurance policies on each other to fund the agreement."
- "A cross-purchase agreement would have allowed Thomas to purchase Michael's shares and keep [the company] in the family, while avoiding the risk that the insurance proceeds would increase the value of Michael's shares. The proceeds would have gone directly to Thomas - not to [the company]."

# *Connelly* (II.Q.4.h.)

- "But, every arrangement has its own drawbacks. A cross-purchase agreement would have required each brother to pay the premiums for the insurance policy on the other brother, creating a risk that one of them would be unable to do so."
- "And, it would have had its own tax consequences."

# *Connelly* (II.Q.4.h.)

- *Connelly* was a bad facts case
- If parties do everything correctly and have a buy-sell agreement that satisfies Code § 2703, would a life insurance-funded redemption agreement work?
- Note that *Connelly* increases risk of redemption if one violates Reg. § 20.2031-2(h)

# Cross-Purchase Agreement
(II.Q.4.i.)

- Each owner holds one or more policies on lives of other owners
- Transfers of existing policies between old and new owners may generate income tax on sale (II.Q.4.c.) and may cause death benefit to lose its income tax exclusion (II.Q.4.b.)
- Contributing to (II.M.3) or receiving distribution from (II.Q.8.b.) partnership not taxable
- Distributing from C or S corporation is taxable event and may cause death benefit to lose its income tax exclusion
- Holding policies in life insurance LLC means that the policies are not transferred as owners come and go; LLC ownership is all that changes (II.Q.4.i.)

# Life Insurance LLC - Letter Ruling 200747002
(II.Q.4.i.)

- LLC held insurance policies to fund cross-purchase
- Corporate trustee was manager (nontax reasons for independent manager, too)
- Operating capital account for administrative expenses
- Each policy had capital accounts associated with it, which were allocated to owners other than insured

# Life Insurance LLC - Letter Ruling 200747002
## (II.Q.4.i.)

- Premiums for term policies allocated to capital accounts of those who paid them
- Death benefit proportionate to relevant capital accounts
- Capital accounts amortized and, immediately before next premium is due, drop to zero
- Trusts who were permitted transferees of operating business can participate

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- Operating company pays premiums and treats them as distributions or compensation to relevant members of life insurance LLC
- Those premium payments should be administratively effectuated without any contractual mandated in operating company's governing documents - important for an S corporation operating business (II.A.2.i.iii, II.A.2.i.xii, and II.A.2.i.xiii)

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- A owns 75% and B owns 25% of Company. Suppose Company is worth $1M
- A needs to buy $250K of insurance on B, whereas B needs to buy $750K of insurance on A
- B needs to buy three times as much life insurance death benefit as does A
- But B receives only one-third (25% divided by 75%) the distributions as A receives

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- If A is older than B is, then cost of each $1K of death benefit on A will be higher than cost of each $1K of death benefit on B, further exacerbating disproportionality of premium payments
- If Company treats premiums as distributions, then deemed disproportionate distribution to B, so A needs additional cash distributions to make overall distributions proportionate

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- If Company is making huge cash distributions, perhaps premium payments will be immaterial relative to cash flow, so make-up distributions to A (or cut-off of cash distributions to B) might not be big deal
- In many cases, B is much younger than A, and B will be frustrated at lack of distributions that B actually takes home

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- So that B does not get frustrated, Company treats as compensation some portion of premiums allocated to B regarding insurance on A's life
- Note that these payments need to be "grossed-up" –additional compensation to pay the income tax on the premium compensation

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- If $10,000 of premium is treated as compensation to B and B is in 40% tax bracket, Company needs to pay $16,667 bonus, of which $10,000 is allocated to premium and $6,667 (which is $16,667 multiplied by 40%) is income tax withholding
- Company (or its owners, if pass-through) will get $16,667 deduction, so save taxes more or less than $6,667 income tax withholding

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- If operating business is C corporation, it would account for premium payments as compensation (as officer or director), because dividends are nondeductible to company and taxable to shareholders
- When operating company taxed as partnership, it might consider setting up separate distribution account for premiums paid on behalf of each owner, to facilitate reconciliation with life insurance LLC is doing

# Life Insurance LLC – Practical Logistics
(II.Q.4.i.v.)

- If Code § 2703 applies, consider whether policies for one insured should be held in separate LLC in which insured is not member to avoid *Huffman* settlement value
- Insured's family needs protection from death benefit being misused if members fire manager and put in someone who will do their bidding or change the use of the death benefit
- Consider protection against that as third-party beneficiaries to operating agreement (II.F.8.)

# Transitioning from Redemption to Cross-Purchase (II.Q.4.i.vii.)

- If the operating business is an entity taxed as a partnership, it can distribute policies to the life insurance LLC
- Deemed tax-free distribution to its owner, followed by
- Deemed tax-free contribution to the life insurance LLC

# Transitioning from Redemption to Cross-Purchase
(II.Q.4.i.vii.)

If the operating business is an entity taxed as a corporation - C or S, then any distribution will constitute a taxable sale:

- Causing income taxation, and
- Needing a special exception from the transfer-for-value rule to preserve the exclusion from income tax

# Transitioning from Redemption to Cross-Purchase (II.Q.4.i.vii.)

Instead of distributing policies from corporation, consider having life insurance LLC rent death benefit under split-dollar economic benefit arrangement:

- Corporation retains death benefit to extent of policy value on date that life insurance LLC agrees
- Corporation pays future premiums
- Life insurance LLC pays corporation annual 1-year term value of LLC's share of death benefit

# Conclusion

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# *Huffman v. Comm'r*

United States Tax Court

January 31, 2024, Filed

Docket Nos. 3255-16, 3256-16, 3261-16, 3526-16

**Reporter**
T.C. Memo 2024-12 *; 2024 Tax Ct. Memo LEXIS 11 **

CYNTHIA L. HUFFMAN AND ESTATE OF CHET S. HUFFMAN, DECEASED, CYNTHIA L. HUFFMAN, EXECUTOR, ET AL.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

**Disposition:** Decisions will be entered under *Rule 155*.

## Case Summary

### Overview

HOLDINGS: [1]-Respondent failed to meet his burden of proof regarding the taxpayer's personal goodwill because he continued to own his personal goodwill up until the acquisition; to that end, as part of the agreement, the taxpayer entered into a noncompete agreement, and thus, any gain on the sale of that personal goodwill would have had to be reported by the taxpayer; [2]-Reasonable-cause exception did not negate the taxpayers' liability for the *26 U.S.C.S. § 6662(a)* penalties attributable to the conceded adjustments, and they were liable for such penalties to that extent; [3]- Because taxpayers did not timely file a gift tax return nor pay tax on the gift, respondent met his burden of proof as to the additions to tax; the taxpayers must demonstrate that the failure to file/pay was due to reasonable cause and not due to willful neglect to avoid the additions.

### Outcome
Orders were entered.

**Counsel: [**1]** Jonathan N. Kalinski, Robert Samuel Horwitz, Edward M. Robbins, Jr., and Evan J. Davis, for petitioners.

Aely K. Ullrich, Alan H. Cooper, D. Anthony Abernathy, and Trent D. Usitalo, for respondent.

**Judges:** ASHFORD, Judge.

**Opinion by:** ASHFORD

## Opinion

[1] Cases of the following petitioners are consolidated herewith: Infinity Aerospace Inc., Docket No. 3256-16; Estate of R. Lloyd Huffman, Deceased, Raymond Lance Huffman, Executor, Docket No. 3261-16; and Patricia Huffman, Docket No. 3526-16.

MEMORANDUM FINDINGS OF FACT AND OPINION

ASHFORD, *Judge*: The Internal Revenue Service (IRS or respondent) determined the following deficiency in federal gift tax and additions to tax for R. Lloyd (Lloyd) Huffman's[2] 2007 taxable year:

| *Year* | *Deficiency* | *Additions to Tax* | |
|---|---|---|---|
| | | *§ 6651(a)(1)*[3] | *§ 6651(a)(2)* |
| 2007 | $3,727,337 | $838,651 | $931,834 |

**[*2]** The IRS determined the following deficiencies in federal gift tax and additions to tax for Patricia (Patricia) Huffman's 2007 taxable year:[4]

| *Year* | *Deficiency* | *Additions to Tax* | |
|---|---|---|---|
| | | *§ 6651(a)(1)* | *§ 6651(a)(2)* |
| 2007 | $3,727,337 | $838,651 | $931,834 |
| | 10,297,337 | 2,316,901 | 2,574,334 |

The IRS determined the following deficiencies in income tax, additions to tax, and penalties for Chet S. (Chet) and Cynthia L. (Cindy) Huffman's[5] 2008 and 2009 taxable years:

| *Year* | *Deficiency* | *Additions to Tax/Penalties* | |
|---|---|---|---|
| | | *§ 6651(a)(1)* | *§ 6662(a)* |
| 2008 | $284,489 | - | $56,898 |
| 2009 | 6,842,147 | $1,591,748 | 1,368,429 |

**[*3]** The IRS determined the following deficiencies in income tax, additions to tax, and penalties for Infinity Aerospace, Inc.'s (Dukes's)[6] 2008-10 taxable years:

| *Year* | *Deficiency* | *Additions [**2] to Tax/Penalties* | |
|---|---|---|---|
| | | *§ 6651(a)(1)* | *§ 6662(a)* |
| 2008 | $1,411,852 | $352,963 | $282,370 |
| 2009 | 481,084 | 133,635 | 96,217 |
| 2009 | 13,031,561 | 5,693,794 | 2,606,312 |

After certain concessions by the parties in the Cindy and Estate of Chet S. Huffman case and in the Dukes case,[7] the issues remaining for decision are whether (1) Patricia and the Estate of Lloyd Huffman made a

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[2] After trial Lloyd died and was substituted for in this proceeding by his executor, Raymond Lance Huffman.

[3] Unless otherwise indicated, statutory references are to the Internal Revenue Code, Title 26 U.S.C. (Code), in effect at all relevant times, regulation references are to the *Code of Federal Regulations*, Title 26 (Treas. Reg.), in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure. Some monetary amounts are rounded to the nearest dollar.

[4] The IRS issued two deficiency notices to Patricia for her 2007 taxable year.

[5] After trial Chet died and was substituted for in this proceeding by his executor, Cindy.

[6] Infinity Aerospace was formerly known as Dukes, Inc.; for convenience we will throughout this Opinion refer to this corporation as Dukes.

taxable gift to Chet in 2007; (2) Patricia made a taxable gift to Chet in 2007; (3) Patricia and the Estate of Lloyd Huffman are liable for **[*4]** additions to tax pursuant to *section 6651(a)(1)* and *(2)* for 2007; (4) Cindy and the Estate of Chet Huffman had ordinary dividend income relating to the sale of Dukes to TransDigm, Inc. (TransDigm), in 2009; (5) Cindy and the Estate of Chet Huffman are liable for accuracy-related penalties under *section 6662* for 2008 and 2009; (6) Cindy and the Estate of Chet Huffman are liable for an addition to tax under *section 6651(a)(1)* for 2009; (7) Dukes is liable for tax on an increase to capital gain net income for 2009; (8) Dukes is liable for additions to tax pursuant to *section 6651(a)(1)* for 2008-10; and (9) Dukes is liable for accuracy-related penalties pursuant to *section 6662* for 2008-10.

When the Petitions were timely filed in these cases, all petitioners resided in California including Dukes, which maintained its principal **[**3]** place of business in California. These cases were consolidated for purposes of trial, briefing, and opinion pursuant to *Rule 141(a)*.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The Stipulation of Facts, the Supplemental Stipulation of Facts, and the attached Exhibits are incorporated herein by this reference.

I. *Background of Dukes and the Huffman Family*

Dukes was incorporated in 1958 and headquartered in Northridge, California. It manufactured and supplied various engineering components to the aerospace industry. Lloyd and Patricia both worked for Dukes; he initially as a design engineer and she as a bookkeeper.

In 1970 Lloyd was made president of Dukes and acquired 113,365 shares in the company. During Lloyd's time as president Dukes employed two of Lloyd and Patricia's sons: Randy and Lance (Randy and Lance) Huffman.

In January 1979 Lloyd and Patricia formed the Huffman Family Trust (Trust). They appointed themselves trustees of the Trust. Lloyd had his 113,365 shares in Dukes reissued to the Trust. The Trust acquired an additional 5,000 shares in 1990.

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[7] By way of a Stipulation of Settled Issues in the Cindy Huffman and Estate of Chet S. Huffman case, the parties agree that Chet (now deceased) and Cindy are (1) entitled to deduct losses on Schedules E, Supplemental Income and Loss, of $580,310 and $379,481 for 2008 and 2009, respectively; (2) not entitled to a *section 166* bad debt deduction of $571,000 nor a $571,000 capital loss deduction for 2008; (3) not entitled to a *section 170* charitable contribution deduction of $120,000 for 2008; and (4) not subject to an increase in ordinary dividend income of $120,000 from Dukes for 2008.

By way of a Stipulation of Settled Issues in the Dukes case, the parties agree that (1) as part of the computation of "Capital Gain Net Income - Schedule D," the amount of "Cost or other basis of property sold" reflected on the Form 886-A, Explanation of Items, attached to the notice of deficiency is increased to $18,079,778 for 2010; (2) Dukes is not entitled to deductions for legal and professional expenses of $306,430, $152,875, and $87,727 for 2008-10, respectively; (3) Dukes is not entitled to deductions for depreciation of $318,973, $644,250, and $104,148 for 2008-10, respectively; (4) Dukes is not entitled to costs of goods sold of $587,239, $319,244, and $63,544 for 2008-10, respectively; (5) Dukes is entitled to a net gain reduction of $2,037,398 for 2010; (6) Dukes is entitled to a net operating loss carryback of $2,578,291 from 2011 to either 2009 or 2010; and (7) Dukes is entitled to *section 170* charitable contribution deductions of $20,000 and $100,000 for 2008 and 2009, respectively. Additionally, on brief in the Dukes case, respondent concedes that the *section 6651(a)(1)* addition to tax for 2010 should be reduced to $2,842,544.

Lloyd held the position of Dukes president until 1987. He stepped down from the role after suffering a near fatal car **[**4]** racing accident. Within days of the accident, Lloyd and Patricia's other son, Chet, was **[*5]** made chief executive officer (CEO) and issued 5,000 shares of Dukes (representing 0.7% of the total outstanding shares).

In March 1990 Lloyd and majority shareholder Robert L. Barneson[8] entered into an agreement (Lloyd-Barneson agreement) whereby Lloyd was granted the right to purchase Mr. Barneson's shares. At that time, Mr. Barneson owned 322,241 shares (representing 43% of the total outstanding shares). The Lloyd-Barneson agreement entitled Lloyd to purchase Mr. Barneson's shares upon Mr. Barneson's death or by a right of first refusal for a price not to exceed $2 per share. There was no specific termination or exercise date for purchasing the shares in the agreement.

In June 1993 Lloyd assigned his rights under the Lloyd-Barneson agreement to Chet (Assignment agreement). In August 1993 Chet exercised his assignee rights under the Lloyd-Barneson agreement. By separate agreement (Chet-Barneson agreement), he agreed to pay Mr. Barneson $150,000 for his 322,241 shares with $50,000 being paid upon execution and the remaining $100,000 being paid in equal installments over the following five years. As **[**5]** a result of the purchase, Chet became the majority shareholder of Dukes with 43.7% of the total outstanding shares.

In November 1993 Chet entered into two additional right to purchase agreements (RTP agreements)—one with Dukes Research and Manufacturing, Inc. (DRM), and another with the Trust. DRM was an S corporation owned entirely by Patricia; it owned 304,124 Dukes shares (representing 40.5% of the total number outstanding). The Trust owned 118,635 Dukes shares (representing 15.8% of the total number outstanding).

For a sum of $2 and "other good and valuable consideration," the RTP agreements provided Chet with the right to purchase DRM's and the Trust's Dukes shares for a price not to exceed $3.6 million and $1.4 million, respectively, upon the death of Lloyd and Patricia. Chet could also purchase the shares by virtue of a right of first refusal. The right of first refusal exempted offers from Randy and Lance, Chet's brothers. The parties executed an addendum to the RTP agreements that provided Chet with the option to purchase the shares at any time, in addition to the stated events in the agreements themselves. **[*6]** Chet was not permitted to sell, assign, or otherwise transfer his rights **[**6]** under the RTP agreements without the consent of the owners. For the RTP agreement between Chet and DRM, Chet had to obtain DRM's consent to override the alienability restrictions. For the RTP agreement between Chet and the Trust, Chet had to obtain Lloyd and Patricia's consent to override the alienability restrictions.

The RTP agreements provided that they were "not compensatory in nature, rather the purpose [was] to retain the ownership of" Dukes within the family. A tax opinion letter Chet obtained from the law firm Proskauer Rose LLP (Proskauer) stated that the purpose behind the RTP agreements "was not compensatory. It was not in connection with the performance of services."

II. *Dukes Under Chet's Leadership*

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[8] By January 1971 Mr. Barneson became the majority shareholder of Dukes.

Chet graduated from Pepperdine University in 1983 with a bachelor's degree in business management. He worked abroad after college for approximately 14 months before returning stateside to work in the off-road racing industry. After his father's accident, he assumed the role of Dukes's CEO, at which time the company had annual revenue of approximately $5 million. From 1993 to 2006 Chet's salary ranged from $65,000 to $85,000. In 2007 it increased to $147,000; at this time the salary **[**7]** of Dukes's only other paid officer was $243,300.

Under Chet's leadership Dukes expanded its product offerings and implemented a new strategy for acquiring and maintaining customers. When Chet started at Dukes, the company mainly produced in-line boost pumps for piston aircrafts. In the early 1990s it began to supply bleed air valves and landed a key contract with the U.S. Air Force. This new product line enabled Dukes to build relationships with manufacturers Hawker Beechcraft and Cessna. In the late 1990s Dukes expanded into cabin pressure control systems.

Chet also altered Dukes's strategy for obtaining new business. In the aerospace parts manufacturing industry, there is a division of how parts are incorporated within an aircraft, both in its original design and in its maintenance and repairs. The original equipment manufacturer (OEM) is the parts supplier to the aircraft manufacturer. To become an OEM, an aircraft parts supplier will solicit parts specification requests from aircraft manufacturers. These are parts that will be incorporated into the aircraft's final design. The parts supplier will then design a part and bid it to the aircraft manufacturer. If the aircraft manufacturer **[**8]** **[*7]** accepts the bid, it will then subject the part to testing, and upon passing the tests, the part will be incorporated into the aircraft.

There is also an aftermarket process by which aircraft parts suppliers may generate business. It involves selling the products to the purchasers of the aircrafts. The Federal Aviation Administration (FAA) has a separate process for this known as Parts & Manufacturing Approval (PMA). In this alternative process the aircraft parts manufacturer would design a product, seek certification of the part by the FAA, and then sell it directly in the aftermarket. The benefit of selling via the PMA process was higher profit margins. The aircraft manufacturer typically purchases parts from the OEM at much lower prices than it will the spare or replacement parts. Chet used the PMA process to expand Dukes customer base as well as enhance its profitability.

In addition to expanding the company's product line and altering its strategy for acquiring new business, Chet networked extensively and strived to acquire and maintain a strong workforce. By expanding into the bleed air valve industry, Chet was able to become personally acquainted with Hawker Beechcraft's president. **[**9]** Through that relationship Chet became a member of the General Aviation Manufacturers Association (GAMA), a lobbying organization for private aircraft. Most other GAMA members were industry leaders: presidents and other corporate executives of major aerospace companies. This allowed Chet to meet and develop personal relationships with customers and competitors alike.

Chet expanded and maintained Dukes's human capital as well. When he began with Dukes in the late 1980s, Dukes had approximately five engineering employees, one of whom was a part-time sales representative. By 2007 he had expanded the engineering team to include 18 full-time employees. Despite a competitive hiring environment, Dukes was able to keep its employee turnover low. It did so by instituting a four-day work week and offering deferred compensation plans for engineering employees,


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among other incentives. Under Chet's leadership Dukes experienced significant growth, and by the end of fiscal year 2006 it had annual revenue of approximately $28.14 million.

Over the years, members of the Huffman family formed and acquired various business entities to support Dukes's operations. On June 25, 2001, Chet and Cindy formed CCC&B, **[**10]** LLC (CCC&B), as equal **[*8]** 50% owners. They formed CCC&B as a holding company for various intellectual property assets, including several licensing agreements with Honeywell Intellectual Properties, Inc. (Honeywell). CCC&B entered into sublicensing agreements for the Honeywell licenses with Dukes and another affiliate, PMA Sales, Inc. (PMA Sales). PMA Sales—owned 60% by Chet Huffman and 40% by Robb Watts—acted as a distributor for Dukes and specialized in aftermarket sales.

On January 1, 2005, CCC&B entered into an asset purchase and sale agreement with GST Industries, Inc., a California corporation that manufactured and assembled hydraulic and electro-mechanical components for the U.S. military. CCC&B then organized a new Arizona corporation, also named GST Industries, Inc. (GST), and transferred all of the acquired tangible operating assets to that entity.

Members of the Huffman family formed various business entities to lease employees and manufacturing equipment to Dukes. As of June 30, 2008, there were three leasing companies: (1) Aviation Manufacturing & Design Corp. (AMDC); (2) DRM; and (3) TRD of California, Inc. (TRD). Dukes was the only customer of each of the three leasing companies. **[**11]** The ownership of the leasing companies is set forth below:

| *Entity* | *Chet* | *Lloyd* | *Patricia* | *Randy* |
|---|---|---|---|---|
| AMDC | 57% | 43% | - | - |
| DRM | - | - | 100% | - |
| TRD | 66% | - | - | 34% |

III. *Hanwha's Proposed Acquisition of Dukes*

In the early 2000s Chet began receiving correspondence from parties interested in acquiring Dukes. He rejected the offers because the company was not for sale. This changed in 2007 when Deloitte Corporate Finance, LLC (Deloitte), contacted Chet regarding a potential acquisition by its client, Hanwha Corp. (Hanwha), a Korean company.

In September 2007 Dukes and Hanwha entered into a nonbinding memorandum of understanding (MOU), which provided the terms of a tentative stock acquisition for a purchase price between $85 million and **[*9]** $105 million, depending on the due diligence findings. The MOU also contemplated a reorganization before any sale. The following Dukes-affiliated entities would transfer their assets to Dukes: (1) CCC&B; (2) DRM; (3) TRD; and (4) AMDC. Chet would then form the Dukes Group, LLC (Dukes Group), and transfer all of the Dukes shares to the new entity. Chet would also transfer all GST shares to Dukes Group. The result would be that Dukes Group would be the sole shareholder of Dukes and GST with Chet as the **[**12]** sole member of Dukes Group.

On October 15, 2007, Chet exercised his rights under the RTP agreements, purchasing all of the Trust's and DRM's Dukes shares for $1.4 million and $3.6 million, respectively. This equates to $11.83 per share. He paid for the shares with a promissory note secured by the shares. At this point he owned 100% of the outstanding stock of Dukes. On June 23, 2008, Chet formed Dukes Group under Nevada law, electing to

treat it as a disregarded entity. He was the managing member and 100% owner. On June 30, 2008, he transferred all of the stock of Dukes and GST to Dukes Group.

As part of the proposed consolidation, Chet caused AMDC, TRD, DRM, and CCC&B to each enter into asset purchase agreements with Dukes. These agreements were effective as of June 30, 2008.

The AMDC Agreement provided that Dukes would pay AMDC $39,929; the parties would void an employee leasing agreement; and AMDC would forgive a $148,508 debt owed by Dukes. The TRD agreement provided that Dukes would pay TRD $41,404; the parties would void an employee leasing agreement and an equipment leasing agreement; and TRD would forgive a $42,123 debt owed by Dukes. The DRM agreement provided that Dukes would **[**13]** pay DRM $85,155; the parties would void an employee leasing agreement; DRM would forgive a $465,000 debt owed by Dukes; and Dukes would assume three third-party contracts. The CCC&B agreement (CCC&B-Dukes agreement) provided that Dukes would forgive a $904,221 debt owed by CCC&B; the parties would void a licensing agreement between Dukes and CCC&B; and Dukes would assume three third-party contracts.

On February 23, 2009, Hanwha sent a letter to Chet stating that it no longer wished to acquire Dukes. The letter informed him that after considering economic conditions and reviewing Dukes's 2007 and 2008 financial statements, Hanwha had concluded that an acquisition would not be in Hanwha's best interest.

**[*10]** After the failed acquisition, Chet caused CCC&B and Dukes to enter into a modification of the CCC&B-Dukes agreement (Additional License Modification or ALM). The ALM was effective as of June 30, 2008. It provided that the original asset purchase agreement between Dukes and CCC&B would be extended to the date of any eventual sale to a third party. It also provided that the consideration for a future sale of Dukes would include any additional Honeywell licenses acquired by CCC&B and that **[**14]** they would be sold for their fair market value at the time of sale. The ALM also stated that CCC&B would be the direct payee for any portion of the purchase price attributable to the Honeywell licenses and any associated goodwill.

Chet caused CCC&B to enter a second modification (Correcting Amendment) of the CCC&B-Dukes agreement. The Correcting Amendment was dated March 1, 2011, with an effective date of June 30, 2008. In addition to the consideration stated in the CCC&B-Dukes agreement, the Correcting Amendment provided that Dukes would pay CCC&B the fair market value of its assets as of the closing date.

IV. *TransDigm's Acquisition of Dukes*

After Hanwha decided not to acquire Dukes and its affiliates, Chet continued to pursue a sale of Dukes. On March 25, 2009, he entered into an agreement on behalf of Dukes with Deloitte to provide corporate finance advisory services. This agreement provided that Deloitte would assist Dukes in developing a brochure—the Confidential Information Memorandum (CIM)—to describe the company, as well as assist Dukes in marketing the business, selecting a buyer, and performing due diligence. Deloitte ultimately distributed the CIM to approximately 40 potential **[**15]** buyers. Dukes chose to pursue negotiation with TransDigm.

On September 2, 2009, TransDigm sent a letter of intent to Dukes, which was approved the same day by Chet as the sole director of Dukes. On December 1, 2009, Dukes and TransDigm entered into an asset

purchase agreement (Dukes-TransDigm agreement). The agreement provided for a $95.75 million purchase price, all of which would be wired to the sellers at closing, save for $10.5 million which would be held in escrow for 24 months. In addition to the base purchase price, the agreement provided Dukes with an earn-out of up to $60 million. The assets acquired by TransDigm were transferred to a newly formed subsidiary of TransDigm, Dukes Aerospace, Inc. (Dukes Aerospace).

**[*11]** The assets sold as part of the Dukes-TransDigm agreement included goodwill, which the agreement defined as "[a]ll goodwill associated with the Business, including any personal goodwill of Chet Huffman . . . as it relates to the Purchased Assets and the Business." TransDigm was also required to engage the investment bank and advisory firm Stout Risius Ross, Inc. (SRR), to prepare a valuation of the purchased assets and allocate the purchase price among those assets.

**[**16]** Dukes was then required to engage an independent valuation expert, other than Deloitte, to perform an additional valuation to determine what portion of the purchase price allocated to goodwill (by SRR) should be considered Chet's personal goodwill versus the company's enterprise goodwill. The final allocation of the purchase price was to be binding on the parties.

In accordance with the Dukes-TransDigm agreement, TransDigm engaged SRR to perform the asset valuation and purchase price allocation. SRR allocated $50.042 million to goodwill. Dukes engaged the consulting firm Duff & Phelps, LLC (Duff & Phelps), to perform the additional valuation and the allocation of the purchase price among the goodwill subcategories. TransDigm approved Duff & Phelps as the designated appraiser.

On June 10, 2010, Duff & Phelps rendered its valuation opinion, finding that Chet's personal goodwill accounted for $21.8 million of the total $50.042 million (reached by SRR). Duff & Phelps determined that $17.4 million was attributable to Chet's relationships with clients and $4.4 million was attributable to his relationships with Dukes's key employees. Shortly before trial, Duff & Phelps revised its valuation **[**17]** of Chet's personal goodwill to $19.2 million to account for an 18-month expected lag time in Chet's ability to compete.

As part of the Dukes-TransDigm agreement, Chet entered into a noncompete agreement with Dukes Aerospace and TransDigm. The term of the agreement was four years. The Dukes-TransDigm agreement also required that PMA Sales execute an agreement relinquishing its rights to the Honeywell licenses that it entered into in 2001 and 2003. Pursuant to this agreement, PMA Sales agreed not to seek parts manufacturer approval from the FAA for four years. Finally, the Dukes-TransDigm agreement provided that the transaction and the legal relations between the parties would be governed by the laws of the State of California.

**[*12]** In April 2010 Chet stopped working at the Dukes Aerospace facility.[9] On August 23, 2011, Chet, Dukes, GST, and Dukes Group filed a complaint against TransDigm and Dukes Aerospace in the Los Angeles County Superior Court, asserting claims for contractual fraud relating to the Dukes-TransDigm agreement. The parties to that suit eventually settled the matter, agreeing to extend the term of Chet's

[9] At a February 3, 2012, meeting of the board of directors of Dukes Aerospace, Chet's employment with Dukes Aerospace was terminated, effective immediately.

noncompetition agreement to nine years and requiring him to sell his **[**18]** interest in PMA Sales, among other terms.

V. *Preparation of Tax Returns*

Beginning in the early 1990s, Dukes and the Huffman family engaged A.R. Beckman and his son Ron Beckman (Mr. Beckman) to prepare the company's and the family's tax returns. After A.R. Beckman passed away, Mr. Beckman took over the practice, employing another certified public accountant (CPA), Tammy Ross-Stearn. Chet hired Mr. Beckman as chief financial officer of Dukes in 2004. Ms. Ross-Stearn took over Mr. Beckman's accounting practice and the responsibility of filing returns on behalf of the Huffman family, Dukes, and all Dukes affiliates.

Ms. Ross-Stearn continued to provide accounting and tax advisory services to the family and Dukes until August 28, 2009, when she terminated the relationship by letter. The termination letter indicated that Dukes should immediately retain a new accounting firm since the 2007 and 2008 returns were coming due. At the same time the IRS was conducting an audit of Dukes's 2006 Form 1120, U.S. Corporation Income Tax Return.

In November 2009 Mr. Beckman contacted a new CPA, Craig Whitfield, about being retained as accountant for the Huffman family and Dukes. Mr. Whitfield was formally **[**19]** engaged on January 4, 2010. His first task was obtaining his new clients' books and records for the year under audit, the delinquent tax returns, and those coming due. He reached out to Ms. Ross-Stearn for this information; she indicated that all the records had been sent to Dukes's Northridge, California, facility after TransDigm's acquisition.

Mr. Whitfield thereafter directed his requests to TransDigm's corporate controller, Sean Maroney. After speaking with Mr. Maroney **[*13]** in January 2010, TransDigm compiled the documents and shipped some 40 boxes to Mr. Whitfield. The boxes began arriving at the end of March and early April 2010. The financial statements were unorganized and incomplete.

On May 14, 2010, Mr. Whitfield sent Ms. Ross-Stearn a formal Circular 230 demand letter, requesting access to Dukes's client records for the fiscal year ending June 30, 2007 (the return for this year was then under audit). This led to a meeting with Ms. Ross-Stearn on June 1, 2010, wherein she provided the trial balance and general ledger of Dukes for the year ending June 30, 2007. Ms. Ross-Stearn asserted that all other documents were in TransDigm's possession.

After speaking with Ms. Ross-Stearn, Mr. **[**20]** Whitfield reached out to BDO Seidman, LLP, and obtained the financial statements it had prepared on behalf of Dukes for fiscal years ending 2007-09. Mr. Whitfield shared these documents with the IRS revenue agent in charge of the audit investigation. He also used the documents to begin filing returns on behalf of Dukes, the Dukes affiliates, and the Huffman family. Mr. Whitfield engaged another CPA, Mark Hutchinson (a partner at the accounting firm Rothstein Kass), to assist in the filing of the returns. Mr. Hutchinson also tried to reach Ms. Ross-Stearn, but she did not return his calls.

Mr. Hutchinson filed Chet and Cindy's 2008 and 2009 Forms 1040, U.S. Individual Income Tax Return, on January 31 and March 8, 2011, respectively. He filed CCC&B's 2009 Form 1065, U.S. Return of

Partnership Income, in March 2011; on that return he reported approximately $12.692 million in gain from the sale of CCC&B's intellectual property assets. As the members of CCC&B, Chet and Cindy reported the intellectual property sale proceeds as *section 1231* gain on their 2009 Form 1040.

Mr. Hutchinson filed Dukes's 2008-10 Forms 1120 on June 22, September 7, and November 22, 2011, respectively. Mr. Hutchinson filed separately **[**21]** Patricia and Lloyd's gift tax returns for 2007 on December 27, 2010.

On October 31, 2014, the IRS issued Letters 950-Z (30-day letter) to Chet and Cindy, as well as to Dukes. The letters stated that they had 30 days to review the proposed adjustments and seek a review from the **[*14]** IRS Office of Appeals;[10] otherwise a notice of deficiency would be forthcoming. IRS Team Manager Bryant Stanik signed each 30-day letter; he was the immediate supervisor of the individual who made the initial penalty determinations that were reflected in each letter. Chet and Cindy, as well as Dukes, did not reach a resolution of their cases at Appeals. On November 12, 2015, the IRS issued notices of deficiency.[11]

OPINION

There are two primary issues in these cases: (1) whether Patricia and the Estate of Lloyd Huffman made a taxable gift when Chet exercised his rights in the RTP Agreements in 2007, buying DRM's and the Trust's shares in Dukes for $5 million; and (2) whether Cindy and the Estate of Chet Huffman, as well as Dukes, properly reported the gain from the sale proceeds of the TransDigm acquisition in 2009 related to Chet's personal goodwill and CCC&B's intellectual property assets. The ancillary issue is **[**22]** whether petitioners are liable for certain accuracy-related penalties and additions to tax.

I. *Burden of Proof Generally*

Generally, the Commissioner's determinations set forth in a notice of deficiency are presumed correct, and taxpayers bear the burden of showing the determinations are erroneous. *Rule 142(a)*; *Welch v. Helvering, 290 U.S. 111, 115, 54 S. Ct. 8, 78 L. Ed. 212, 1933-2 C.B. 112 (1933)*. *Section 7491(a)* provides an exception that shifts the burden of proof to the Commissioner as to any factual issue relevant to the taxpayer's tax liability if the taxpayer introduces credible evidence with respect to the issue and meets certain other conditions. *See § 7491(a)(2)*.

Petitioners argue that respondent bears the burden of proof on all issues because respondent asserted valuations at trial that differed from those in the notices of deficiency. In the notices of deficiency the IRS valued DRM's and the Trust's shares in Dukes as of October 15, 2007, **[*15]** at $23.9 million and $9.3 million, respectively. The IRS valued Chet's personal goodwill at zero. At trial respondent's expert

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[10] On July 1, 2019, the IRS Office of Appeals was renamed the IRS Independent Office of Appeals. *See* ***Taxpayer First Act, Pub. L. No. 116-25, § 1001, 133 Stat. 981, 983 (2019)***. We will use the name in effect at the times relevant to these cases, i.e., the Office of Appeals or Appeals.

[11] Patricia was issued two notices of deficiency. One indicated her joint liability—with Lloyd—for the gift tax and additions to tax associated with the Trust's shares. Lloyd received an identical deficiency notice for the liability associated with the Trust's shares. The second notice of deficiency that Patricia received indicated her sole liability for the gift tax and additions to tax associated with DRM's shares.

testified that DRM's and the Trust's shares were worth $22.5 million and $8.8 million, respectively. Respondent's expert testified that Chet's personal goodwill was worth $3.9 million.

Petitioners argue that *Estate of Simplot v. Commissioner, 249 F.3d 1191, 1193 (9th Cir. 2001)*, *rev'g and remanding 112 T.C. 130 (1999)*, and *Estate of Mitchell v. Commissioner, 250 F.3d 696, 702 (9th Cir. 2001)* **[**23]** , *aff'g in part, vacating and remanding in part T.C. Memo. 1997-461*, prove their point. We agree in part.

In *Estate of Simplot v. Commissioner, 249 F.3d at 1193*, the Commissioner conceded that the assessed deficiency was erroneous, thus forfeiting the presumption of correctness. In *Estate of Mitchell v. Commissioner, 250 F.3d at 702*, the Commissioner concluded in the notice of deficiency that the stock at issue was worth $105 million; at trial, the Commissioner's expert valued the stock at $81 million. This represented a 19% deviation. The U.S. Court of Appeals for the Ninth Circuit determined that this change in value rendered the Commissioner's initial assessment "arbitrary and excessive," and therefore the Commissioner had the burden of proving whether a deficiency existed and if so the amount. *Id.*

Respondent has not conceded that the deficiency notice determinations were erroneous; therefore, *Estate of Simplot* is inapposite. Respondent did, however, alter his valuations. At trial respondent's expert valued DRM's and the Trust's shares at amounts that represent a 6% and a 5% change, respectively. We do not think this makes respondent's initial valuation arbitrary and excessive. These figures are still entitled to a presumption of correctness.

The IRS determined in the notices of deficiency that no amount **[**24]** should have been attributed to Chet's personal goodwill. In pretrial briefing, respondent offered the alternative position that Chet's personal goodwill should be valued at $3.9 million.

On the basis of the Ninth Circuit's analysis in *Estate of Mitchell*, we agree with petitioners that the IRS's initial determination as to the personal goodwill was arbitrary. *See id. at 703*. Respondent bears the burden of proof on the issue of valuing Chet's personal goodwill as it relates to the TransDigm acquisition of Dukes in 2009. All other determinations retain the presumption of correctness.

**[*16]** II. *Gift Tax Issue*

Respondent asserts that Patricia and the Estate of Lloyd Huffman are liable for gift tax arising from the sale of Dukes shares to Chet in 2007 when he exercised the options in the RTP agreements. To that point respondent argues that the RTP agreements are not controlling as to the fair market value of the shares, i.e., the shares were not in fact worth $5 million in 2007.

Respondent contends that the shares were worth approximately $31.3 million and so the differential value between the purchase price and the true fair market value should be deemed a gift. Petitioners maintain that the RTP Agreements were valid business **[**25]** arrangements and therefore should be conclusive as to the value of the Dukes shares. We agree with respondent that the RTP Agreements should be disregarded. We ascertain the proper value below.

A. *Section 2703*

*Section 2703(a)(1)* provides that the value of any property must be determined without regard to "any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right)." *Section 2703(b)* provides an exception to *section 2703(a)* for any option, agreement, right, or restriction that meets all of the following requirements: (1) it is a bona fide business arrangement; (2) it is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and (3) its terms are comparable to similar arrangements entered into by persons in an arm's-length transaction.

If *section 2703(b)* requirements are satisfied, then the agreement may be respected for valuation purposes. *See Holman v. Comm'r, 130 T.C. 170, 191 (2008)*, *aff'd*, *601 F.3d 763 (8th Cir. 2010)*. To meet the first requirement of *section 2703(b)*, an "agreement must further some business purpose." *Estate of Amlie v. Commissioner, T.C. Memo. 2006-76, slip op. at 33*. Maintaining managerial control or family ownership **[**26]** satisfies *section 2703(b)(1)*. *See Holman, 130 T.C. at 194* ("[B]uy-sell agreements serve a legitimate purpose in maintaining control of a closely held business.").

For the second requirement of *section 2703(b)*, we consider the totality of the facts and circumstances. *Estate of Morrissette v. Commissioner, T.C. Memo. 2021-60, at *100*. Whether an agreement **[*17]** "constitutes a testamentary device depends *in part* on the fairness of the consideration received by the transferor when it executed the transaction." *Id.* (emphasis added) (citing *Estate of True v. Commissioner, T.C. Memo. 2001-167*, *aff'd*, *390 F.3d 1210 (10th Cir. 2004)*).

The regulations provide guidance on the final requirement of *section 2703(b)*:

> A right or restriction is treated as comparable to similar arrangements entered into by persons in an arm's length transaction if the right or restriction is one that could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm's length.

*Treas. Reg. § 25.2703-1(b)(4)(i)*. "A right or restriction is considered a fair bargain among unrelated parties in the same business if it conforms with the general practice of unrelated parties under negotiated agreements in the same business." *Id.* This determination will generally entail consideration of the following factors: (1) **[**27]** the expected term of the agreement; (2) the current fair market value of the property; (3) the anticipated changes in value during the term of the arrangement; and (4) the adequacy of any consideration given in exchange for the rights granted. *Id.*

This Court has described the final prong of the *section 2703(b)* exception as "more of a safe harbor than an absolute requirement that multiple comparables be shown." *Estate of Morrissette, T.C. Memo. 2021-60, at *103* (quoting *Estate of Amlie, T.C. Memo. 2006-76, slip op. at 41*). It is therefore permissible to use an isolated comparable to establish that *section 2703(b)(3)* is satisfied. *Estate of Amlie, T.C. Memo. 2006-76, slip op. at 41*.

B. *Analysis of the RTP Agreements*

On the basis of the interrelatedness of the parties to the RTP agreements, we review them with respect to *section 2703* with a heightened level of scrutiny. *See Estate of True, T.C. Memo. 2001-167, slip op. at 72* ("In evaluating whether buy-sell agreements were substitutes for testamentary dispositions, greater

scrutiny was applied to intrafamily agreements restricting stock transfers in closely held businesses than to similar agreements between unrelated parties."). **[*18]** The parties agree that the first requirement of *section 2703(b)* is satisfied **[**28]** given that the stated purpose of the RTP agreements was to "retain ownership of the Dukes Shares within the Huffman Family." *See Holman, 130 T.C. at 194*. The parties disagree as to the other requirements, which we discuss below.

1. *Whether the RTP Agreements Were a Testamentary Device*

Respondent asserts that Chet paid less than adequate consideration when he entered into the RTP agreements. According to respondent's expert, Joseph Ruble of Caliber Advisers, Inc., the RTP agreements were together worth approximately $79,800 in 1993 when they were executed. Chet paid only the stated consideration of $2 for these rights.

Petitioners put forth two alternative arguments on the basis of their expert's valuation of the agreements. They first argue that the RTP agreements were worth only $2 each, and so Chet did in fact pay the full consideration. Petitioners' expert, Curtis Kimball of Willamette Management Associates, asserted in his report that $2 is the correct value "if Dukes simply continued to be operated by the Owners without any change in strategy or inputs from an incentivized Grantee."

Petitioners alternatively assert that the rights under the RTP agreements were worth $77,850 "if Dukes was operated by the **[**29]** Owners with changes in strategy and inputs from an incentivized Grantee." They argue that notwithstanding this higher valuation, Chet still paid full consideration, not in dollars up front but in reduced compensation from the time he became CEO until the time he sold the company. From 1993 to 2006, Chet's salary ranged from $65,000 to $85,000. In 2007 it increased to $147,000 but was far less than the only other paid officer's salary of $243,300. This, petitioners argue, led to Chet's forgoing approximately $3.5 million in compensation over the years.

Petitioners contend that the RTP agreements contemplated reduced compensation as a form of payment because each stated that the agreements were entered into for "Two Dollars ($2.00) *and for other good and valuable consideration*." They argue then that the "other good and valuable consideration" was the reduced compensation.

Respondent disagrees with petitioners that reduced compensation could have formed part of the consideration that Chet paid for the rights under the RTP agreements. Respondent points to the **[*19]** text of the agreements, which each state that "this Agreement is not compensatory in nature, rather the purpose is to retain the **[**30]** ownership of" Dukes within the family. Respondent also notes that a tax opinion letter Chet obtained from Proskauer came to the same conclusion, noting that the purpose behind the RTP agreements "was not compensatory. It was not in connection with the performance of services."

We agree with respondent that the rights associated with the RTP agreements were worth substantially more than $2. This finding is supported by both parties' experts' valuations of the agreements. Still, we do not think that the RTP agreements were a testamentary device by which Lloyd and Patricia attempted to pass assets on to their son Chet. We make this determination on the basis of all of the facts and circumstances involved. *See Estate of Morrissette, T.C. Memo. 2021-60, at *100*.

If we viewed the exchange of $2 for the rights under the RTP agreements without considering the circumstances, we would agree that this was an inequitable exchange. While we take note that the agreements themselves purported not to be compensatory, Chet *did* accept a reduced salary during his years as Dukes's CEO. Given his significant contributions to the company, we think that his reduced salary should be deemed consideration for **[**31]** the RTP agreements.

We note the significant amount of earnings growth that would have had to occur for the options to become "in the money." According to respondent's expert, the Dukes shares were worth approximately $0.51 per share in 1993; petitioners' expert says they were worth approximately $0.47 per share. In 2007 Chet was able to purchase the shares for $11.83 per share. If we average the parties' per-share 1993 values ($0.49 per share), the Dukes shares that Chet purchased in 2007 had increased in value by 2,414%.

We view this level of growth as unusual and unexpected. It is supported by the 1993 transaction by which Chet purchased Mr. Barneson's shares for $150,000. Chet and Mr. Barneson—unrelated parties—reached this figure by estimating annual revenue growth for Dukes at 4% per year. Using a 4% growth rate, the shares that Chet was able to purchase via the RTP agreements would have taken between 50 and 70 years to reach an "in the money" value.

**[*20]** We also note that the RTP agreements—though negotiated among family members—did have the characteristics of an arm's-length transaction. Both parties were motivated to reach a fair price. Lloyd and Patricia were willing to part with **[**32]** their shares only for $5 million—an amount which they considered sufficient for their retirement. Chet on the other hand was incentivized to drive this number down so that he could reach the "in the money" value we mentioned above sooner. This incentivized Chet both to stay with the company and to increase its per-share value.

Taking these facts together, we do not think that the RTP agreements were a testamentary device by which Lloyd and Patricia transferred Dukes shares to Chet for less than full consideration. *Section 2703(b)(2)* is satisfied.

2. *Comparability of the RTP Agreements to Similar Arrangements*

Petitioners argue that the final *section 2703(b)* requirement is satisfied by the Lloyd-Barneson agreement, which they claim is comparable to the RTP agreements and was entered into in an arm's-length transaction. Petitioners note that the Lloyd-Barneson agreement contained the following provisions, which are also included in the RTP agreements: (1) a right to purchase on the death of the grantor and by a right of first refusal; (2) a maximum purchase price; and (3) no specific termination or exercise date. Petitioners also point out that the Lloyd-Barneson agreement was entered into by unrelated parties—Lloyd and **[**33]** Mr. Barneson—and executed at arm's length.

Respondent counters that the Lloyd-Barneson agreement cannot serve as a good comparable because it was not submitted into evidence. Respondent notes that there are only two pieces of evidence which describe the Lloyd-Barneson agreement: a one-paragraph reference in the Assignment agreement and another in the Chet-Barneson agreement. Otherwise, the only information provided about the Lloyd-Barneson agreement comes from witnesses' testimony, which made vague references to the agreement.

Respondent contends that even if we are to find that the testimony regarding the Lloyd-Barneson agreement is credible, there are differences among it and the RTP agreements which render the Lloyd-Barneson agreement not a good comparable. The noted differences are that (1) Lloyd Huffman was allowed to freely transfer his **[*21]** rights whereas Chet had to obtain consent from the owners; (2) the right of first refusal in the RTP agreements exempted offers from Chet's brothers; (3) the RTP agreements had an addendum that granted Chet the right to purchase the shares at any time at his discretion; and (4) the stated purpose of the RTP agreements was to retain ownership of **[**34]** Dukes within the Huffman family.

We agree with respondent. As we noted in *Estate of Amlie, T.C. Memo. 2006-76, slip op. at 41*, reliance on an isolated comparable is adequate given that the regulations "delineate more of a safe harbor than an absolute requirement that multiple comparables be shown." Use of the Lloyd-Barneson agreement then would be acceptable to show that the RTP agreements had terms similar to an agreement entered into at arm's-length. But as respondent notes, we do not have the Lloyd-Barneson agreement in evidence. We have only vague and incomplete references to it and testimony based on those references. We do not have an isolated comparable to undergo the *section 2703(b)(3)* analysis.

Even if we were to accept witnesses' testimony as sufficient evidence, we do not think that the Lloyd-Barneson agreement is sufficiently similar. Even though the three agreements purport to create rights to purchase Dukes shares for a maximum price, the differences among them are significant. For example, Chet had the unfettered right to purchase the Dukes shares at any time and at his sole discretion; Lloyd did not have this same right. Further, Lloyd was permitted to assign or otherwise transfer his **[**35]** purchase rights whereas Chet had to obtain consent to do the same. Chet then had rights superior to Lloyd's in purchasing the shares but inferior in transferring those rights. The terms of the agreements are therefore not comparable within the meaning of *section 2703(b)(3)*.

On the basis of the foregoing, we do not think that petitioners have satisfied the final requirement of *section 2703(b)*. *See* *Estate of Blount v. Commissioner, T.C. Memo. 2004-116, slip op. at 48* (finding that solely testimony without production of comparable agreements was insufficient to satisfy *section 2703(b)(3)*), *aff'd in part, rev'd in part and remanded*, *428 F.3d 1338 (11th Cir. 2005)*. *Section 2703(b)* is therefore not satisfied, and so the RTP agreements must be disregarded for purposes of valuing the Dukes shares that Chet purchased in 2007. *See* *§ 2703(a)*.

**[*22]** C. *Value of Dukes Shares in 2007*

Lloyd and Patricia indirectly owned shares in Dukes by virtue of their interests in the Trust and DRM. While they had equal interests in the Trust's shares, only Patricia had an interest in DRM's shares. On October 15, 2007, Chet exercised his rights under the RTP agreements, purchasing the Trust's and DRM's shares for $1.4 million and $3.6 million, respectively. Respondent argues that the shares were worth more than the amount **[**36]** Chet paid, and therefore Lloyd and Patricia made taxable gifts when they caused the Trust and DRM to transfer their shares.

In the notice of deficiency issued to Lloyd (for his interest in the Trust), the IRS valued the Trust's 118,635 shares at $10.7 million. Since Chet paid $1.4 million for the Trust's shares, the IRS determined that Lloyd made a $9.3 million gift to Chet.

In the first notice of deficiency issued to Patricia (for her interest in the Trust), the IRS similarly valued the Trust's 118,635 shares at $10.7 million.[12] Since Chet paid $1.4 million for the Trust's shares, the IRS determined that Patricia made a $9.3 million gift to Chet. In the second notice of deficiency issued to Patricia (for her interest in DRM), the IRS valued DRM's 304,124 shares at $27.5 million. Since Chet paid $3.6 million for the shares, the IRS determined that Patricia made a $23.9 million gift to Chet.

At trial respondent's expert concluded that the aggregate fair market value of Dukes shares as of October 15, 2007, should be $31.3 million: $22.5 million attributable to DRM's shares and $8.8 million attributable to the Trust's shares.[13] Under this valuation, Patricia made a taxable gift of $18.9 million **[**37]** attributable to DRM's shares and together **[*23]** Patricia and Lloyd made a taxable gift of $7.4 million attributable to the Trust's shares.

Petitioners argue that the shares were worth in total $5 million—as provided in the RTP agreements—and therefore Patricia and Lloyd did not make a taxable gift on October 15, 2007. Alternatively, petitioners' expert submitted that the fair market value of the Trust's 118,645 shares was approximately $4.5 million while that of DRM's shares was approximately $11.6 million. Under that valuation, Patricia made a taxable gift of approximately $8 million attributable to DRM's shares and together Patricia and Lloyd made a taxable gift of approximately $3.1 million attributable to the Trust's shares. We consider the parties' expert reports and arguments below.

1. *Parties' Experts' Reports*

a. *Respondent's Valuation*

Mr. Ruble testified on behalf of respondent as an expert for the purpose of valuing the Dukes shares. Mr. Ruble used three valuation approaches to ascertain the fair market value of Dukes Group on a marketable, controlling interest basis: (1) income approach using a discounted cashflow (DCF) analysis; (2) market approach using a guideline company analysis; **[**38]** and (3) market approach using a business transaction analysis. Mr. Ruble determined the value of Dukes Group under each method, then took the weighted average of the three values to reach an enterprise value of $74.8 million.

To determine the fair market value of invested capital in Dukes Group, Mr. Ruble added to the enterprise value $5.3 million in noncore net assets and $1.8 million in net working capital. Taking these adjustments

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[12] Patricia and Lloyd received identical notices of deficiency for their role as donors of the Trust's shares in Dukes.

[13] When Chet exercised his rights under the RTP agreement with the Trust, he purchased its shares for $1.4 million. In the notices of deficiency issued to Patricia and Lloyd, the IRS determined that they were each liable for gift tax for that transaction because they had caused the Trust to transfer its shares to Chet for less than their fair market value.

When Chet exercised his rights under the RTP agreement with DRM, he purchased its shares for $3.6 million. In the notice of deficiency issued to Patricia, the IRS determined that Patricia was liable for gift tax for that transaction because she had caused DRM to transfer its shares to Chet for less than their fair market value.

into account, Mr. Ruble reached a fair market value of invested capital for Dukes Group at $81.9 million as of the valuation date.

To determine the fair market value of the invested capital in Dukes, Mr. Ruble subtracted the fair market value of the Dukes-related affiliates' (DRM, AMDC, TRD, and CCC&B) assets from the Dukes Group invested capital value. He determined that the fair market value of the Dukes-related affiliates' assets (DRA) was $1.8 million. After subtracting the $1.8 million in DRA assets and $3 million in debt owed by Dukes, Mr. Ruble found that the fair market value of the invested capital in Dukes was $77 million as of the valuation date. **[*24]** Lastly, Mr. Ruble took into account discounts for lack of control and lack of marketability. He determined **[**39]** that the appropriate minority interest discount was 10%. He determined that the appropriate marketability discount was 20%. After considering the discounts, Mr. Ruble determined that the fair market value of Dukes shares on a privately held, minority-interest basis was $55.3 million, or $74 per share. He found that the value of the Dukes stock transferred from Lloyd and Patricia to Chet in 2007 was $31.3 million: $22.5 million attributable to DRM's shares and $8.8 million attributable to the Trust's shares.

b. *Petitioners' Valuation*

Petitioners' expert, Duff & Phelps, used the same three valuation methods as Mr. Ruble. Duff & Phelps's report similarly weighted each of the three valuation approaches equally to reach an enterprise value of $25.9 million. It then added various adjustments: (1) $2.6 million as the present value of the operating cashflows from CCC&B; (2) $4.4 million and $160,100 as the loan receivable from Chet and the amount due from PMA Sales, respectively; and (3) $2.5 million as the excess of working capital. After these adjustments, Duff & Phelps determined that the enterprise value of Dukes was $35.6 million.

Duff & Phelps next determined a key person discount by valuing **[**40]** Chet's personal relationships with key clients and key employees. It determined the value of Dukes attributable to Chet's personal relationships with key clients to be $3 million. It determined the value of Dukes attributable to Chet's relationships with key employees to be $2.6 million. Duff & Phelps then discounted the $2.6 million to $1.3 million to account for a 50% probability that the key employees would leave if Chet left. Taking that together, Duff & Phelps reached a key person discount of $4.3 million or 16.7%.

After deducting the key person discount, Duff & Phelps reached a $31.3 million value for Dukes. It then deducted the interest-bearing debt obligations of Dukes to reach a total fair market value of all equity in Dukes at $28.7 million. It found this equated to $38.20 per share. Duff & Phelps then valued the shares held by DRM and the Trust as of 2007 using this per-share value, reaching the final figure of $16.3 million as the aggregate value.

**[*25]** 2. *Parties' Arguments as to Value*

a. *Respondent's Arguments*

Respondent first notes that Duff & Phelps did not use any information from the Hanwha MOU or the Deloitte CIM in its analysis. Respondent asserts that these should have **[**41]** been considered in the valuation determination because they represented actual market transactions, albeit proposed ones.



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Respondent also notes that Duff & Phelps removed certain revenues from Dukes relating to the CCC&B licenses after three years. Duff & Phelps assumed that the sublicense agreement would not be renewed because the royalty paid was not market rate. Respondent contends that the royalty was within the market rate range in 2007 and therefore should not have been phased out in 2010. Mr. Ruble testified that there would have been an additional $10 million of value if Dukes had been able to continue using the licenses to sell Honeywell products.

Respondent asserts that Duff & Phelps calculated the key person discount improperly. Respondent contends that—instead of subtracting from the weighted average enterprise value—Duff & Phelps should have used only the income approach valuation figure as a starting point. Respondent further contends that Duff & Phelps should have compared the value of the business assuming that Chet left Dukes to the value of the business assuming that Chet stayed with Dukes pursuant to the income approach. According to respondent, Duff & Phelps attributes **[**42]** too high a value to other key employees. For these reasons, respondent argues that the total value of the key person discount should be reduced from $4.3 million to $1.75 million.

Additionally, respondent argues that Duff & Phelps used improper pricing multiples for the market approaches. Respondent asserts that Duff & Phelps selected companies that fell at or below the lowest quartile of industry performance. For the market transaction method, Duff & Phelps used multiples of 0.8×, 0.8×, 7.0×, and 7.0×, while the industry medians were 1.7×, 2.4×, 10.0×, and 8.2×, respectively. For the market comparable method, Duff & Phelps used multiples of 1.11×, 1.19×, 6.5×, and 8×, while the industry medians were 1.27×, 1.26×, 11.26×, and 9.87×. Myron Marcinkowski of Duff & Phelps testified that had he used pricing multiples closer to the median, the concluded value would have increased.

**[*26]** Respondent lastly notes that Mr. Ruble's valuation of Dukes ($81 million) was comparable to the offer made in the Hanwha MOU (between $85 and $105 million) and the TransDigm purchase price ($95 million). Since petitioners estimated the enterprise value of Dukes at $35.6 million, it is not close to the actual transactions **[**43]** that took place and therefore is unreliable.

b. *Petitioners' Arguments*

Petitioners contend that the difference in enterprise values reached by the parties' experts is largely attributable to their EBITDA figures.[14] Petitioners assert that Mr. Ruble's inflated EBITDA calculation resulted from his reduction of the cost of goods sold and operating expense figures for fiscal year 2007. Petitioners argue that Mr. Ruble's adjustments were based on the CIM, which they believe is unreliable since Deloitte did not independently verify the accuracy of the information forming the adjustments.

Petitioners similarly criticize Mr. Ruble's use of the Hanwha MOU, asserting that it was nonbinding and contingent and therefore cannot serve as the basis for a proper valuation. Petitioners also note that the MOU and Dukes-TransDigm agreement were completely different transactions. The former contemplated acquiring all Dukes and GST stock, CCC&B's intellectual property, and the workforce and assets of the affiliate companies. In contrast, the Dukes-TransDigm agreement was structured as an asset purchase.

[14] EBITDA is an abbreviation for earnings before interest, taxes, depreciation, and amortization.

Petitioners assert that Mr. Ruble erroneously included the revenues of GST. They contend this inflated the **[**44]** Dukes valuation by at least $2 million despite GST's having gross profit of less than $900,000 in 2007.

Additionally, petitioners argue that CCC&B would not have renewed its license with Dukes after 2010. They note that despite there being market-level royalties for 2007, Chet had control over the licenses. And if he left Dukes, he would have caused CCC&B to enter into sublicensing agreements with GST and PMA Sales instead of Dukes. Petitioners further stress that CCC&B would not have renewed the licenses because the royalties were projected to be below market for 2008, 2009, and 2010.

**[*27]** Petitioners lastly voiced concerns about Mr. Ruble's minority interest discount and marketability discount. They noted that once Dukes's EBITDA is adjusted to account for advertising expenses and the affiliate companies' shares of earnings, the discounts would bring Mr. Ruble's enterprise value below petitioners' value.

3. *Conclusions as to Value of Dukes Shares in 2007*

We find that petitioners failed to meet the burden of proof regarding why their expert's valuation is correct. We agree with respondent that Duff & Phelps miscalculated the key person discount. In its report Duff & Phelps calculated the **[**45]** operating value attributable to Chet by first calculating the enterprise value without Chet using a DCF method. Duff & Phelps then subtracted that figure from the enterprise value calculated using the weighted average of the three methods. As respondent notes, this creates an apples-to-oranges comparison whereby the formula will always yield at least $2.5 million of value attributable to Chet regardless of whether he competes with Dukes. We think the better approach, as respondent notes, would have been to use the DCF enterprise value as the starting point.

We also agree with respondent that Duff & Phelps undervalued the Dukes shares when using the market approaches. In conducting this analysis, it selected 19 comparable companies for which to compare multiples. For both the market transaction and the market comparable methods, Duff & Phelps selected multiples that were at or below the lowest quartile of guideline companies. Mr. Ruble selected median quartile gross profit and EBITDA multiples.

Mr. Ruble's valuation is proper except for one adjustment: We direct the parties to adjust the valuation by removing the revenues associated with the CCC&B licenses as done by Duff & Phelps.

We **[**46]** agree with petitioners that the licensing agreement between Dukes and CCC&B would not likely have been renewed after its expiration on July 30, 2010, because the licensing fees that Dukes paid to CCC&B were too low. Although they were consistent with the market rate in 2007, Duff & Phelps projected that they would be below market for 2008-10. We do not think that Chet would have allowed CCC&B to renew the licensing agreement if he could generate higher fees from a different licensee.

Even if the fees were projected to be at or above market rate beyond the expiration date, we do not think Chet would have allowed **[*28]** CCC&B to renew the licensing agreement because he would no longer have an interest in the licensee after leaving Dukes. Since he controlled CCC&B, it is far more likely that he would have caused it to enter into a new licensing agreement with GST, another manufacturing

company capable of using the licenses, which he owned entirely. We conclude petitioners properly reduced Dukes's revenue associated with the Honeywell licenses owned by CCC&B.

Where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of **[**47]** the property exceeds the value of the consideration is deemed a gift. *§ 2512(b)*. We direct the parties to make the above change to Mr. Ruble's valuation. Chet paid $5 million ($3.6 million for shares from DRM and $1.4 million for shares from the Trust); this amount should be deducted from the value and the remaining amount is subject to gift tax.

III. *Income Tax Issues*

The next issue concerns the treatment of sale proceeds from the Dukes-TransDigm agreement. First, we consider whether Chet and Cindy, as well as Dukes, properly reported the portion of the sale proceeds attributable to the CCC&B intellectual property assets. Second, we consider whether they properly valued and reported the sale proceeds associated with Chet's personal goodwill. In each case Chet and Cindy reported the sale proceeds and income. Respondent contends that all of the income should have been reported by Dukes as capital gain net income and then by Chet and Cindy as ordinary dividend income.

A. *Sale of CCC&B's Intellectual Property Assets*

1. *Parties' Arguments*

Respondent argues that the gain from the sale of the CCC&B intellectual property assets (i.e., the Honeywell licenses) should have accrued to Dukes and thereafter **[**48]** as a constructive dividend to Chet and Cindy. Respondent asserts that petitioners misreported the gains on CCC&B's Form 1065 and on Chet and Cindy's Form 1040 for 2009.

Respondent asserts that Dukes Group was the proper party to report the gain because CCC&B sold the assets before the Dukes-TransDigm agreement was executed. Respondent contends that the CCC&B-Dukes agreement controlled the methodology of the asset transfer and that by the terms of that agreement, the only consideration **[*29]** was Dukes's forgiveness of a $904,221 debt in addition to other nonmonetary considerations. Therefore, respondent argues, no portion of the approximately $12 million in gain should have been reported by CCC&B.

Petitioners disagree. Although they recognize the CCC&B-Dukes agreement, they assert that it was never fulfilled because the Hanwha deal fell through. On that point petitioners assert that the loan was never forgiven and CCC&B continued to own the Honeywell licenses until the TransDigm acquisition in December of 2009.

Petitioners argue that CCC&B properly reported the gain from the TransDigm acquisition because they modified the terms of the CCC&B-Dukes agreement. They allege that they did so twice. **[**49]** Chet testified that shortly after the Hanwha deal fell through, he executed the *first amendment*, the ALM. Petitioners argue that the ALM extended the effectiveness of the CCC&B-Dukes agreement to the date of an eventual sale to a third party (which turned out to be TransDigm) and increased the consideration to the fair market value of the Honeywell licenses then owned by CCC&B.

Petitioners additionally argue that the second amendment to the CCC&B-Dukes agreement, the Correcting Amendment, also increased the consideration to the fair market value of the licenses. Chet testified that he executed this second amendment having forgotten about executing the ALM.

Respondent argues that neither of the amendments should be treated as effective. As to the ALM, respondent notes that it is not dated and therefore cannot be relied upon as having been executed before the TransDigm acquisition. Since it was not executed before the TransDigm acquisition, respondent argues, the CCC&B-Dukes agreement controlled. This would mean that only debt forgiveness was the consideration for the Honeywell licenses and therefore nothing further should have been reported by CCC&B or Chet and Cindy.

As for the Correcting Amendment, **[**50]** respondent argues that—in contrast to the ALM—it did not (1) extend the effectiveness of the CCC&B-Dukes agreement, (2) include additional Honeywell licenses acquired in 2009, or (3) require that CCC&B be the direct payee of the sales portions attributable to the Honeywell licenses.

**[*30]** 2. *Discussion*

The first principle of income taxation is that tax must be imposed on income to the party that earned it. *Commissioner v. Culbertson, 337 U.S. 733, 739-40, 69 S. Ct. 1210, 93 L. Ed. 1659, 1949-2 C.B. 5 (1949)*. As we have further concluded, "[t]he choice of the proper taxpayer revolves around the question of which person or entity in fact controls the earning of the income rather than the question of who ultimately receives the income." *Vercio v. Commissioner, 73 T.C. 1246, 1253 (1980)* (first citing *Am. Sav. Bank v. Commissioner, 56 T.C. 828 (1971)*; and then citing *Wesenberg v. Commissioner, 69 T.C. 1005 (1978)*).

We agree with respondent that CCC&B did not directly sell the intellectual property assets to TransDigm in the 2009 acquisition. CCC&B was not a named party to the Dukes-TransDigm agreement, nor was it to be specifically allocated any of the purchase price. We, however, conclude petitioners properly reported the gain.

The facts indicate that the parties did not follow through with the CCC&B-Dukes agreement in 2008 as contemplated. The Honeywell licenses were still listed on CCC&B's 2008 Form 1065 at yearend and so too was the **[**51]** loan payable owing to Dukes. The terms of the CCC&BDukes agreement then were not carried out as anticipated, and CCC&B still owned the intellectual property assets going into 2009.

We believe that the ALM was duly executed in February or March of 2009 as Chet testified. Although the document is not dated, we acknowledge Chet's strategy in keeping the CCC&B intellectual property held separately. Chet testified that he had modeled this strategy after Honeywell, which kept its intellectual property assets in an entity separate from the operating business entity.

We agree that the timing of the ALM gives its alleged execution date credibility. Once the Hanwha deal fell through, Chet testified that he began more aggressively marketing Dukes for sale, hence the CIM sales brochure generated by Deloitte. This makes it more plausible that Chet would have sought to extend the effectiveness of the CCC&BDukes agreement until the date of an eventual sale.

Finally, we think that extending the effectiveness of the CCC&BDukes agreement—especially in early 2009—would have been advantageous to any eventual purchaser given that Hanwha had wanted to buy the Dukes organization (and its affiliates) as a whole. **[**52]** **[*31]** Creating a mechanism then by which all assets would eventually come under the same corporate umbrella is plausible.

All of these facts lead us to the conclusion that petitioners have satisfied their burden of proof as to the CCC&B asset sale. We agree that the ALM amended the CCC&B-Dukes agreement, increasing the stated consideration to the fair market value of the then-owned Honeywell licenses and any other intellectual property held by CCC&B. On that basis, we agree with petitioners that CCC&B—and not Dukes—was the proper party to report the gain from the sale. Cindy and the Estate of Chet Huffman are not liable for dividend income related to the CCC&B intellectual property assets.

B. *Sale of Chet's Personal Goodwill*

1. *Parties' Arguments*

The next issue is the treatment of the TransDigm acquisition sale proceeds that petitioners allocated to Chet's personal goodwill. On their 2009 Form 6252, Installment Sale Income, Chet and Cindy reported approximately $21.8 million as the sale price attributable to Chet's personal goodwill. Of that amount, they reported $19.4 million as installment sale income.

Respondent argues that no amount of the sale proceeds can be attributed to Chet's personal **[**53]** goodwill, so it was improper for Chet and Cindy to report the income. Respondent argues that Nevada law applies because Dukes Group was a Nevada limited liability company. Respondent notes that under Nevada law, any property owned by a limited liability company must be held and owned in the name of the company. *See* *Nev. Rev. Stat. § 86.281* (2010).

Respondent asserts that Chet was not a party to the Dukes-TransDigm agreement. Since he was not listed in the agreement, respondent asserts that the personal goodwill either was not properly transferred to TransDigm via the Dukes-TransDigm agreement or was already owned by Dukes Group before the sale. In either case, respondent argues that the income should have been reported instead by Dukes.

Petitioners argue that they properly reported the income according to the terms of the Dukes-TransDigm agreement. Section 2.01 of the agreement describes the purchased assets, which include goodwill. Goodwill is defined to include "[a]ll goodwill associated with **[*32]** the Business, including any personal goodwill of Chet, the sole member of Dukes Group, as it relates to the Purchased Assets and the Business." Section 2.07 requires that the parties engage SRR to allocate the purchase **[**54]** price among the purchased assets.

Section 2.07 further provides that the sellers (i.e., Dukes) would hire an independent valuation expert, other than Deloitte, to prepare an allocation of the goodwill between enterprise goodwill and the personal goodwill of Chet. If TransDigm disagreed with the suballocation, then it could hire a different valuation firm to provide the analysis. Otherwise, the decision reached by the appraiser was to be binding on the parties. Section 2.07 finally provides that "[t]he Sellers will allocate the Adjusted Purchase Price between them and Chet Huffman with respect to the personal goodwill, if any, as they agree and in a manner consistent with this Section."

Petitioners assert that the parties followed these provisions to the letter. SRR valued the purchased assets including the goodwill, to which it ascribed a value of approximately $50 million. Dukes then hired Duff & Phelps to perform the suballocation among the personal and enterprise goodwill components. At trial Chet testified that TransDigm agreed to the engagement of Duff & Phelps. Duff & Phelps valued Chet's personal goodwill at $21.8 million. Petitioners argue that because the Dukes-TransDigm agreement specifically **[**55]** allocated this amount to Chet, it was his responsibility to report it.

Despite the valuation from Duff & Phelps, the IRS determined in the notice of deficiency that Chet's personal goodwill had no value. Respondent contends that the expert report from Duff & Phelps cannot be relied upon because Mr. Marcinkowski made errors. First, respondent notes that Mr. Marcinkowski changed his personal goodwill valuation before trial. He lowered the personal goodwill amount from $21.8 million to $19.2 million after changing his assumption regarding when Chet would be effective in competing against Dukes. He decided that it would instead take Chet 18 months to become competitive. Respondent argues that this deviation weighs against Mr. Marcinkowski's credibility as an expert.

Respondent also notes that Mr. Marcinkowski used a perpetuity model to determine the residual value of Chet's personal goodwill. Respondent contends that this was improper because Chet was 48 years old at the time of the TransDigm acquisition in 2009. If Chet retired within the next 20 years, the value of his personal goodwill would be **[*33]** reduced to $15.5 million. Finally, respondent argues that there should have been no portion **[**56]** of Chet's personal goodwill which was attributable to other employees at Dukes. Respondent contends that this is problematic because these employees, like Chet, did not have an employment agreement in place.

As an alternative argument, respondent's expert, Mr. Ruble, asserted that Chet's personal goodwill did have some value, approximately $3.9 million worth. Mr. Ruble confined his report to the areas in which he assumed that Chet offered the most value to Dukes: generating new business, either to existing customers or to new customers. Mr. Ruble asserted that the existing customers were mostly focused on pricing, quality, and the ability to deliver products timely. Respondent relies upon Chet's testimony that the driving factors of growth for Dukes were a combination of acquisitions and winning new programs as well as choosing good products with high profit margins.

In his report, Mr. Ruble concluded that it was unlikely Dukes would have had fewer opportunities if Chet were no longer with the company. Mr. Ruble contended that Dukes would likely have hired a qualified replacement to mitigate the damages created by Chet's lack of engagement with the company. Dukes could have hired a replacement **[**57]** from either an industry competitor, TransDigm, existing Dukes management, or one of Dukes's customers.

2. *Discussion*

As discussed below, we find that Chet had personal goodwill and that he and Cindy properly reported the sale proceeds attributable to the goodwill to the extent of its fair market value.

Petitioners assert that Nevada law is irrelevant despite Dukes Group's being formed there. We agree. The Dukes-TransDigm agreement specifically provides that the transaction and the legal relations between the parties will be governed by the laws of the State of California. We apply California law then in determining whether goodwill can be separated from a business and attributed to an individual.

Goodwill has been defined as the expectation of continued patronage. *Newark Morning Ledger Co. v. United States, 507 U.S. 546, 555, 113 S. Ct. 1670, 123 L. Ed. 2d 288 (1993)*. It has also been defined as "the sum total of those imponderable qualities which attract the custom of a business—what brings patronage to the business." *Philip Morris Inc. & Consol. Subs.* ***[*34]*** *v. Commissioner, 96 T.C. 606, 634 (1991)* (quoting *Boe v. Commissioner, 307 F.2d 339, 343 (9th Cir. 1962)*, *aff'g 35 T.C. 720 (1961)*), *aff'd*, *970 F.2d 897 (2d Cir. 1992)*. Goodwill can generally take two forms: (1) personal goodwill owned by key employees or shareholders and (2) corporate or enterprise goodwill developed and owned by the company or employer. *Bross Trucking, Inc. v. Commissioner, T.C. Memo. 2014-107, at *21*. **[**58]** A business can only distribute corporate assets and cannot distribute assets personally owned by shareholders. *See Martin Ice Cream Co. v. Commissioner, 110 T.C. 189, 209 (1998)*. Key employees may transfer their personal goodwill via employment contracts or noncompete agreements. *Bross Trucking, Inc., T.C. Memo. 2014-107, at *27* (citing *Martin Ice Cream Co., 110 T.C. at 207*).

We agree with petitioners that Chet created personal goodwill through his relationships with key employees and customers during his time as Dukes's CEO. We also agree on the basis of the Dukes-TransDigm agreement that the parties to that transaction allocated a portion of the sale proceeds to Chet as his personal goodwill. Under California law, personal goodwill is an intangible asset capable of being owned by an individual. *See, e.g., In re Marriage of Nichols, 27 Cal. App. 4th 661, 33 Cal. Rptr. 2d 13, 20 n.4 (Ct. App. 1994)*.

While working for Dukes Chet did not have an employment contract, nor was he subject to a noncompete agreement. For that reason we disagree with respondent that he somehow transferred his goodwill to Dukes before the acquisition. *See Bross Trucking, Inc., T.C. Memo. 2014-107, at *27*. He continued to own his personal goodwill up until the TransDigm acquisition in December 2009; to that end, as part of the Dukes-TransDigm agreement, Chet entered into a noncompete agreement. **[**59]** Thus, any gain on the sale of that personal goodwill would have had to be reported by its owner, Chet. *See Commissioner v. Bollinger, 485 U.S. 340, 344, 108 S. Ct. 1173, 99 L. Ed. 2d 357* ("For federal income tax purposes, gain or loss from the sale or use of property is attributable to the owner of the property."). On the basis of these findings, we conclude that respondent has failed to meet his burden of proof regarding Chet's personal goodwill.

Mr. Marcinkowski derived the personal goodwill value by performing a scenario analysis using the DCF method. He performed this same analysis for each component of the personal goodwill value: that attributable to Chet's personal relationships with key clients and that attributable to Chet's personal relationships with key employees. **[*35]** The first step he took for the key clients analysis was assessing the operating value of Dukes if TransDigm received full cooperation and assistance from Chet in perpetuity (Scenario 1). He discounted future cashflows from years 2010-14 to derive the Scenario 1 operating value of $87.084 million.

He then calculated the operating value of Dukes if TransDigm received no cooperation or assistance from Chet in perpetuity (Scenario 2). He similarly discounted future cashflows from years 2010 to **[**60]** 2014 to derive a range of potential values for Scenario 2: between $63.859 million and $75.471 million. The Scenario 2 range of values was calculated by estimating the percentage of revenue that would be lost if Chet did not cooperate with TransDigm after the acquisition.

His report indicated which clients would be vulnerable to Chet's influence. Revenue from most clients was expected to remain the same. Only revenue related to specific aircraft from Bombardier, Cessna, Cirrus Design, Hawker Beechcraft, and Lockheed Martin was expected to decline as a result of Chet's leaving. All other aircraft and clients were expected to generate the same level of revenue despite Chet's absence. Mr. Marcinkowski determined the percentage of revenue lost as follows for these clients:

***Percentage Revenue Retained After Chet's Leaving***

| *Client* | *Aircraft* | *Low-End* | *High-End* |
|---|---|---|---|
| Bombardier | Challenger 604/605 | 75% | 50% |
| Bombardier | Challenger 850/850CD | 50% | 0% |
| Cessna | Citation Sovereign | 50% | 0% |
| Cessna | Citation X | 50% | 0% |
| Cirrus Design | SR22-G3 | 50% | 0% |
| Hawker Beechcraft | 450 | 55% | 10% |
| Hawker Beechcraft | Premier II | 70% | 40% |
| Lockheed Martin | F-16 | 50% | 0% |

**[*36]** These percentages were then multiplied by the unadjusted, projected revenues for each client to reach the adjusted revenues. **[**61]** The adjusted revenues formed the basis for calculating the future cashflows that would be discounted back to the present to reach an operating value. Once Mr. Marcinkowski had derived low- and high-end operating values for Scenario 2, he averaged the two figures and subtracted the averages from the Scenario 1 values to reach the values attributable to Chet's relationship with key clients. A similar analysis was done to reach the values attributable to Chet's relationships with key employees.

While we find Mr. Marcinkowski's methodology sound, we think that his report overestimated the percentage of revenue that would be lost as a result of Chet's failing to cooperate or assist TransDigm after the acquisition. We agree with Mr. Ruble that Chet would have had a much lesser impact on revenues from existing clients. His true value came from his ability to generate new business, be that from existing clients or new ones. Once the clients were obtained, keeping them was more a matter of continuing to provide quality products timely. This **[*37]** was not an area that Chet himself had a direct influence on and should have been accounted for in Mr. Marcinkowski's analysis.

On that basis we conclude **[**62]** that instead of averaging the low- and high-end Scenario 2 values, it would be more appropriate to use the low-end value. We direct the parties to use the low-end operating value of $75.471 million as the Scenario 2 figure (from Exhibit 197, Exhibit C, p. 1) to reach the value attributable to Chet's relationship with key clients. The parties should additionally take into account the 18-month lag time that, Mr. Marcinkowski conceded at trial, Chet would need to become competitive with Dukes. We otherwise agree with Mr. Marcinkowski's valuation.

Our adjustments will lower the value attributable to Chet's personal goodwill. This means that the difference between the new value and that originally reported by Chet and Cindy should have been attributed to enterprise goodwill and reported by Dukes. Since this amount was distributed to Chet and Cindy, we agree with respondent that it must reclassified as a constructive dividend. *See* Truesdell v.

*Commissioner, 89 T.C. 1280, 1295 (1987)* ("The crucial concept in a finding that there is a constructive dividend is that the corporation has conferred a benefit on the shareholder in order to distribute available earnings and profits without expectation of repayment.").

Cindy and the Estate of Chet Huffman **[**63]** had ordinary dividend income pursuant to *section 301*, which provides that a dividend is taxed as ordinary income only to the extent of the distributing corporation's earnings and profits. *§ 301(c)*; *Benson v. Commissioner, T.C. Memo. 2004-272, slip op. at 43-44*, *supplemented by T.C. Memo. 2006-55*, *aff'd*, *560 F.3d 1133 (9th Cir. 2009)*. Any excess is a nontaxable return of capital to the extent of the taxpayer's basis, and any remaining amount received is taxable as capital gain from the sale or exchange of a capital asset. *Benson, T.C. Memo. 2004-272, slip op. at 44* (first citing *§ 301(c)*; then citing *Truesdell, 89 T.C. at 1295-98*; and then citing *Barnard v. Commissioner, T.C. Memo. 2001-242*).

Because a portion of the sale proceeds attributed to Chet's personal goodwill was actually enterprise goodwill, Dukes understated capital gain net income on its 2009 Form 1120. The amount by which Chet and Cindy overvalued Chet's personal goodwill should have been reported by Dukes with the rest of the sale proceeds on its 2009 Form 6252. Dukes is therefore liable for tax on an increase to capital gain net income for 2009.

**[*38]** IV. *Accuracy-Related Penalties and Additions to Tax*

We now address the ancillary issue of petitioners' liability for certain *section 6662* accuracy-related penalties and *section 6651* additions **[**64]** to tax. The IRS determined accuracy-related penalties against Cindy and the Estate of Chet Huffman, as well as Dukes, and on the basis of our redeterminations in this Opinion with respect to those petitioners, together with the concessions previously noted, *see supra* note 7, there are grounds for *section 6662* penalties. For all petitioners, their failure to timely file certain returns and pay the amounts owing provides grounds for *section 6651* additions to tax.

A. *Burden of Proof*

Under *section 7491(c)*, the Commissioner bears the burden of production with respect to the liability of an individual for any penalty or addition to tax. The Commissioner satisfies that burden by presenting sufficient evidence to show that it is appropriate to impose the penalty in the absence of available defenses. *Graev v. Comm'r, 149 T.C. 485, 493 (2017)* (citing *Higbee v. Commissioner, 116 T.C. 438, 446 (2001)*), *supplementing and overruling in part 147 T.C. 460 (2016)*.

This burden includes satisfying *section 6751(b)(1)*, which provides that "[n]o penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher-level official as the Secretary may designate." *Section 6751(b)* does not apply, however, to the addition to tax under *section 6651*. *See § 6751(b)(2)(A)* **[**65]** ; *ATL & Sons Holdings, Inc. v. Commissioner, 152 T.C. 138, 150 (2019)*.

In *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner, 29 F.4th 1066, 1071 (9th Cir. 2022)*, *rev'g and remanding* *154 T.C. 68 (2020)*, the Ninth Circuit considered the timeline for obtaining supervisory approval of "assessable penalties," which are not subject to deficiency procedures. The Ninth Circuit held that, for an assessable penalty, supervisory approval is timely if secured before the penalty is assessed or "before the relevant supervisor loses discretion whether to approve the penalty assessment." *Id. at 1074*. More recently, in *Kraske v. Commissioner, No. 27574-15, 161 T.C., 2023 U.S. Tax Ct. LEXIS 4055 (Oct. 26, 2023)*, a case (like the cases here) appealable to the Ninth Circuit (absent stipulation to the contrary), *see § 7482(b)*, we addressed whether the holding in *Laidlaw's Harley Davidson* should be read so as to encompass penalties subject to **[*39]** deficiency procedures as well. We held that it should, and pursuant to *Golsen v. Commissioner, 54 T.C. 742, 757 (1970)*, *aff'd*, *445 F.2d 985 (10th Cir. 1971)*, applied the holding to the facts of the case. *Kraske*, 161 T.C., slip op. at 7-8. We will afford precedential weight to, and follow, *Kraske* in the instant cases as it is squarely on point here.

For nonindividual taxpayers, the burden of production as to penalties remains with the taxpayer because *section 7491(c)* does not apply to corporations. *See* *NT, Inc. v. Comm'r, 126 T.C. 191, 195 (2006)*. We held previously that the Commissioner does not have the burden of production as to supervisory approval under *section 6751(b)* for a penalty determined against a corporation in **[**66]** a notice of deficiency. *Dynamo Holdings Ltd. P'ship v. Commissioner, 150 T.C. 224, 231-32 (2018)*. Accordingly, respondent does not bear the burden of production for the penalties determined against Dukes.

Petitioners argue that respondent has not satisfied the burden of proof because the supervisory approval did not take a specific form. They note that the IRS supervisor did not sign a Civil Penalty Approval Form as encouraged by the Internal Revenue Manual. The supervisor instead signed the 30-day letter, which generally indicates the IRS's position on the disputed tax items and provides taxpayers a 30-day deadline to take their case to Appeals.

As we noted in *Palmolive Building Investors, LLC v. Commissioner, 152 T.C. 75, 85-86 (2019)*, "*[s]ection 6751(b)* does not require written supervisory approval on any particular form." "[P]enalty approval [can] be found in 'a signed 30-day letter sent by the supervisor of the examining agent.'" *Castro v. Commissioner, T.C. Memo. 2022-120, at *6* (quoting *Tribune Media. Co. v. Commissioner, T.C. Memo. 2020-2, at *21*). Since the IRS supervisor involved in these cases signed the 30-day letter, approval was properly obtained for the penalties in question, and respondent has satisfied his initial burden of proof under *section 6751(b)* as to the individual petitioners.

B. *Section 6662* *Penalties*

1. *Liability*

*Section 6662(a)* imposes a 20% accuracy-related penalty **[**67]** on any portion of an underpayment of tax required to be shown on a return if, as provided by *section 6662(b)(1)*, the underpayment is attributable to "[n]egligence or disregard of rules or regulations." The penalty may also **[*40]** be imposed for an underpayment attributable to any "substantial understatement of income tax." *§ 6662(b)(2)*.

For *section 6662(b)(1)* purposes, "negligence" includes "any failure to make a reasonable attempt to comply" with the internal revenue laws, and "disregard" includes "any careless, reckless, or intentional

disregard." *§ 6662(c)*. Negligence also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. *Treas. Reg. § 1.6662-3(b)(1)*.

An understatement is substantial within the meaning of *section 6662(b)(2)* if it exceeds the greater of (1) 10% of the tax required to be shown on the return for the taxable year or (2) $5,000. *§ 6662(d)(1)(A)*. For corporations, there is a substantial understatement of income tax for any taxable year if the amount of the understatement exceeds the lesser of (1) 10% of the tax required to be shown on the return for the taxable year (or, if greater, $10,000) or (2) $10,000,000. *§ 6662(d)(1)(B)*. The accuracy-related penalty does not apply with respect to any portion of the underpayment for which the taxpayer shows that **[**68]** he or she had reasonable cause and acted in good faith. *§ 6664(c)(1)*; *see Higbee, 116 T.C. at 448-49*.

Respondent asserts that Cindy and the Estate of Chet Huffman, as well as Dukes, are liable for substantial understatement penalties under *section 6662(b)(2)*, or alternatively, for negligence penalties under *section 6662(b)(1)*. Only one accuracy-related penalty may be applied with respect to any given portion of an underpayment, even if that portion is subject to the penalty on more than one ground. *Treas. Reg. § 1.6662-2(c)*. As a result of our holdings herein and the parties' concessions in the cases involving Cindy and the Estate of Chet Huffman, as well as Dukes, the *Rule 155* computations must confirm substantial understatements of income tax by those petitioners. Should the *Rule 155* computations show substantial understatements of income tax (which we think they should), we conclude that respondent has met his burden of production for the accuracy-related penalties under *section 6662(b)(2)*.[15]

**[*41]** 2. *Reasonable Cause Defense*

Cindy and the Estate of Chet Huffman, as well as Dukes, assert that they had reasonable cause that negates any *section 6662(a)* penalties because their accountant, Ms. Ross-Stearn, terminated the business relationship on August 28, 2009. They claim that her hasty departure impeded their ability to timely submit **[**69]** accurate tax returns. They further claim that the delay was exacerbated by Ms. Ross-Stearn's and TransDigm's reluctance to provide financial statements that would form the basis of the tax returns for all of them.

Cindy and the Estate of Chet Huffman, as well as Dukes, claim that after Ms. Ross-Stearn disengaged, they employed two accountants to help them submit all the individuals' and Dukes-affiliated entities' income tax returns. They first hired Mr. Whitfield and later Mr. Hutchinson to expedite the process and determine how Dukes's sale proceeds should be reported.

They claim that they started first by considering the valuation provided by Duff & Phelps, which determined that $21.8 million of the sale proceeds were attributable to Chet's personal goodwill. They assert that they relied on the Duff & Phelps valuation as well as the Dukes-TransDigm agreement to allocate the $21.8 million entirely to Chet.

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[15] We note that respondent has in any event demonstrated that Chet and Cindy, as well as Dukes, acted negligently because the record before us shows that they failed to maintain books and records sufficient to accurately reflect their incomes. *See Treas. Reg. § 1.6662-3(b)(1)*.

As for the proceeds attributable to the CCC&B intellectual property assets, Cindy and the Estate of Chet Huffman, as well as Dukes, assert that Mr. Whitfield independently determined that the intellectual property was held by CCC&B—and not Dukes. Mr. Whitfield also reviewed the licensing **[**70]** agreements and CCC&B's prior tax returns in reaching the conclusion that CCC&B was the proper entity to report the gain from the sale. Since Chet and Cindy were the sole owners of CCC&B, they contend that it was their responsibility to report the passthrough income from the sale.

Cindy and the Estate of Chet Huffman, as well as Dukes, claim that their reliance on the tax professionals excuses them from *section 6662(a)* penalties. The Court's caselaw sets forth the following three requirements for a taxpayer to use reliance on a tax professional to avoid liability for a *section 6662(a)* penalty: "(1) The adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer actually relied in good faith on the adviser's **[*42]** judgment." *Neonatology Assocs., P.A. v. Commissioner, 115 T.C. 43, 99 (2000)*, *aff'd*, *299 F.3d 221 (3d Cir. 2002)*.

Chet and Cindy Huffman, as well as Dukes, relied on Mr. Whitfield and Mr. Hutchinson in determining how to report the sale proceeds from TransDigm's asset purchase. Both Mr. Whitfield and Mr. Hutchinson were licensed CPAs with significant experience in public and private tax accounting. Therefore, Chet and Cindy Huffman, as well as Dukes, were justified in relying on **[**71]** their advice.

At trial Chet testified that he provided complete access to the books and records of Dukes, the affiliated entities, and the individual family members. Chet also testified that he and Mr. Whitfield took great measures to obtain the tax documents of Dukes and the affiliated entities once Ms. Ross-Stearn disengaged. They successfully obtained approximately 40 boxes of financial data from Dukes and later were able to obtain the Dukes trial balance and general ledger from Ms. Ross-Stearn. On the basis of this testimony, as well as Mr. Hutchinson's testimony, we conclude that Chet and Cindy Huffman, as well as Dukes, provided the tax professionals with as much accurate information as they could assemble.

Finally, we believe that Chet and Cindy Huffman, as well as Dukes, relied in good faith on Mr. Whitfield's and Mr. Hutchinson's advice. Although Chet was a business school graduate and had successfully run Dukes for many years by the time of the TransDigm acquisition in 2009, he was not familiar with complex tax matters such as these. To ensure that he reported these items accurately, Chet hired two licensed accountants who rendered reasonable interpretations of the Code and **[**72]** the regulations. On that basis we find that Chet and Cindy Huffman, as well as Dukes, had reasonable cause with respect to the reporting of the Dukes-TransDigm sale proceeds, and thus they are not liable for the *section 6662(a)* penalties attributable to that underpayment. However, because they seemingly do not argue, and the record does not support in any event, that the reasonable-cause exception negates their liability for the *section 6662(a)* penalties attributable to the conceded adjustments, they are liable for such penalties to that extent.

**[*43]** C. *Section 6651 Additions to Tax*

1. *Liability*

*Section 6651* imposes additions to tax for failure to file timely returns or failure to pay timely the amount shown as tax on any return. For failure to file timely returns, there shall be added to the amount required to be shown as tax 5% of such tax if the failure is for not more than one month. *§ 6651(a)(1)*. The penalty increases by 5% for each additional month the failure continues. *Id.*

For a failure to pay timely, there shall be added to the amount shown as tax 0.5% if the failure is for not more than one month. *§ 6651(a)(2)*. The penalty increases by 0.5% for each additional month the failure continues. *Id.* For failure either to file or pay timely, the addition to tax may **[**73]** not exceed 25% in the aggregate. *§ 6651(a)(1)* and *(2)*. There will be no additions to tax if the failure to file or pay was due to reasonable cause and not due to willful neglect. *Id.* The IRS determined *section 6651* additions to tax against all petitioners.

Lloyd and Patricia—who were issued separate notices of deficiency for their varying interests in the Trust and DRM—did not report any taxable gifts for 2007. The due date for the 2007 gift tax return was April 15, 2008. Under our valuation, they should have reported a taxable gift to Chet. Because Lloyd and Patricia did not timely file a gift tax return nor pay tax on the gift, respondent has met his burden of proof as to the additions to tax. Patricia and the Estate of Lloyd Huffman must demonstrate that the failure to file/pay was due to reasonable cause and not due to willful neglect to avoid the additions.

Chet and Cindy's 2009 income tax return was due on October 15, 2010. They did not file the return until March 8, 2011. Because they filed the return late, respondent has met his burden of proving that they are liable for the additions to tax. Cindy and the Estate of Chet Huffman must demonstrate that the failure was due to reasonable cause and not due **[**74]** to willful neglect to avoid the additions.

Dukes's 2008 return was due September 15, 2008. Its 2009 return was due on September 15, 2009. Its 2010 return was due on September 15, 2010. Dukes filed its 2008-10 income tax returns on June 22, September 7, and November 22, 2011, respectively. Because it filed the returns late, it is liable for the additions to tax unless it can show that the failures were due to reasonable cause and not due to willful neglect.

**[*44]** 2. *Reasonable Cause Defense*

All of the aforementioned income tax returns for Chet and Cindy, as well as Dukes, were filed late. Regardless of whether Ms. Ross-Stearn was employed during this time, they were responsible for timely submissions. *United States v. Boyle, 469 U.S. 241, 252, 105 S. Ct. 687, 83 L. Ed. 2d 622 (1985)* ("The failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for a late filing under *§ 6651(a)(1)*."). Their argument that Ms. Ross-Stearn's departure gives them reasonable cause for the untimely filings is therefore unavailing. The *section 6651(a)(1)* additions to tax will be sustained as to Cindy and the Estate of Chet Huffman, as well as to Dukes.

Patricia and the Estate of Lloyd Huffman assert a different argument against imposition **[**75]** of the additions to tax under *section 6651(a)(1)* and *(2)*. They claim that they were completely unaware of any gift tax liability. They believed that Chet paid the fair market value for the Dukes shares by exercising his

rights under the RTP agreements in 2007. Their argument then is not that they failed to file so much as that they did not think a filing was required.

They claim that Ms. Ross-Stearn did not advise them of any potential gift tax liability and so they did not file a return for that year. We think that is distinguishable from the other petitioners' *section 6651* defenses. *See Boyle, 469 U.S. at 251* ("When an accountant or attorney *advises* a taxpayer on a matter of tax law, *such as whether a liability exists*, it is reasonable for the taxpayer to rely on that advice." (Second emphasis added.)).

We agree with Patricia and the Estate of Lloyd Huffman that they had reasonable cause for their failure to report any gift tax liability. As they noted, the analysis in *Cavallaro v. Commissioner, T.C. Memo. 2014-189, at *66-71*, *aff'd in part, rev'd in part and remanded*, *842 F.3d 16 (1st Cir. 2016)*, is instructive. In that case we relied on the same three-part analysis described in *Neonatology Associates, P.A.* for determining whether the taxpayer's reliance on a tax **[**76]** professional was sufficient to avoid liability for penalties and additions to tax. *Cavallaro, T.C. Memo. 2014-189, at *71*. We will do the same in these cases.

Lloyd and Patricia relied on Ms. Ross-Stearn to advise on their tax liability. Ms. Ross-Stearn was a licensed accountant with many years of experience performing the accounting and payroll function of **[*45]** Dukes, its affiliates, and the individual family members. She had enough experience to justify their reliance on her advice.

Chet testified that Ms. Ross-Stearn was "most certainly aware" of the RTP agreements and his decision to exercise his rights under the agreements in 2007. He also testified that Ms. Ross-Stearn would have had knowledge of the RTP agreements because she "effectively served as Dukes'[s] accounting department" and was integral to the proposed acquisition by Hanwha. On that basis, we find that Ms. Ross-Stearn was provided all the necessary information which would have alerted her to a potential gift tax liability owing from Lloyd and Patricia.

Finally, Patricia testified at trial that she "[t]otally relied" on Ms. Ross-Stearn to advise on tax matters. She further testified that she had no income or gift tax training **[**77]** whatsoever. She explained that had there been any indication that a gift tax return should be filed, she would have made the necessary efforts to do so. On the basis of that testimony, we agree that Lloyd and Patricia relied in good faith on Ms. Ross-Stearn. They therefore acted with reasonable cause in their failure to file a gift tax return and failure to pay the outstanding gift tax. Therefore, Patricia and the Estate of Lloyd Huffman are not liable for the additions to tax. Cindy and the Estate of Chet Huffman, as well as Dukes, are liable for the additions to tax as stated above.

We have considered all of the arguments made by the parties and, to the extent they are not addressed herein, we find them to be moot, irrelevant, or without merit.

To reflect the foregoing,

*Decisions will be entered under Rule 155*.

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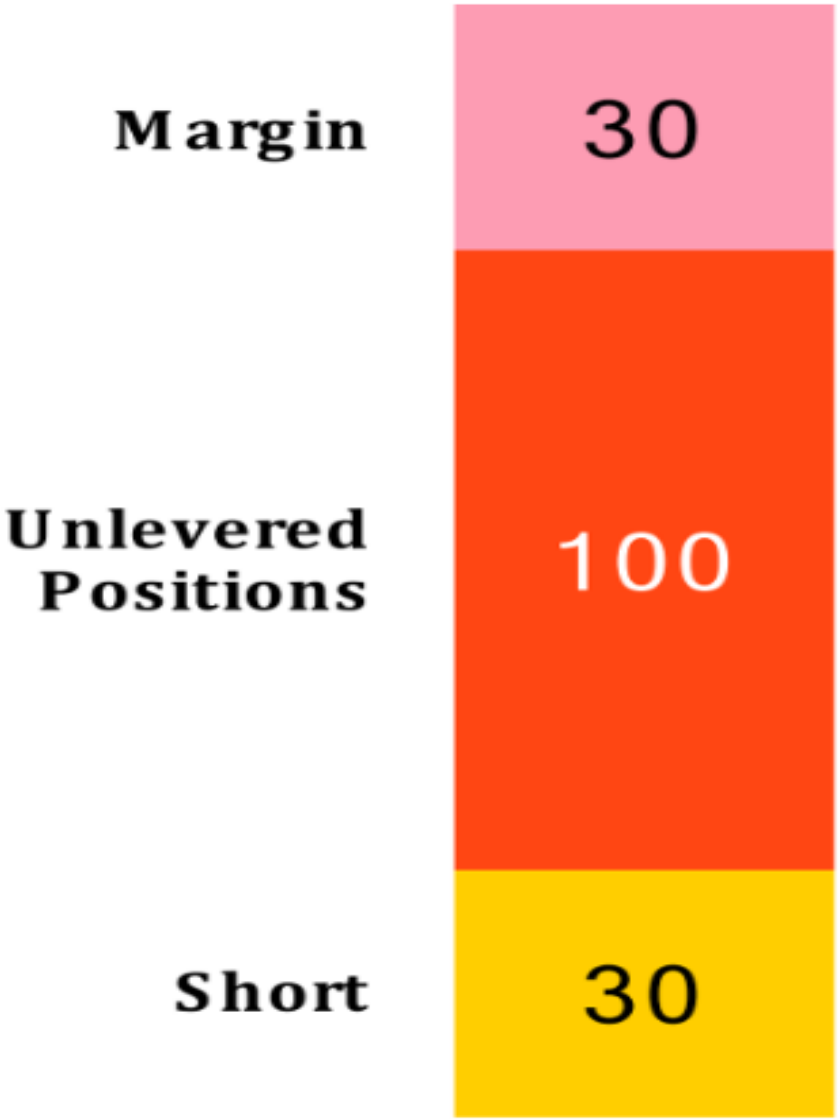
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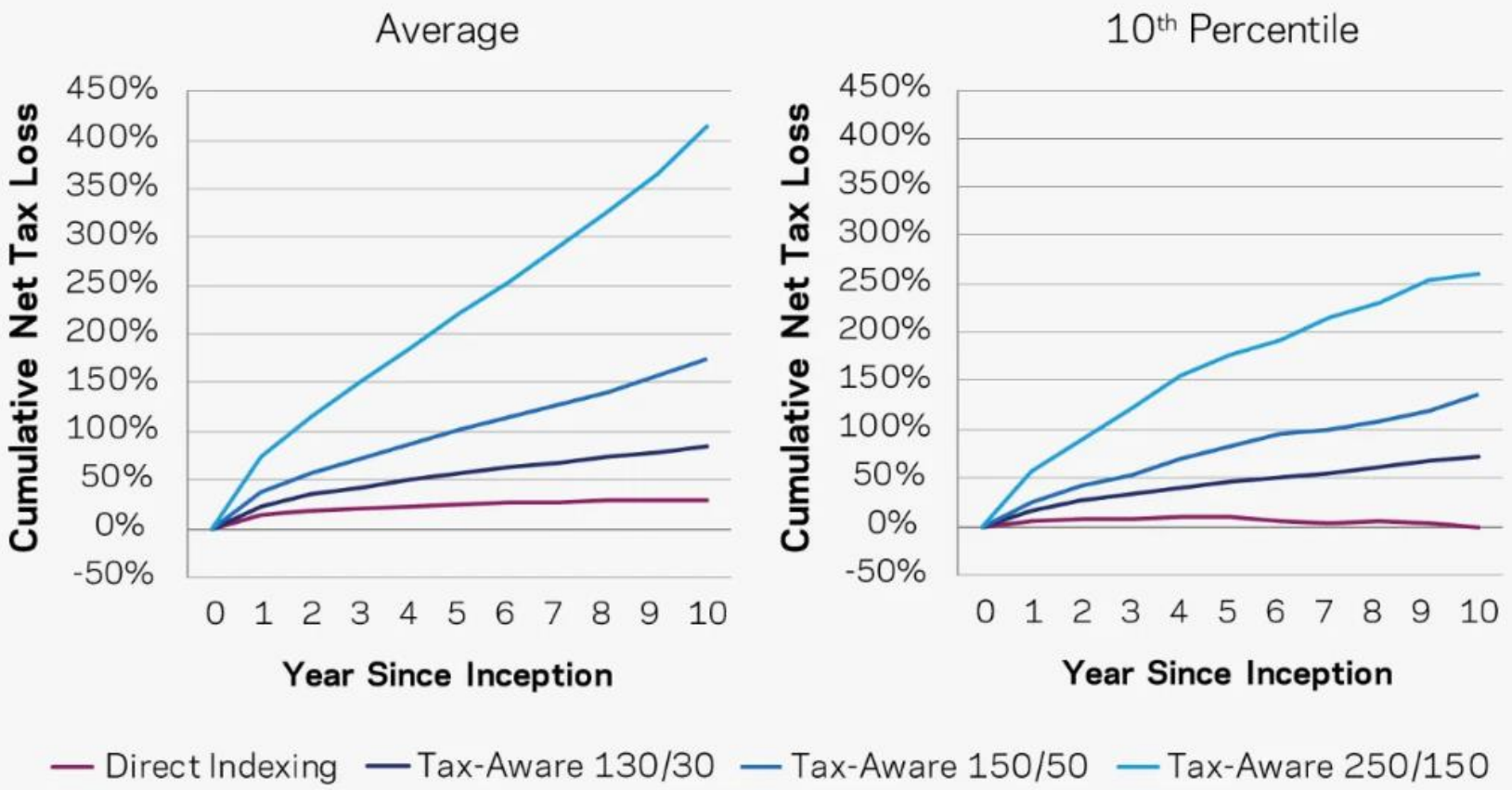
## Exhibit 2. Tax-Loss-Harvesting Potential of Long-Only and Long-Short Strategies




AQR: "Regardless of How You Deal with Low-Basis Stock, Long-Short Strategies Can Help"

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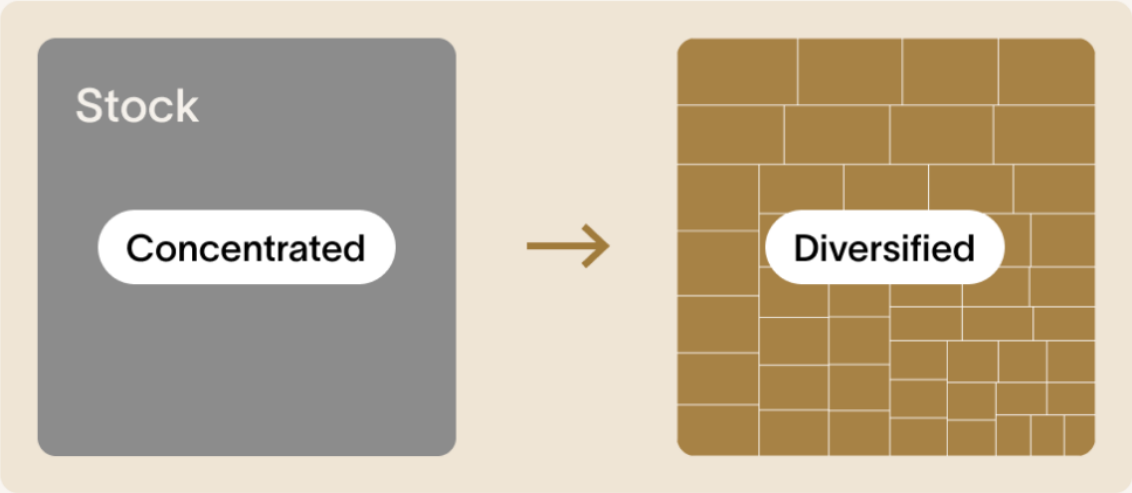


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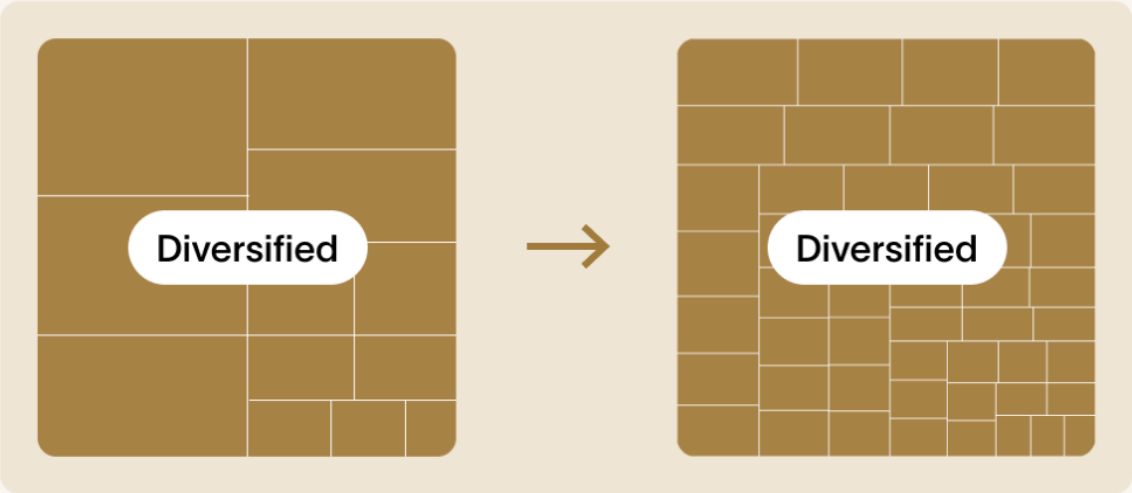
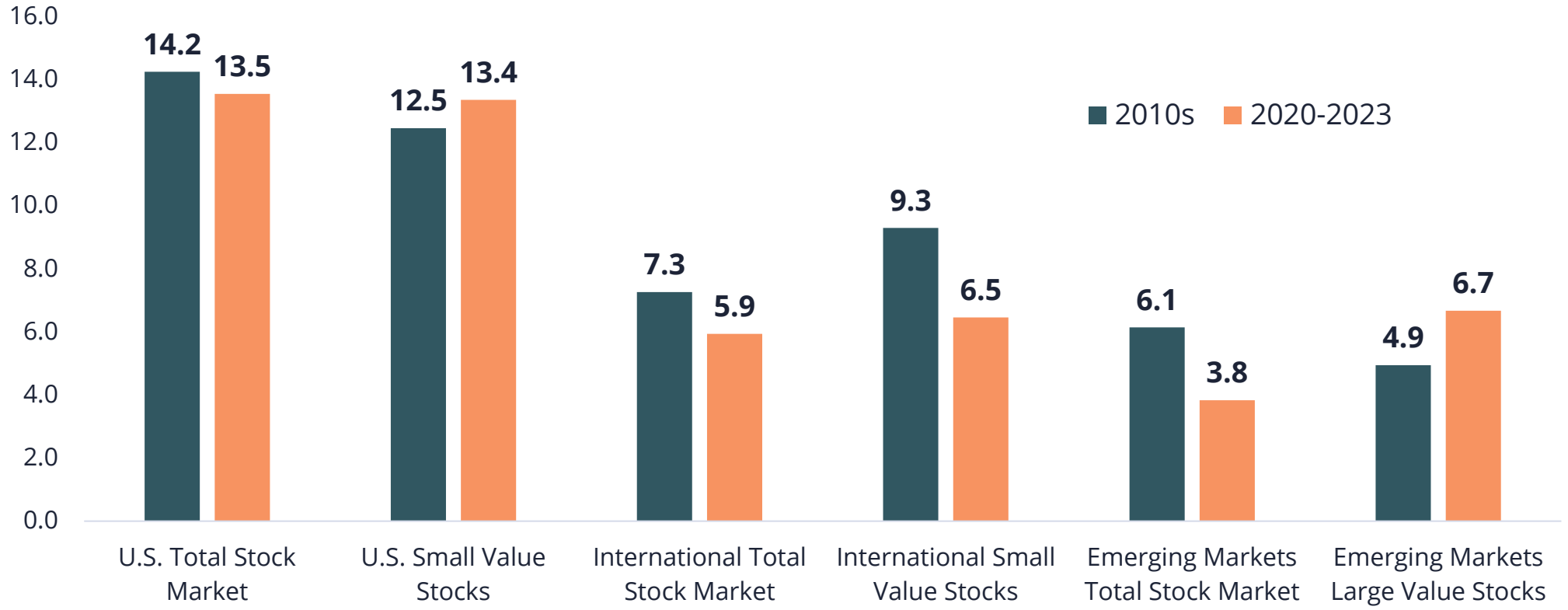


# Historical Asset Class Returns

## Average annual returns




Source: Ken French Data Library. Reflects the arithmetic average annual returns over 2010-2019 and 2020-2023, respectively, for each series.

# U.S. Market Valuations vs. U.S. Small Value

U.S. market P/E relative to U.S. small value P/E

Source: Dimensional. Returns from June 1975 through June 2024. Reflects the ratio of the total market value of U.S. stocks compared to the aggregate trailing 12 months earnings for those companies, the P/E ratio. This is scaled by the same calculation for small value companies in the U.S.

# U.S. Market Valuations vs. Ex-U.S. Market

U.S. market P/E relative to international market P/E

Source: Dimensional. Returns from June 1975 through June 2024. Reflects the ratio of the total market value of U.S. stocks compared to the aggregate trailing 12 months earnings for those companies, the P/E ratio. This is scaled by the same calculation for all companies in developed markets outside of the U.S.

# Summary

- U.S. market remains richly priced relative to almost all other equity asset classes.
- Globally diversified, factor-tilted portfolios have recently underperformed the broad U.S. market.
- Keeping clients disciplined to their long-term strategy is critical.
- For investors who are not already broadly diversified, now is (likely) a great time to reconsider.

# *2023 IRS CCA LEXIS 38*

US Internal Revenue Service

November 28, 2023

IRS CCA 202352018

**Reporter**
2023 IRS CCA LEXIS 38 *; IRS CCA 202352018

## Chief Counsel Advice Memoranda 202352018

## Subject Matter

Gift tax consequences of modifying a grantor trust to add a tax reimbursement clause

**[*1]**

**Reference:** Release Date: 12/29/2023; CC:PSI:B04; POSTN-121906-23

**UI List:** UILC: 2511.04-00

## Core Terms

grantor, gift, donor, reimburse, gift tax, discretionary, modification, taxable income, distribute, inclusion

## Text

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from: Holly Porter
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Issue

What are the gift tax consequences to the beneficiaries when the trustee of an irrevocable trust, with respect to which the grantor is treated as the owner under *subpart E, part I, subchapter J, chapter 1 (subpart E) of the Internal Revenue Code (Code)*, modifies the trust, with the beneficiaries' consent, to add a tax reimbursement clause that provides the trustee the discretionary power to make distributions of income or principal from the trust in an amount sufficient to reimburse the grantor for the income tax attributable to the inclusion of the trust's income in the grantor's taxable income?

Conclusion

The modification to add the tax reimbursement clause will constitute a taxable gift by the trust beneficiaries because the addition of a discretionary power to distribute income and principal to the grantor is a relinquishment of a portion of the beneficiaries' interest in the trust.

Facts

In Year 1, *A* establishes **[*2]** and funds Trust, an irrevocable inter vivos trust, for the benefit of *A*'s Child and Child's descendants. Trustee is the current trustee of Trust and satisfies the governing instrument requirement that a trustee of Trust must be a person not related or subordinate to *A* within the meaning of *§ 672(c) of the Code*. Under the governing instrument of Trust, a trustee of Trust may distribute income and principal to or for the benefit of Child in the trustee's absolute discretion. Upon Child's death, Trust's remainder is to be distributed to Child's issue, per stirpes. Under the governing instrument of Trust, *A* retains a power that causes *A* to be the deemed owner of Trust under *§ 671 of the Code*, and, accordingly, all items of income, deductions, and credits attributable to Trust are included in *A*'s taxable income.

Neither State law nor the governing instrument of Trust requires or provides authority to a trustee of Trust to distribute to *A* amounts sufficient to satisfy *A*'s income tax liability attributable to the inclusion of Trust's income in *A*'s taxable income.

In Year 2, when Child has no living grandchildren or more remote descendants, Trustee petitions State Court to modify the terms of Trust. Pursuant to State Statute, Child **[*3]** and Child's issue consent to the modification. Later that year, State Court grants the petition and issues an Order modifying Trust to provide a trustee of Trust the discretionary power to reimburse *A* for any income taxes *A* pays as a result of the inclusion of Trust's income in *A*'s taxable income.

Law

Under *§ 671 of the Code*, if the grantor of a trust is treated as the owner of any portion of the trust under subpart E, those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust must be included in computing taxable income or credits of the grantor.

*Section 2501(a)(1)* imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual. *Section 2511(a)* provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

*Section 25.2511-1(c)(1)* of the Gift Tax Regulations provides that the gift tax applies to gifts indirectly made. Further, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

*Section 25.2511-1(e)* provides that if a **[*4]** donor transfers by gift less than their entire interest in property, the gift tax is applicable to the interest transferred. Further, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to the gift.

*Section 25.2511-1(g)(1)* provides in relevant part that donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

*Section 25.2511-2(a)* provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. Rather, it is a tax upon the donor's act of making the transfer. The measure of the gift is the value of the interest passing from the donor with respect to which they have relinquished their rights without full and adequate consideration in money or money's worth.

*Section 25.2511-2(b)* provides that as to any property, or part thereof or interest therein, **[*5]** of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for their own benefit or for the benefit of another, the gift is complete. If a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among the donor's descendants, no portion of the transfer is a completed gift. On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or X's heirs, the entire transfer would be a completed gift.

*Rev. Rul. 67-370, 1967-2 C.B. 324*, concludes that a defeasible remainder interest in trust which is subject to termination at the will of another is an interest in property within the meaning of *§ 2033 of the Code*. The ruling notes that the fair market value of the interest would be affected by its possible divestment under general transfer tax rules for the valuation of property, but the value of that interest would not necessarily be nominal.

In *Rev. Rul. 2004-64, 2004-2 C.B. 7*, a grantor created an irrevocable inter vivos trust for the benefit of the grantor's descendants and retained sufficient **[*6]** powers with respect to the trust so that the grantor is treated as the owner of the trust under subpart E of the Code. In relevant part, the ruling considers two situations in which the trustee reimburses the grantor for taxes paid by the grantor that are attributable to the inclusion of all or part of the trust's income in the grantor's income. In *Situation 2* of *Rev. Rul. 2004-64*, the distribution reimbursing the grantor is mandated under the terms of the governing instrument. In *Situation 3* of *Rev. Rul. 2004-64*, the governing instrument provides the trustee with the discretionary authority to make a reimbursing distribution. In both of these situations, when the trustee of the trust reimburses the grantor for the income tax paid by the grantor, the ruling concludes that the payment does

not constitute a gift by the trust beneficiaries because the distribution was either mandated by the terms of the governing instrument or made pursuant to the exercise of the trustee's discretionary authority granted under the terms of the governing instrument.

Analysis

Under the governing instrument of Trust, Child and Child's issue each have an interest in the trust property. As a result of the Year 2 modification of Trust, *A* acquires a beneficial **[*7]** interest in the trust property in that *A* becomes entitled to discretionary distributions of income or principal from Trust in an amount sufficient to reimburse *A* for any taxes *A* pays as a result of inclusion of Trust's income in *A*'s gross taxable income. In substance, the modification constitutes a transfer by Child and Child's issue for the benefit of *A*. This is distinguishable from the situations in *Rev. Rul. 2004-64* where the original governing instrument provided for a mandatory or discretionary right to reimbursement for the grantor's payment of the income tax. Thus, as a result of the Year 2 modification, Child and Child's issue each have made a gift of a portion of their respective interest in income and/or principal.[1] *See § 25.2511-1(e)* and *§ 25.2511-2(b)*. *See also Robinette v. Helvering, 318 U.S. 184, 63 S. Ct. 540, 87 L. Ed. 700, 1943 C.B. 1141 (1943)*. The result would be the same if the modification was pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise their right to object.

The gift from Child and Child's issue of a portion of their interests in trust should be valued in accordance with the general rule for valuing interests in property for gift tax purposes in accordance with the regulations under **[*8]** *§ 2512* and any other relevant valuation principles under subtitle B of the Code.[2]

*Section 6110(k)(3)* provides that this document may not be used or cited as precedent.

Please call Daniel J. Gespass at (202) 317-6859 if you have any further questions.

Sincerely,

Associate Chief Counsel

(Passthroughs & Special Industries)

By: Karlene M. Lesho

Chief, Branch 4

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[1] *PLR 201647001* concludes that the modification of a trust to add a discretionary trustee power to reimburse the grantor for the income tax paid attributable to the trust income is administrative in nature and does not result in a change of beneficial interests in the trust. These conclusions no longer reflect the position of this office.

[2] Although the determination of the values of the gifts requires complex calculations, Child and Child's issue cannot escape gift tax on the basis that the value of the gift is difficult to calculate. *See Smith v. Shaughnessy, 318 U.S. 176, 180, 63 S. Ct. 545, 87 L. Ed. 690, 1943 C.B. 1144 (1943)* ("The language of the gift tax statute, 'property . . . real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent.")



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Office of the Associate Chief Counsel

(Passthroughs and Special Industries)

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Office of Chief Counsel Internal Revenue Service Memorandum

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# Trust Modification: Planning in Light of CCA 20235018

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# Review of Materials

- Slides
- Newsletter article
- Several thousand page PDF, “Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications,” appended to course materials

# Navigate between Slides and Big PDF

- Open both documents
- Highlight cross-reference in slides
- Ctrl-c to copy
- Go to FULL TABLE OF CONTENTS in big PDF
- Crtl-f to find
- Ctrl-v to paste
- Click ENTER to execute search (might need to specify “exact” or “whole word” search
- Warning: search works only for to the fifth level of the heading, not the sixth, which ends in parentheses. For the latter, use the fifth level of the heading and scroll down just a little.

# Trust Modification (III.B.1.b.ii.)

- Income tax - Trust Divisions, Mergers, and Commutations; Decanting (II.J.18)
- Trust Divisions (II.J.18.a)
- Trust Mergers (II.J.18.b)
- Decanting (II.J.18.c), including What Is Decanting (II.J.18.c.i)
- Trust Commutations (II.J.18.d)
- Ed Morrow on Potential Income Tax Disasters for Early Trust Terminations (II.J.18.e)
- Commutation vs Mere Division (II.J.18.f)

# Trust Divisions (II.J.18.a)

- Partition of jointly owned property not sale or other disposition when co-owners sever their joint interests
- Uniform Trust Code § 816: trustee may make non-pro-rata distributions and allocate particular assets in proportionate or disproportionate shares
- Supreme Court in Cottage Savings concluded that exchange of property is realization event under § 1001 if properties exchanged are “materially different”

# Trust Divisions (II.J.18.a)

- Reg. § 1.1001-1(h): Severing trust is not "is not an exchange of property for other property differing materially either in kind or in extent" if severance and non-pro rata funding are authorized
- If trust is divided so that each trust has same beneficial interests but different assets and trustees, division will not carry out income from one trust to the other
- If trust divides but distributes property to satisfy pecuniary obligation to a beneficiary, the latter distribution is a deemed sale, but rest of distribution is nontaxable
- If one trust later distributes to another trust as conduit to make distributions to beneficiaries, distribution will carry out DNI; however, if distribution is just to shift funds between trusts without shift being related to distributions, shift does not carry out DNI

# Trust Mergers (II.J.18.b)

- Letter Ruling 200552009 merger followed by division:
- No IRC § 1001 event
- Tax basis and holding period tack
- Preserved net operating loss carry forward, net capital loss, and other tax attributes, including passive activity losses and credit carryforwards, of merging trusts
- Consider new ESBT election (III.A.3.e.ii.(a))

# Decanting (II.J.18.c.i.)

- Decanting is trustee distributing assets from one trust to another trust
- For over 100 years, tool to allow trustee to change trust's terms in some manner – whether to facilitate administration or to change beneficial interest
- Uniform Trust Decanting Act authorizes amending trust without transferring assets (important for QSSTs (III.A.3.e.i.(a)))
- *Horvitz v. Commissioner* (2023) – IRS conceded after Tax Court order

# Decanting (II.J.18.c.ii.)

- Decanting may divide trust
- Decanting may involve merging from old trust into new trust
- If purely administrative, might have no effect
- If change beneficial interest, may constitute gift; if constitute transfer of beneficial interest, IRC § 2702 may mean transfer of entire beneficial interest, with no credit for rights retained
- Dividing trust before modifying it may ameliorate IRC § 2702 issues

# Trust Commutations (II.J.18.d)

Sale of Interest in Trust:

- When sell life interest in property, interest in property for term of years, or income interest in trust - no basis with respect to trust's assets, so recognize gain on entire value
- If all beneficiaries get together and simultaneously sell interests to third party (perhaps a contingent remainderman), they would use basis
- Remaindermen can use basis, which is their portion of adjusted uniform basis of entire property assignable to such interest at time of sale or other disposition under Reg. § 1.1014-5

# Trust Commutations (II.J.18.d)

Sale of Interest in Trust:

- Sale taxed as capital gain
- Rev. Rul. 98-8 applies special gift tax rules for QTIP trusts so that spouse's purchase of remainder interest is gift to the extent of greater of value of remainder interest or value of property or cash transferred to remaindermen; also see various PLRs on details, including net gift
- When term interest in charitable remainder trust sold, uniform basis reduced by "portion of the sum of the following amounts assignable to that interest: (1) the amount of undistributed net ordinary income described in section 664(b)(1); and (2) the amount of undistributed net capital gain described in section 664(b)(2)"
- Free non-CPE webinar: Business Owner Compensation vs. Distribution; Modifying Trusts or Their Investments in Light of Proposed Income Tax Changes

# Ed Morrow on Potential Income Tax Disasters for Early Trust Terminations (II.J.18.e)

- Criticizes and describes implications of Letter Ruling 201932001
- Some reasoning and conclusions of that ruling were questionable, but questionable conclusions were immaterial relative to scope of what taxpayer sought in those particular facts
- Better income tax result if all parties sold their interest to third party or perhaps if other alternatives had been used

# Commutation vs Mere Division (II.J.18.f)

- Need to reconcile law on trust divisions (II.J.18.a) with law on Trust Commutations (II.J.18.d)
- Reg. § 1.1002-1(b), "Strict construction of exceptions from general rule," provides:

  The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

# Commutation vs Mere Division (II.J.18.f)

- Ultimately need to see whether beneficial interest constitutes entitlement that one can compare to measurable expectation of financial benefits
- Income interest or its equivalent (unitrust, annuity, etc.) can be measured
- Ascertainable standards tend to constitute measurable economic interest
- Need to measure beneficial interests (III.B.1.e.ii)

# Commutation vs Mere Division (II.J.18.f)

- When is change of expected series of distributions material?
- Given lack of concrete examples for trusts, perhaps see whether change in right to series of payments in other areas, such as debt modifications (II.G.31.a)
- Conversion from straight income interest to unitrust did not constitute income taxable event, but conversion from income interest with floor and ceiling to unitrust was income taxable event

# Commutation vs Mere Division (II.J.18.f)

- To extent that beneficiary does not have well-defined rights, difficult to say that beneficiary has exchanged something of value
- If trustee has absolute discretion to distribute currently to primary beneficiary and to remaindermen, then distribution to all beneficiaries may be mere nontaxable distribution and not a commutation

# Trust Modification (III.B.1.b.ii.)

- CCA 202352018 considers situation in which tax reimbursement provision is added to existing grantor trust by means of judicial modification with beneficiaries' consent
- Consider: What is Chief Counsel Advice (CCA)?
  - ¬Reflects IRS litigating position
  - ¬No input from taxpayer
  - ¬Private document but for FOIA
  - ¬Advocacy piece
  - ¬Not entitled to deference in court

# Trust Modification (III.B.1.b.ii.)

- CCA 202352018 asserts that beneficiary makes gift by consenting (or not objecting) to trust modification that grants beneficial interest to the grantor
- It cites Reg. § 25.2511-1(g)(1), which provides:

  Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor. However, there are certain types of transfers to which the tax is not applicable. It is applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee. A transfer by a trustee of trust property in which he has no beneficial interest does not constitute a gift by the trustee (but such a transfer may constitute a gift by the creator of the trust, if until the transfer he had the power to change the beneficiaries by amending or revoking the trust). The gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth, or to ordinary business transactions, described in §25.2512-8.

# Trust Modification (III.B.1.b.ii.)

- CCA 202352018 does not address whether a grantor's allowing grantor trust status to continue is consideration
- For context to the citation to Reg. § 25.2511-1(g)(1), note that Reg. § 25.2511-1(g)(2) provides:

  If a trustee has a beneficial interest in trust property, a transfer of the property by the trustee is not a taxable transfer if it is made pursuant to a fiduciary power the exercise or nonexercise of which is limited by a reasonably fixed or ascertainable standard which is set forth in the trust instrument....

# Trust Modification (III.B.1.b.ii.)

- Idea underlying first sentence of Reg. § 25.2511-1(g)(2): trustee-beneficiary constrained by ascertainable standards must make distribution
- Argument implicit in CCA 202352018 – as beneficiary, trustee-beneficiary has duty to fight against distributions to other beneficiaries
- Reg. § 25.2511-1(g)(2) precludes that argument

# Trust Modification (III.B.1.b.ii.)

- Failure to object: continuum rather than absolute, depending on how clearly trustee acting within scope of authority
- Income tax - Commutation vs Mere Division (II.J.18.f): attenuating beneficiary's legal rights means action that diminishes beneficiary's rights may have little or no effect

# Trust Modification (III.B.1.b.ii.)

Letter Ruling 202206008:

- Trustee authority to distribute for beneficiary's welfare gave that beneficiary general power of appointment
- IRS did not address whether other beneficiaries made a gift in agreeing to that modification
- Naturally, if a trustee can distribute outright (equivalent to granting presently exercisable general power of appointment), then trustee can grant beneficiary testamentary general power of appointment

# Trust Modification (III.B.1.b.ii.)

- Note that attenuating beneficiary's rights may also attenuate beneficiary's status as adverse party under grantor trust rules
- "Adverse party" means person having substantial beneficial interest in trust adversely affected by making or not making distribution (III.B.2.h.vii.(a).)

# Trust Modification (III.B.1.b.ii.)

- *DiMarco v. Commissioner* (1986) rejected imposing gift tax on benefits employer provided taxpayer's family
- Tax Court quoted Reg. § 25.2511-2(a):

  The gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer…. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, [and] is measured by the value of the property passing from the donor

# Trust Modification (III.B.1.b.ii.)

- *DiMarco v. Commissioner* - taxpayer did not make gift merely by working – reminiscent of Transfers with Contingencies Based on Acts of Independent Significance (III.B.1.i)
- Reasoning:

  We also agree with petitioner that decedent never made a taxable gift of any property interest in the survivors income benefit because we find no act by decedent that qualifies as an act of "transfer" of an interest in property. His participation in the plan was involuntary, he had no power to select or change the beneficiaries of the survivors income benefit, no power to alter the amount or timing of the payment of the benefit, and no power to substitute other benefits for those prescribed by the plan

# Trust Modification (III.B.1.b.ii.)

- Reasoning continued:

  He had no voice in selecting the beneficiaries of the survivors income benefit and no ability to affect or determine the benefits payable to them. The categories of beneficiaries, the determination whether a claimant is an eligible beneficiary, and the amounts payable to the beneficiaries all were controlled directly by the provisions of the plan and indirectly by IBM, and payments were made directly to the beneficiaries by IBM. Furthermore, the benefits were payable out of the general assets of IBM, not out of any fund in which decedent had a vested interest, and the benefits did not accrue until decedent's death. Most importantly, IBM had the power and the right to modify the plan and the survivors income benefit at any time and in its sole discretion. Under these circumstances, we have little difficulty in concluding that decedent never acquired fixed and enforceable property rights in the survivors income benefit that he was capable of transferring during his lifetime.

# Trust Modification (III.B.1.b.ii.)

- Not quite on point with trust modification, but consistent with idea that the more attenuated beneficiary's rights are, the less beneficiary's ability to object to - and obtain remedy for - trustee's actions
- Together with Reg. § 25.2511-1(g)(2), beneficiary has no duty to object:
  - ¬ If and to extent trustee clearly acting within scope of trustee's authority and discretion, or
  - ¬ If and to extent beneficiary has no right to compel trustee to make distributions to beneficiary (or reserve funds in excess of what is needed to fund any distributions beneficiary may reasonably expect to receive)

# Trust Modification (III.B.1.b.ii.)

- However, *DiMarco* held that determining whether a beneficiary made a gift may involve many a heavily nuanced analysis does not preclude the need to do that analysis, quoting the U.S. Supreme Court:

  > We cannot accept any suggestion that the complexity of a property interest … can serve to defeat a tax…. Even though these concepts of property and value may be slippery and elusive they cannot escape taxation so long as they are used in the world of business. The language of the gift tax statute, "property … real or personal, tangible or intangible," is broad enough to include property, however conceptual or contingent….

# Trust Modification (III.B.1.b.ii.)

- That CCA 202352018 raised specter of gift without valuing it is consistent with IRS' prior position
- In addition to CCA citing Rev. Rul. 67-370 as requiring valuation of remainder interest that can be divested at will, Letter Ruling 201122007 asserted:

  Taxpayer attests that Taxpayer has never received a distribution from Trust and that her income and resources are sufficient to maintain her current standard of living for the remainder of her lifetime. However, that does not negate the fact that under Section 6(a) of Trust, Taxpayer has an income interest entitling her to distributions of income in the case of emergency and at the discretion of the trustee. The interest may be nominal, however, the value of the gifted interest is a factual determination, not a determination of whether or not Taxpayer has made a gift of the interest.

# Trust Modification (III.B.1.b.ii.)

- IRS' position is that various action or inaction should be reported and remains an open issue indefinitely unless and until the statute of limitations runs under Adequate Disclosure on Gift Tax Returns (III.B.4)
- Rev. Rul. 84-105:
  - ¬ Surviving spouse made gift by failing to object to underfunding of general power of appointment marital deduction trust for her benefit over which she appeared to have unlimited withdrawal right
  - ¬ She made gift when statute of limitations ran, barring her ability to make claim

# Trust Modification (III.B.1.b.ii.)

- If one reports transfer/transaction and runs statute of limitations at earliest possible time before trust assets grow, one may be able to minimize (potential) gift's magnitude
- Uniform Trust Code Section 1005:

(a) A beneficiary may not commence a proceeding against a trustee for breach of trust more than one year after the date the beneficiary or a representative of the beneficiary was sent a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the time allowed for commencing a proceeding

# Trust Modification (III.B.1.b.ii.)

- Uniform Trust Code Section 1005 continued:

(b) A report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows of the potential claim or should have inquired into its existence.

(c) If subsection (a) does not apply, a judicial proceeding by a beneficiary against a trustee for breach of trust must be commenced within five years after the first to occur of:

(1) the removal, resignation, or death of the trustee;

(2) the termination of the beneficiary's interest in the trust; or

(3) the termination of the trust.

# Trust Modification (III.B.1.b.ii.)

- Statute does not require formal trust accounting to run statute of limitations
- Rather, the report "adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows of the potential claim or should have inquired into its existence."
- For what I tend to do, see Helping the Trustee Provide Annual Notices to Beneficiaries to Reduce Exposure (II.J.4.j)

# Trust Modification (III.B.1.b.ii.)

- Given that release evidences transfer and lapse of right to sue is not necessarily transfer, running statute of limitations for making claim against trustee tends to be less likely to trigger transfer tax consequences than release would
- When action by trustee, other fiduciary, or trust protector suffices to effectuate desired change, I tend to have trustee, etc. reserve right to undo the action if beneficiary makes claim before statute of limitations runs
- Thus, trustee, etc. needs to remain in position to undo action

# Trust Modification (III.B.1.b.ii.)

- This strategy is less than perfect, in that beneficiary may argue that beneficiary had insufficient information and perfecting right to undo depends on practical authority of person taking the action
- Beneficiary having well-qualified lawyer can help avoid latter, and written legal advice from lawyer to beneficiary that making a claim would not be productive may help evidence lack of gift by beneficiary
- Trustee might offer to cause trust to pay beneficiary's reasonable legal fees in deciding whether to make claim
- Ultimately, however, trustee, etc., needs to be comfortable that no beneficiary is likely to bring claim before trustee relies on this approach

# Trust Modification (III.B.1.b.ii.)

- For retroactivity (or lack thereof), see Rescissions, Including Rescinding Conversion of Entity (II.P.3.g), which includes gift/estate tax retroactivity
- It explains that mistake of law, clarification of ambiguity, or change in state law may have retroactive effect and not have any gift/estate tax adverse effect
- Contrast that with court order or nonjudicial settlement agreement that, if not in one of those categories, may be legally effective and recognized for gift tax purposes (and may constitute gift) and estate tax purposes (perhaps to avoid or cause estate inclusion), but only prospectively

# Trust Modification (III.B.1.b.ii.)

- Of course, beneficiary cannot give more value than beneficiary has
- See Valuing a Beneficial Interest in a Trust (III.B.1.e.ii)
- If assets are moved to another trust, beneficiary's interest in other trust is unlikely to be applied to reduce value of any gift that beneficiary made in that transfer; see Code § 2702 Overview (III.B.7.d)

# Trust Modification (III.B.1.b.ii.)

- More controversial argument IRS might try to assert under Code § 2702 is that modification that reduces beneficiary's interest in that trust constitutes gift of beneficiary's entire interest in that trust, using principle that one must ignore donor beneficiary's retained interest (also III.B.7.d)
- If not inconsistent with desired goal, dividing trust and then modifying new trust may help control this issue

# Trust Modification (III.B.1.b.ii.)

- Modifying trust that is exempt or otherwise protected from GST tax may cause that trust to lose part or all of that protection
- See generally Generation-Skipping Transfer (GST) Issues (III.B.1.d), especially Effect of "Additions" on Grandfathering from GST Rules (III.B.1.d.i)
- See also various situations analyzed in Chronological Review of a Potpourri of Transfers (III.B.1.b.i)

# Trust Modification (III.B.1.b.ii.)

IRS won't rule on whether decanting resulting in change in beneficial interests:

- Carries out DNI to any distributee
- Is gift
- Causes the loss of GST exempt status or constitutes taxable termination or taxable distribution

# Trust Modification (III.B.1.b.ii.)

Steve's understanding is that:

- IRS applies this also to decline ruling on trust modifications; note that, in many jurisdictions, decanting can be done merely by modifying trust
- Instead of modification, need to merely clarify ambiguity, correct a scrivener's error, etc.

# Conclusion

- “Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications,” appended to course materials, is updated via free quarterly newsletter that includes the most recent version of the PDF and a comparison against the prior quarter’s version
- To subscribe for free, complete form at **********.thompsoncoburn.com/forms/gorin-newsletter

# *Est. of Anenberg v. Comm'r*

United States Tax Court

May 20, 2024, Filed

Docket No. 856-21.

**Reporter**
2024 U.S. Tax Ct. LEXIS 1284 *; 162 T.C. No. 9

ESTATE OF SALLY J. ANENBERG, DONOR, DECEASED, STEVEN B. ANENBERG, EXECUTOR AND SPECIAL ADMINISTRATOR, Petitioner(s) v. COMMISSIONER OF INTERNAL REVENUE, Respondent

**Disposition:** An appropriate order will be issued.

## Case Summary

### Overview

HOLDINGS: [1]-Termination of marital trusts and distribution of the qualified terminable interest property (QTIP) assets to a surviving spouse did not result in a deemed gift and gift tax liability under *I.R.C. § 2519* because the surviving spouse's qualifying income interest had terminated. While there was a transfer, there was no transfer of property by gift, a predicate for the Code's imposition of gift tax under *I.R.C. § 2501(a)(1)*.

### Outcome
Estate's motion for partial summary judgment granted.

## Syllabus

S and her husband, D, established a family trust. After D's death in 2008, property held in the family trust, including shares in S and D's company (C), passed to marital trusts in which S held an income interest for life and D's children held contingent remainder interests. A qualified terminable interest property (QTIP) election was made on D's estate tax return for the property passing to the marital trusts under *I.R.C. § 2056(b)(7)*, and D's estate claimed a corresponding marital deduction with respect to the QTIP.

In March 2012, with the consent of D's children and S, a state court terminated the marital trusts, and all of the underlying property held by those trusts was distributed to S. After S made an intervening gift of a portion of the C shares to D's children in August 2012, S sold the remaining C shares from the marital trusts to D's children and grandchildren in September 2012 for interest-bearing promissory notes for the purchase price of the C shares. S filed a gift tax return for 2012 and, in relevant part, reported gift tax only for the August 2012 gift of C shares to D's children. Sometime later, S passed away.

R examined S's 2012 gift tax return and issued a Notice of Deficiency to S's estate (E) determining that the termination of the marital trusts and sale of the C shares for promissory notes was a disposition of S's qualifying income interest for life in QTIP under *I.R.C. § 2519* and that E is liable for gift tax on the value of the QTIP minus the value of S's qualifying income interest for life. R also determined an accuracy-related penalty. A timely Petition for redetermination of the deficiency and penalty followed.

E filed a Motion for Partial Summary Judgment maintaining that (1) the termination of the marital trusts and distribution of QTIP to S did not result in a taxable gift and (2) neither did S's sale of the C shares in exchange for promissory notes.

R filed a competing Motion for Partial Summary Judgment in effect arguing for the opposite conclusions.

*Held*: Assuming there was a transfer of property under *I.R.C. § 2519* when the marital trusts were terminated, E is not liable for gift tax under *I.R.C. § 2501* because S received back the interests in property that she was treated as holding and transferring under *I.R.C. §§ 2056(b)(7)(A)* and *2519* and made no gratuitous transfer, as required by *I.R.C. § 2501*.

*Held, further*, E is not liable for gift tax on the sale of C shares for promissory notes because after the termination of the marital trusts S's qualifying income interest for life in QTIP terminated and *I.R.C. § 2519* did not apply to the sale.

*Held, further*, E's Motion for Partial Summary Judgment will be granted.

*Held, further*, R's Motion for Partial Summary Judgment will be denied.

**Counsel: [*1]** John W. Porter, Keri D. Brown, and Tyler R. Murray, for petitioner.

Randall L. Eager, William Benjamin McClendon, Richard C. Mills III, and Randall S. Trebat, for respondent.

**Judges:** TORO, Judge. KERRIGAN, FOLEY, BUCH, NEGA, PUGH, ASHFORD, URDA, COPELAND, JONES, GREAVES, MARSHALL, and WEILER, JJ., agree with this opinion of the Court.

**Opinion by:** TORO

## Opinion

TORO, *Judge*: In this gift tax case, we are called upon to interpret complex provisions concerning the taxation of transfers between spouses. For many years, Congress has treated spouses as a single economic


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unit for estate and gift tax purposes. As an example, marital gifts between spouses generally are not subject to the gift tax. *See* *I.R.C. § 2523(a)*.[1] And when one spouse dies, any assets passing to the surviving spouse generally are not subject to the estate tax, because their value may be deducted from the decedent's gross estate (marital deduction). *See* *I.R.C. § 2056(a)*. Thus, transfer taxes on marital assets typically are deferred until the death of the surviving spouse—that is, until the value of the assets leaves the marital unit. *See* *Estate of Morgens v. Commissioner, 133 T.C. 402, 410 (2009)*, *aff'd*, *678 F.3d 769 (9th Cir. 2012)*.

But this treatment is subject to exceptions. For example, the marital deduction generally is unavailable for a temporary **[*2]** interest (such as a lifetime interest) passed to a surviving spouse. *See* *I.R.C. § 2056(b)*. This rule is designed to prevent the value of the interest from escaping tax altogether, first by being deducted from the decedent's gross estate and then (as in the case of a lifetime interest) terminating before its inclusion in the surviving spouse's estate.

Congress has, however, provided an option for taxpayers seeking to bequeath temporary interests to their spouses while still taking advantage of the marital deduction. Such circumstances are governed by the "qualified terminable interest property" (QTIP) regime. *I.R.C. § 2056(b)(7)*. The QTIP rules permit the estate of a decedent who leaves a qualifying lifetime property interest to a surviving spouse—often while leaving the remainder interest to the decedent's children—to take the marital deduction for the full value of the QTIP.[2] For these purposes, the rules create a legal fiction under which the surviving spouse is treated as receiving all of the QTIP, when in reality the surviving spouse has acquired only a lifetime income interest in that property.

Here we must decide what happens when taxpayers subject to the QTIP regime take steps to conform their actual legal arrangements **[*3]** to the regime's legal fiction. Specifically, the parties' Cross-Motions for Partial Summary Judgment address the treatment of interests in property designated to be treated as QTIP when Alvin Anenberg (Alvin), the husband of Sally J. Anenberg (Sally), passed away. The underlying property was held in trust. Following Alvin's death, Sally obtained a qualifying income interest for life, and, upon her death, the remainder interests in the corpus would contingently go to trusts for the benefit of Alvin's children. But eventually, with the consent of both Alvin's children and Sally, the trusts holding the underlying property were terminated by a state court and all the property held by the trusts was distributed to Sally, putting her in the position she would have been in if all that property had originally passed from Alvin to her. Sally later gifted and sold different pieces of the underlying property to Alvin's children and

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[1] Unless otherwise indicated, statutory references are to the *Internal Revenue Code, Title 26 U.S.C. (I.R.C. or Code)*, in effect at all relevant times, regulation references are to the *Code of Federal Regulations*, Title 26 (Treas. Reg.), in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure.

[2] The estate must make a QTIP election and meet certain other requirements, as described further below.


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grandchildren. Eventually, Sally passed away, leaving the gift tax consequences of these transactions to be resolved by her estate (Estate).

In his Motion, the Commissioner of Internal Revenue (Commissioner) argues that, under *section 2519*, the transactions we just described resulted **[*4]** in gift tax liability for Sally. The Estate disagrees in its own Motion. For reasons we describe further below, we agree with the Estate.[3] We will therefore grant partial summary judgment in favor of the Estate and deny the Commissioner's Motion.

*Background*

The following facts are derived from the parties' pleadings and Motion papers, the First, Second, and Third Stipulations of Fact, and their attached Exhibits. They are stated solely for the purpose of ruling on the Motions before us and not as findings of fact in this case. *See Rowen v. Comm'r, 156 T.C. 101, 103 (2021)* (reviewed). Sally resided in California when she died. Steven B. Anenberg (Steven) is the executor of the Estate and, in his capacity as the Trustee of a survivor's trust, a successor in interest to Sally.[4] He lived in California when the Petition was filed.

Sally was married to Alvin. Alvin had two sons from a prior marriage: Steven and Neil R. Anenberg (Neil). Alvin also had five grandchildren.

In 1971, Sally, Alvin, and an unrelated third party formed the Al-Sal Oil Company (Al-Sal). In time, Alvin and Sally came to own 100% of the shares of Al-Sal. Al-Sal owned and operated gas stations, principally in Los Angeles. Steven, Neil, and one of Alvin's grandchildren **[*5]** became more involved in the company as it grew, ultimately taking on corporate leadership roles.

In 1987, Sally and Alvin formed the Anenberg Family Trust, a revocable trust. Among the assets held by the Anenberg Family Trust were 100% of the shares of Al-Sal. The Anenberg Family Trust provided for the creation of various subtrusts upon Alvin's death, including two marital trusts (Marital Trusts). It also provided the trustee of the Marital Trusts with discretion to elect to treat certain property held in the Marital Trusts as QTIP under *section 2056(b)(7)* and claim a corresponding marital deduction.

In March 2008, Alvin passed away, survived by Sally, his children, and his grandchildren. As a result of Alvin's passing, various assets from the Anenberg Family Trust passed to the Marital Trusts, including 199

[3] The parties also dispute whether the period of limitations for assessing gift tax for the relevant year (2012) remains open considering the disclosures made on Sally's 2012 gift tax return. But, given our decision on the merits, we need not address this issue.

[4] We recognized Steven as Special Administrator for purposes of the gift tax issues in this case.


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shares of Al-Sal (out of 400 total outstanding shares), representing a 49.75% interest in the company.[5] Additionally, some cash and a 50% interest in Sally and Alvin's home passed to the Marital Trusts. In relevant part, the Anenberg Family Trust directed that all income from the Marital Trusts be paid out to Sally at least annually and that the trustee distribute corpus to Sally as the trustee "deem[ed] **[*6]** necessary" for Sally's support. Trusts created for the benefits of Steven and Neil had contingent remainder interests in the corpus of the Marital Trusts. Steven was the trustee of the Marital Trusts.

In 2009, Steven, as the executor of Alvin's estate, filed Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. On the return, the estate elected to treat the property in the Marital Trusts as QTIP under *section 2056(b)(7)*. Alvin's estate then claimed a corresponding marital deduction for the value of the property.

In October 2011, Steven, in his capacity as trustee of the Marital Trusts, petitioned the Superior Court of California for the Central District of the County of Los Angeles (Superior Court) to terminate the Marital Trusts pursuant to *California Probate Code § 15403* (West 2011), which provides for the termination of irrevocable trusts by consent of all beneficiaries upon the filing of a petition to a court.[6] The petition also sought "outright" distribution of the assets of the Trusts to Sally. Stipulation of Facts Ex. 6-J, at 5. In relevant part, Steven represented in the petition that he "anticipates receiving consents to the termination of the Marital Trust[s] from the surviving Settlor [Sally], Trustee **[*7]** [Steven], and all beneficiaries (current and contingent)." Stipulation of Facts Ex. 6-J, at 6.[7]

In March 2012, the Superior Court issued an order approving the petition to terminate the Marital Trusts. As of March 2, 2012, the fair market value of the Marital Trusts' property was $25,450,000, and the fair market value of Sally's income interest was $2,599,463. The Superior Court's order stated that, "[o]n proof made to the satisfaction of the Court, the Court finds that all notices of hearing have been given as required by law and that all allegations in the petition are true." Stipulation of Facts Ex. 16-J, at 1. The Superior Court then terminated the Marital Trusts and ordered that Steven, as trustee, "is directed to transfer all assets

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[5] The remaining 201 shares of Al-Sal (or 50.25% of the company) were distributed from the Anenberg Family Trust to another subtrust created for Sally's benefit. Later in 2008, a 5% interest in Al-Sal was transferred from this other subtrust to an irrevocable trust created for Sally.

[6] At all times relevant to this case, *California Probate Code § 15403(a)* provided that "if all beneficiaries of an irrevocable trust consent, they may compel modification or termination of the trust upon petition to the court."

[7] Also in October 2011, Al-Sal was recapitalized to create two classes of shares—voting and nonvoting. Before the recapitalization, as already noted, there were 400 shares in Al-Sal. After the recapitalization, there were 400 voting shares and 39,600 nonvoting shares. Of the post-recapitalization shares, the Marital Trust held 199 voting shares and 19,701 nonvoting shares. This is equal to a 49.75% interest in the voting shares (199 / 400 = 0.4975) and a 49.75% interest in the nonvoting shares (19,701 / 39,600 = 0.4975) of Al-Sal. The remaining 50.25% of Al-Sal shares remained in Sally's other trusts.


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of [the Marital Trusts] to Sally." Stipulation of Facts Ex. 16-J, at 2. As a result of the termination of the Marital Trusts, Sally received 199 voting shares and 19,701 nonvoting shares in Al-Sal, among other assets.[8]

In August 2012, Sally made a gift to each of the trusts of Steven and Neil of some of the Al-Sal shares she received upon the termination of the Marital Trusts. The fair market value of each of these gifts for federal gift tax **[*8]** purposes was $1,632,622.

In September 2012, Sally sold virtually all of her remaining Al-Sal shares (including the shares from the Marital Trusts and shares from one or both of her other trusts) to various trusts created for the benefit of Alvin's children and grandchildren. In return, she received nine-year promissory notes in amounts equal to the value of the Al-Sal shares and bearing annual interest at the applicable federal rate.[9] These promissory notes were secured by interests in the Al-Sal shares and were partially guaranteed. The promissory notes were payable in installments and "[a]ll outstanding principal and accrued and unpaid interest" on the promissory notes was to be "paid on September 1, 2021."

For the 2012 tax year, Sally timely filed Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. On the gift tax return, she reported the gifts of Al-Sal shares she made to Steven and Neil. She also took the position that the September 2012 sales of the Al-Sal shares to the various trusts for Alvin's heirs did not result in gift tax.

The Commissioner examined Sally's 2012 gift tax return. On December 1, 2020, he issued a Notice of Deficiency to Sally's Estate **[*9]** as Sally died in 2016. The Commissioner determined that the Estate was liable for a gift tax deficiency of more than $9 million as a result of the termination of the Marital Trusts and the subsequent sales of the Al-Sal shares. The Commissioner also determined an accuracy-related penalty of over $1.8 million.

A timely Petition for redetermination by this Court followed. The Commissioner answered the Petition and amended his Answer twice. In his second amendment, the Commissioner alleged for the first time that the termination of the Marital Trusts by itself was a disposition of Sally's qualifying income interest for life in the QTIP and that she is liable for gift tax as a result of that disposition.

The Estate filed a Motion for Partial Summary Judgment on May 4, 2023, asking us to determine "that (i) the termination of the Marital Trusts and the distribution of the assets of the Marital Trusts to Sally did not result in a deemed gift under *[section] 2519*; [and that] (ii) Sally's sale of the Al-Sal shares received from the Marital Trusts in exchange for promissory notes did not result in a deemed gift under *[section] 2519*."

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[8] While the parties stipulated that Sally received a 48.75% interest in Al-Sal, our review of the record indicates that she actually received a 49.75% interest in Al-Sal. *See supra* note 7. Sally also received cash and a 50% interest in her home.

[9] The parties agree that the applicable federal rate at the time was 0.84%.


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Pet'r's Mot. Summ. J. 3. The Commissioner filed his own Motion for Partial Summary Judgment **[*10]** on July 7, 2023, asking us in effect to reach the opposite conclusions. After briefing was completed, we held a hearing on the Motions on February 21, 2024.

*Discussion*

I. *Summary Judgment Standard*

The purpose of summary judgment is to expedite litigation and avoid costly, time-consuming, and unnecessary trials. *Fla. Peach Corp. v. Commissioner, 90 T.C. 678, 681 (1988)*. The Court may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered as a matter of law. *Rule 121(a)(2)*; *Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992)*, *aff'd*, *17 F.3d 965 (7th Cir. 1994)*. In deciding whether to grant summary judgment, we construe factual materials and inferences drawn from them in the light most favorable to the adverse party. *Sundstrand Corp., 98 T.C. at 520*. The parties agree that summary adjudication is appropriate here.

II. *General Legal Principles*

A. *The Marital Deduction*

Upon the death of a citizen or resident of the United States, *section 2001(a)* imposes tax on the taxable estate transferred to the decedent's heirs. In computing the amount of the taxable estate, the value of property passing from the decedent to his or her surviving spouse is generally deductible. *See I.R.C. § 2056(a)*, *(b)(7)*; *Treas. Reg. § 20.2056(a)-1(a)*. The policy behind the marital deduction is that property passes untaxed from the first spouse to die to the surviving spouse, but is then included in the estate **[*11]** of the surviving spouse. *See Estate of Letts v. Commissioner, 109 T.C. 290, 295 (1997)*, *aff'd*, *212 F.3d 600 (11th Cir. 2000)* (unpublished table decision). The marital deduction does not eliminate or reduce the tax on the transfer of marital assets out of the marital unit, but instead permits deferral until the death of or gift by the surviving spouse. *See Estate of Morgens, 133 T.C. at 410*.

Ordinarily a marital deduction is not allowed for terminable interest property passing from the decedent to the surviving spouse (terminable interest rule). *See I.R.C. § 2056(b)*. A terminable interest is an interest passing from the decedent to the surviving spouse that will end on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur. *See I.R.C. § 2056(b)(1)*. The terminable interest rule denies a marital deduction if (1) an interest passing to the surviving spouse is a terminable interest, (2) an interest in such property passes from the decedent to someone other than the surviving spouse for less than full and adequate consideration in money or money's worth, and (3) a third person will possess or enjoy the property after the termination or failure of the interest passing to the surviving spouse. *See I.R.C. § 2056(b)(1)*. The purpose of the terminable interest rule is to deny the marital


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deduction for **[*12]** transfers between spouses if the transfer has been structured to avoid estate tax when the surviving spouse dies. *See* *Estate of Morgens, 133 T.C. at 410*; *Estate of Novotny v. Commissioner, 93 T.C. 12, 16 (1989)*.

B. *QTIP Regime*

*Section 2056(b)(7)* provides an exception to the terminable interest rule for QTIP. *See* *Morgens v. Comm'r (Estate of Morgens), 678 F.3d at 771* ("The QTIP [regime] is an exception to an exception to an exception."). The provision allows a marital deduction for QTIP even though the surviving spouse receives only an income interest and has no control over the ultimate disposition of the property. *See id.* In other words, under *section 2056(b)(7)*, the decedent may pass to the surviving spouse an income interest in property for the spouse's lifetime while still being permitted to deduct the full value of the property (not just the value of the income interest) from the decedent's taxable estate. After the death of the surviving spouse, the property passes to beneficiaries designated by the first spouse to die. *See* *Estate of Morgens v. Commissioner, 678 F.3d at 771*.

Three requirements must be met for terminable interest property to qualify as QTIP: (1) the property must pass from the decedent, (2) the surviving spouse must have a qualifying income interest for life[10] in the property, and (3) the executor of the estate of the first spouse to die must make an affirmative election to designate the property **[*13]** as QTIP. *See* *I.R.C. § 2056(b)(7)(B)*. For these purposes, *section 2056(b)(7)* creates a legal fiction under which the surviving spouse is treated as receiving all of the QTIP passing from the deceased spouse, when in reality the surviving spouse has acquired only a lifetime income interest in that property. *See* *I.R.C. § 2056(b)(7)(A)(ii)*; *see also* *Estate of Sommers v. Commissioner, 149 T.C. 209, 223-24 (2017)*. Through this fiction, *section 2056(b)(7)* allows the decedent's estate to take full advantage of the marital deduction for that property under *section 2056(a)*. *See* *I.R.C. § 2056(b)(7)(A)(i)*; *Estate of Morgens v. Commissioner, 678 F.3d at 771* ("The underlying premise of the QTIP regime is that the surviving spouse is deemed to receive and then give the entire QTIP property, rather than just the income interest. The purpose of the QTIP regime is to treat the two spouses as a single economic unit with respect to the QTIP property while still allowing the first-to-die spouse to control the eventual disposition of the property.").

Other Code provisions continue the fiction that the surviving spouse owns the QTIP outright to ensure that, if not consumed by the surviving spouse during her lifetime, the QTIP ultimately is subject to either the estate or gift tax. *See* *Estate of Sommers, 149 T.C. at 223*. Specifically, *section 2044* requires that, upon the

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[10] *Section 2056(b)(7)(B)(ii)* provides that the surviving spouse has a qualifying income interest for life if the surviving spouse is entitled to all income from the property, payable annually or more frequently, or has a usufruct interest for life in the property, and generally no person has the power to appoint any part of the property to any person other than the surviving spouse.


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surviving spouse's death, the value of her gross estate include the value of any QTIP.[11] And as a corollary, *section 2519* addresses **[*14]** dispositions of a qualifying income interest for life in any QTIP during the surviving spouse's lifetime, triggering potential gift tax in certain circumstances. Operating together, these provisions generally mean that a QTIP election produces the same tax outcome that the marital deduction would have if the surviving spouse in fact owned the QTIP—namely, deferral until the surviving spouse dies or conveys his or her interest in the QTIP by gift. *See Estate of Morgens, 133 T.C. at 410* (describing the effects of the marital deduction); *Estate of Novotny, 93 T.C. at 16-17* ("To the extent it applies, the marital deduction results in property in a marital unit being subject to estate tax once, not twice.").

Of particular relevance here is *section 2519*, addressing dispositions of QTIP during the surviving spouse's lifetime. In relevant part, *section 2519* provides as follows:

> *Sec. 2519(a)*. General rule.—
> For purposes of this chapter [imposing the gift tax] and chapter 11 [imposing the estate tax], any disposition of all or part of a qualifying income interest for life in any [QTIP] shall be treated as a transfer of all interests in such [QTIP] other than the qualifying income interest.

Accordingly, for gift and estate tax purposes, *section 2519* treats any disposition of the surviving spouse's income interest **[*15]** in QTIP as if the surviving spouse transferred 100% of the remainder interests in QTIP.[12] In this case, we consider *section 2519* in the gift tax context.

C. *Gift Tax Regime*

The Code "taxes 'the transfer of property by gift.'" *United States v. Irvine, 511 U.S. 224, 232, 114 S. Ct. 1473, 128 L. Ed. 2d 168 (1994)*. The gift tax is imposed by *section 2501(a)(1)*. As relevant here, it provides: "A tax, computed as provided in *section 2502*, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual ...." Under *section 2502(a)*, the gift tax is computed on the amount of a taxpayer's "taxable gifts" for current and preceding periods. *Section 2503(a)*, in turn, defines "taxable gifts" to mean "the total amount of gifts made during the calendar year, less [certain] deductions."

The gift tax generally applies "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." *I.R.C. § 2511(a)*. When the

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[11] The estate of the surviving spouse may recover from QTIP recipients the amount by which the surviving spouse's estate tax is increased by the inclusion of the QTIP in the estate. *See I.R.C. § 2207A(a)*.

[12] The gift tax treatment of the surviving spouse's qualifying interest for life is determined separately under *section 2511(a)*. *See Treas. Reg. § 25.2519-1(a)*, *(c)*.


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gift is made in property, the amount of the gift is the value of the property at the date of the gift. *See I.R.C. § 2512(a)*. The Code also makes clear that "[w]here property is transferred for less than an adequate and full consideration in money or money's worth," the value of the transferred property less the value of the consideration **[*16]** is deemed to be a gift. *I.R.C. § 2512(b)*.

As the foregoing provisions show, a transfer *by gift* is a foundation for the imposition of gift tax. But, despite the Code's liberal use of the term "gift" throughout the relevant provisions, it is not statutorily defined. Consistent with the common understanding of the term, however, the Supreme Court has described "gift in the statutory sense . . . [as] proceed[ing] from a 'detached and disinterested generosity' . . . 'out of affection, respect, admiration, charity or like impulses.'" *Commissioner v. Duberstein, 363 U.S. 278, 285, 80 S. Ct. 1190, 4 L. Ed. 2d 1218 (1960)* (first quoting *Comm'r v. LoBue, 351 U.S. 243, 246, 76 S. Ct. 800, 100 L. Ed. 1142, 1956-2 C.B. 967 (1956)*; and then quoting *Robertson v. United States, 343 U.S. 711, 714, 72 S. Ct. 994, 96 L. Ed. 1237, 1952-2 C.B. 66 (1952)*). And our Court and the governing regulations have explained transfers in exchange for full and adequate consideration are not gifts. *See, e.g., Redstone v. Comm'r (In re Estate of Redstone), 145 T.C. 259, 269 (2015)*; *see also Treas. Reg. § 25.2511-1(g)(1)* ("The gift tax is not applicable to a transfer for a full and adequate consideration in money or money's worth ....").

III. *The Parties' Dispute*

The parties agree that, following Alvin's death, Sally owned a qualifying income interest for life in QTIP (including the lifetime income interest in the Al-Sal shares). But they disagree on the application of *section 2519* to Sally's 2012 transactions with respect to the Al-Sal shares.

Specifically, the Commissioner contends that Sally disposed of her qualifying **[*17]** income interest for life in the QTIP within the meaning of *section 2519* at one of two times: (1) when Sally agreed to the termination of the Marital Trusts and accepted the Marital Trusts' distribution of a complete ownership interest in all the Trusts' assets, including the Al-Sal shares or (2) when Sally, having accepted the shares from the Marital Trusts, sold them in exchange for promissory notes. In the Commissioner's view, either one of these two events was a "disposition" sufficient to trigger *section 2519*. The Commissioner therefore contends that Sally is treated as transferring the full value of the QTIP (the Al-Sal shares) less the value of her qualifying income interest as a gift, resulting in a gift tax liability of more than $9 million and related penalties.

Unsurprisingly, the Estate disagrees with the Commissioner, arguing that neither event was a disposition within the meaning of *section 2519*. In the Estate's view, the 2012 transactions, taken together, amount to no more than a permissible conversion of Sally's qualifying income interest for life in the QTIP into an equivalent interest in other property. Under the applicable regulations, the Estate says, such conversions are not a disposition under *section 2519*. And **[*18]** in the alternative, the Estate argues, even if there was a disposition when Sally received the Trust's assets or later sold the shares, no gift tax is due because Sally


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did not make a gift. Instead, Sally received full and adequate consideration for the property she was deemed to transfer.

As we explain below, we agree that Sally did not make a gift as the Commissioner contends and therefore resolve the Motions in the Estate's favor.

A. *Receipt of the Al-Sal Shares*

There is some question as to whether the termination of the Marital Trusts (through which Sally held her qualifying income interest for life in the Al-Sal shares) and the distribution of the Al-Sal shares to Sally by order of the Superior Court was a disposition within the meaning of *section 2519(a)*.[13] *See, e.g., Rome I, Ltd. v. Commissioner, 96 T.C. 697, 704 (1991)* (discussing the plain meaning of the term "disposition"); *see also Disposition, Black's Law Dictionary* (5th ed. 1979) ("Act of disposing: transferring to the care of possession of another. The parting with, alienation of, or giving up property.").[14] But we need not resolve this question because, even if the termination of the Marital Trusts and distribution of the Al-Sal shares was a disposition under *section 2519(a)*, we conclude it did not result **[*19]** in gift tax liability for Sally.

As we have discussed, *section 2519* provides that, if Sally disposed of all or part of her qualifying income interest for life in the Al-Sal shares, then, for purposes of determining her gift tax liability, she is treated as transferring all the interests in the Al-Sal shares other than her qualifying income interest.[15] So far, so good.

A transfer alone, however, is insufficient to create a gift tax liability. Rather, *section 2501* tells us that gift tax applies "on the *transfer* of property *by gift* during [the] calendar year." *I.R.C. § 2501(a)(1)* (emphasis added); *Irvine, 511 U.S. at 232*; *see also Estate of Howard v. Commissioner, 910 F.2d 633, 636 (9th Cir. 1990)* (construing the provisions governing QTIPs and observing that "[i]n a statute so carefully crafted every difference counts"), *rev'g 91 T.C. 329 (1988)*. And, as the Supreme Court observed in *Irvine*, "[w]e

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[13] The parties' Motion papers focus on the Al-Sal shares, and we do the same here. However, the same analysis would apply with respect to Sally's other QTIP (i.e., the Marital Trusts' other assets).

[14] On the one hand, for the Marital Trusts to be terminated, Sally had to consent to relinquish her interests in the Marital Trusts. And under state law those interests represented separate property rights. Although the relinquishment of those interests was conditioned on Sally's receiving all of the property the Marital Trusts held, one might think of the elimination of the initial interests as an "act of disposing" or as "parting with" or "giving up" the separate property rights. Thus, one could view Sally's agreement to termination as a disposition, as the Commissioner argues. On the other hand, given that Sally agreed to relinquish the interests in the Marital Trusts only because she was assured she would receive all of the underlying property outright, one could also view Sally's agreement to the termination of the Marital Trusts as resulting in no disposition, because after the termination of the Marital Trusts she held in her own name the full bundle of sticks, *see United States v. Craft, 535 U.S. 274, 278, 122 S. Ct. 1414, 152 L. Ed. 2d 437 (2002)* ("A common idiom describes property as a 'bundle of sticks'—a collection of individual rights which, in certain combinations, constitute property."), with respect to the underlying property, including the right to receive the income generated by the property.

[15] In this scenario, no deeming rule is necessary with respect to the qualifying income interest, because it is transferred in fact.


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have repeatedly emphasized that [the Code's] comprehensive language was chosen to embrace all *gratuitous* transfers." *Irvine, 511 U.S. at 232-33* (emphasis added); *id. at 235* ("[T]he capacious language of *Internal Revenue Code §§ 2501(a)(1)* and *2511(a)* . . . encompasses all *gratuitous* transfers of property and property rights of significant value." (Emphasis added.)). In other words, a gratuitous transfer—not just a transfer—is required to impose gift tax.

Applying these principles to this case is simple. If we assume that Sally's **[*20]** relinquishment of her interest in the Marital Trusts in exchange for the Al-Sal shares was a disposition, *section 2519(a)* treats her as having transferred away (but not necessarily by gift) all the interests in the Al-Sal shares other than her qualifying income interest. *See also Treas. Reg. § 25.2519-1(a)*. The value of the deemed transfer is the fair market value of the shares, less Sally's qualifying income interest. *See id. para. (c)(1)*. To determine whether Sally is liable for any gift tax on this deemed transfer, we must consider whether the transfer was also a gift by Sally.

This task turns out to be straightforward. To determine whether Sally made a gift, in connection with the deemed transfer, we compare what she had before and after the transaction. When doing so, we find that, after the transaction, Sally had full ownership of the Al-Sal shares. As a result of the Superior Court's order, she received free and clear the underlying property that *section 2056(b)(7)* deemed her to have received from Alvin to start with and with respect to which (we assume) *section 2519(a)* deemed her to have transferred remainder interests upon the termination of the Marital Trusts. Put another way, Sally's deemed transfer of the remainder interests in the Al-Sal shares held in trust **[*21]** (other than her qualifying income interest) resulted in her actual receipt of all the Al-Sal shares unencumbered (other than those attributable to her qualifying income interest). At the end of the day, she gave away nothing of value as a result of the deemed transfer. Accordingly, the termination of the Marital Trusts did not result in any "gratuitous transfers" by Sally, deemed or otherwise. *See Irvine, 511 U.S. at 232*. Because there was no gratuitous transfer, she made no gift. A long line of cases echoes this principle. *See, e.g., Turman v. Commissioner, 35 T.C. 1123, 1129 (1961)* (holding that a surviving spouse made no gift when she took under her husband's will and thereby gave up her one-half interest in their community property because the value of property she gave up (the one-half interest) was less than what she received in return (a life estate in all the community property)); *Siegel v. Commissioner, 26 T.C. 743, 747 (1956)* (stating on similar facts that "[i]f [the taxpayer] received more than she surrendered then, of course, no gift has been made"), *aff'd*, *250 F.2d 339 (9th Cir. 1957)*.

A conclusion that Sally made a taxable gift in the circumstances here would be difficult to reconcile with the regulations under *section 2511*. Those regulations explain that the gift tax "is an excise upon [her] act of making the transfer [and] **[*22]** is measured by the value of the property passing from the donor." *Treas. Reg. § 25.2511-2(a)*. The regulations further observe that a "gift is complete" "[a]s to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in [her]


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no power to change its disposition, whether for [her] own benefit or for the benefit of another." *Id.* *para. (b)*. "But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case." *Id.* Tying these principles together, the regulations note that "in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined." *Id.*[16]

If one examines "all the facts in [Sally's] particular case," as the regulations contemplate, it would be difficult to avoid concluding (as we already have) that she made no taxable gift. First, consideration of all the facts shows that, even if we deem Sally to have transferred the remainder interests, no value would appear to have passed from her to anyone else because she ultimately received all the property held by the Marital Trusts as part of the same transaction, leaving nothing on which the "excise" could operate. *See id.* *para. (a)*. Second, Sally's decision to agree to the termination of the Marital Trusts was conditioned on her receipt of the property held by the Marital Trusts. While (we assume) that decision could be viewed as a disposition that is treated as a transfer under *section 2519*, it is not clear **[*24]** how Sally could be viewed as having "parted with dominion and control as to leave in [her] no power to change its disposition." *Treas. Reg. § 25.2511-2(b)*. Quite to the contrary, after the termination of the Marital Trusts, she had full control over the disposition of the assets previously held in trust. Accordingly, under the regulations, any gift by Sally would appear to be viewed as wholly incomplete. *See also* *Estate of Sanford v. Commissioner, 308 U.S. 39, 43, 60 S. Ct. 51, 84 L. Ed. 20, 1939-2 C.B. 340 (1939)* ("[A] retention of control over the disposition of the trust property, whether for the benefit of the donor or others, renders the gift incomplete until the power is relinquished whether in life or at death."); *Robinson v. Commissioner, 675 F.2d 774, 777 (5th Cir. 1982)* ("There can be no completed gift before the donor surrenders dominion and control of the subject matter of the gift." (quoting 4 Jacob Rabkin & Mark H. Johnson, *Federal Income, Gift and Estate Taxation* § 51.04B(1) (1982)), *aff'g* *75 T.C. 346 (1980)*.

*Treasury Regulation § 25.2511-2(c)* points the same way. It provides that "[a] gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in [herself]." Here, in agreeing that the Marital Trusts be terminated, Sally was assured that she would receive the assets held

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[16] The regulations then offer an illustration:

> [I]f a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, *no portion of the transfer is a completed gift*. On the other hand, if the donor had not retained the testamentary power of appointment, but **[*23]** instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift. However, if the exercise of the trustee's power in favor of the grantor is limited by a fixed or ascertainable standard (see *paragraph (g)(2) of § 25.2511-1*), enforceable by or on behalf of the grantor, then the gift is incomplete to the extent of the ascertainable value of any rights thus retained by the grantor.

*Treas. Reg. § 25.2511-2(b)* (emphasis added).


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by the trusts. While not cast in the form of a reserved power, one might view the arrangement presented to the Superior Court as amounting to Sally's agreeing **[*25]** to part with her qualifying income interest for life (and to the deemed transfer of the remainder interests in the QTIP) on the condition that she was reserving the power to revest title in the property in herself, a power that was promptly exercised upon the termination of the Marital Trusts.

Consideration of *section 2512* further confirms the conclusion that Sally did not make a taxable gift. In explaining how gifts should be valued for purposes of the gift tax, *section 2512(b)* provides that, if property is transferred for less than full and adequate consideration, then the amount by which the property's value exceeds the value of the consideration is a gift. A necessary corollary of this rule is that no taxable gift results to the extent the value of transferred property is equal to or less than the value of the consideration received. *See, e.g., Estate of Redstone, 145 T.C. at 269*.

Considering the circumstances that existed when the Superior Court directed the trustee of the Marital Trusts to transfer all of the assets of those trusts to Sally free and clear, we see the following. Before the termination of the Marital Trusts, Sally held a qualifying income interest for life in the QTIP. She was deemed for estate and gift tax purposes to hold **[*26]** the remainder interests as well. But these interests, even when considered together, did not equate to unencumbered ownership. She was not free to do what she wished with the QTIP, which was held in the trusts. After the Superior Court order, Sally received the QTIP free of any trust restrictions. In these circumstances, to the extent *section 2519* viewed Sally as transferring away the interests in property that the QTIP regime treated her as holding in the first place, it is hard to understand why Sally would not have received full and adequate consideration in return when she was also at the receiving end of the transfer of the property unencumbered. Before the Marital Trusts terminated, she actually held an income interest in the Marital Trusts' property valued at approximately $2.6 million, but was deemed to hold the entirety of the Marital Trusts' property valued at approximately $25.5 million. Immediately after the Marital Trusts terminated and (we assume) Sally was deemed to transfer the residual value of the Marital Trusts' property (approximately $22.9 million), she actually held assets valued at approximately $25.5 million. Sally could thus be viewed as fully compensated for whatever **[*27]** interest she was deemed to transfer.[17]

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[17] The result would be different if Sally had received only the value of her qualifying income interest for life when the Marital Trusts terminated. In such a case, Sally would have been left with assets valued at approximately $2.6 million. The gratuitous transfer under *section 2519* would be plain (although deemed) and would total approximately $22.9 million ($25.5 million of assets deemed held before the termination less her $2.6 income interest).


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In sum, when looking for a gratuitous transfer in the circumstances here, one comes up short. Simply put, Sally made no gift.[18] So, while (we assume) there was a transfer, there was no transfer of property *by gift*, a predicate for the Code's imposition of gift tax. *See* I.R.C. § 2501(a)(1).

B. *Exchange of the Al-Sal Shares for Promissory Notes*

Neither does the gift tax apply to Sally's subsequent sale of the Al-Sal shares in exchange for promissory notes. For at least two reasons, that transaction could not have triggered *section 2519(a)*.

First, if the termination of the Marital Trusts and distribution of the Trusts' assets to Sally constituted a disposition of her qualifying income interest for life in QTIP, as we assume above, then that event would already have triggered *section 2519*. Thus, *section 2519* would no longer apply at the time Sally sold the shares.[19] Essentially, Sally would have already satisfied the requirements of the QTIP regime, and her future transactions in the Al-Sal shares would be covered by the ordinary estate and gift tax rules rather than the QTIP regime.

Second, even if the termination of Marital Trusts and the distribution of QTIP to Sally was not a disposition, Sally's qualifying income **[*28]** interest for life in the QTIP would still have ceased to exist at that point, eliminating the mechanism needed to trigger *section 2519* in the future.

It is axiomatic that a surviving spouse must hold a qualifying income interest for life to implicate *section 2519*. Such a property interest is defined by the Code and exists only when the surviving spouse is entitled to all income from the property, payable annually or more frequently, or has a usufruct interest for life in the property, and no person (including the surviving spouse) has the power to appoint any part of the property to any person other than the surviving spouse (unless such power is exercisable only after the death of the surviving spouse). *See* I.R.C. § 2056(b)(7)(B)(ii); Treas. Reg. § 20.2056(b)-7(d)(1). When the Superior Court terminated the Marital Trusts, the property interest Sally received was outright ownership of the Al-Sal shares, not an income interest. And because the Marital Trusts terminated, the property interest Sally received was unencumbered by any restrictions that were placed on it while it was in the Trusts, including restrictions that would have limited distributions to individuals other than Sally. For these reasons,

[18] We express no view on whether the other beneficiaries of the Marital Trust could be treated as making a gift to Sally for gift tax purposes.

[19] The qualifying disposition would have already occurred, and there appears to be no dispute that a qualifying disposition occurs only once.


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Sally no longer held a qualifying income interest for life as **[*29]** defined by *section 2056(b)(7)(B)(ii)*.[20] Consequently, her sale of the Al-Sal shares for promissory notes could not trigger *section 2519*.[21]

C. *The Commissioner's Arguments*

1. *Checking Out of the QTIP Regime*

The Commissioner argues that, when *section 2519* is triggered, the surviving spouse automatically owes gift tax on the full value of the QTIP (less the value of the qualifying income interest) regardless of what happens with the QTIP or any consideration the surviving spouse receives as part of the transfer. In other words, according to the Commissioner, "once the estate of the first spouse to die irrevocably 'checks-in' to the QTIP regime, there is no method to 'check-out' absent paying the deferred tax." R. Memo. 17.

In one version of this argument, the Commissioner asserts that *section 2519* itself "imposes gift tax." R. Memo. 4. But of course the text of the Code makes plain that this is not the case. Instead, *section 2519* deems a transfer to be one upon which *section 2501* *may* impose gift tax, but only if the requirements of the latter section are met. Among those requirements is that a transfer be "by gift" to create a gift tax liability. *See* *I.R.C. § 2501(a)*. And, as we have explained above, the facts here do not support finding a gratuitous transfer. *See supra* Part III.A.

Repeatedly, **[*30]** the Commissioner ignores the textual limits of *section 2519(a)*. Specifically, the provision says only that a disposition "shall be treated as a transfer" and not that it shall be treated "as a transfer by gift" or "as a gift." Congress could have used either formulation to ensure the imposition of gift tax regardless of what happens with the QTIP or the consideration the surviving spouse receives, but it did not. And it made this choice despite the frequent use of the phrase "transfer by gift" in neighboring provisions, including in *section 2501* itself. *See, e.g.*, *I.R.C. § 2056A(b)(13)* (treating taxable lifetime distributions from a qualified domestic trust "as a transfer by gift"); *I.R.C. § 2501(a)* (imposing the gift tax on "the transfer of property by gift during [the] calendar year"); *I.R.C. § 6019* (requiring that "[a]ny individual who in any calendar year makes any transfer by gift" file a gift tax return, subject to certain limitations). Our interpretation of *section 2519* respects this congressional choice. *See, e.g.,* *Gallardo ex rel. Vassallo v. Marstiller, 596 U.S. 420, 142 S. Ct. 1751, 1759, 213 L. Ed. 2d 1 (2022)* ("[W]e must give effect to, not nullify, Congress' choice to include limiting language in some provisions but not others, see

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[20] The Commissioner appears to agree that Sally's qualifying income interest for life did not survive the termination of the Marital Trusts. In relevant part, he says that "[t]he Superior Court's Order unequivocally terminated the trusts which, in turn, resulted in the termination of Sally's qualifying income interest[] in those trusts," and "[o]nce the assets were distributed to Sally, the Marital QTIP Trusts and Sally's qualifying income interest[] in those trusts ceased to exist." Resp't's Memo. in Support of Cross-Summ. J. (R. Memo.) 27 (footnotes omitted).

[21] For the same reason, Sally's gifts of portions of her Al-Sal shares to trusts held for Steven and Neil in August 2012 did not trigger *section 2519*.


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[*Russello v. United States, 464 U.S. 16, 23, 104 S. Ct. 296, 78 L. Ed. 2d 17 (1983)]*."); *Me. Cmty. Health Options v. United States, 590 U.S. 296, 140 S. Ct. 1308, 1323, 206 L. Ed. 2d 764 (2020)* ("This Court generally presumes that 'when Congress includes particular language in one section of a statute but omits **[*31]** it in another,' Congress 'intended a difference in meaning.'" (quoting *Digital Realty Tr., Inc. v. Somers, 583 U.S. 149, 138 S. Ct. 767, 777, 200 L. Ed. 2d 15 (2018)*)).

This outcome also makes sense in context. Recall that, working together, *section 2519* and *section 2044* generally operate to ensure that QTIP is treated the same as nonterminable interest property (i.e., regular property) for purposes of the marital deduction—namely, not eliminating or reducing tax on the transfer of marital assets out of the marital unit, but rather permitting deferral until the death of or gift by the surviving spouse. Where, as here, a surviving spouse receives the QTIP with respect to which she is deemed to transfer remainder interests, the value of the marital assets is preserved in her estate and will be taxed upon her death, assuming she does not consume the property or transfer it by gift at a later date. This is the same result that obtains when the marital deduction applies without regard to the QTIP regime.

The Commissioner highlights various cases, rulings, and examples from the regulations that he says require gift tax to be imposed whenever a surviving spouse disposes of her qualifying income interest in QTIP. R. Memo. 29, 31-32 (citing *Estate of Morgens v. Commissioner, 678 F.3d at 771*; *Estate of Novotny, 93 T.C. at 18*; *Estate of Kite*, T.C. Memo 2013-43; Order and Decision at 8-9, *Estate* ***[*32]*** *of Kite*, T.C. Memo. 2013-43 (No. 6772-08); *Treas. Reg. § 25.2519-1(a)*, *(f)*, *(g)* (examples 1 and 2); *Rev. Rul. 98-8, 1998-1 C.B. 541*). But in many of the sources the Commissioner cites, the surviving spouse either disposed of the entire qualifying income interest by gift (i.e., for no consideration whatsoever) or else received consideration for the value of the income interest only. *See, e.g., Estate of Morgens v. Commissioner, 678 F.3d at 772-73* (addressing a surviving spouse who gave her income interest in QTIP to the decedent's heirs, receiving nothing in return, and was deemed to transfer the remainder interest under *section 2519*);[22] *Treas. Reg. § 25.2519-1(g)* (example 1) (treating a surviving spouse as making a gift of both the life interest and the remainder when she transferred to decedent's children for no consideration the entire interest in the personal residence in which she had been left a life estate); *Treas. Reg. § 25.2519-1(g)* (example 2) (treating a surviving spouse as making a gift of the remainder interest when she transferred to decedent's children the entire interest in the personal residence in which she had been left a life estate and was compensated only for her life interest). Accordingly, a straightforward application of *section 2519*, together with the gift tax principles we have discussed, clearly required that gift tax be imposed. Otherwise, the **[*33]** value of the remainder interest in QTIP would have passed out of the surviving spouse's hands (and thus out of the

[22] And, in *Estate of Morgens*, our Court recognized that gift tax would not necessarily be due every time *section 2519* is triggered. *See Estate of Morgens, 133 T.C. at 411* (describing how *section 2207A(b)* applies "[*i*]*f* gift tax is due upon the deemed transfer of the QTIP by a surviving spouse" (emphasis added)).


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marital unit) without ever being subject to estate or gift tax, contrary to the policy underlying the marital deduction and QTIP rules.

In another permutation of the same fact pattern, Revenue Ruling 98-8 describes a transaction in which a surviving spouse purchased the remaindermen's interest in QTIP, transferring to the remaindermen a promissory note of the value of the interest (and therefore diminishing her estate by the same amount), even though, under the Code, the surviving spouse was deemed to already own the QTIP. That transfer clearly represented a gift. As the Commissioner points out, the surviving spouse could not be viewed as purchasing with the note the remaindermen's interest because, under the QTIP regime, the remaindermen's interest was already hers.

By contrast, here Sally's receipt of the QTIP (and later the promissory notes) preserves the value of the marital assets in her hands for future gift or estate taxation. *See Estate of Novotny, 93 T.C. at 16, 17-18*; *see also I.R.C. § 2033* ("The value of the gross estate shall include the value of all property to the extent of the interest therein of the **[*34]** decedent at the time of his death."). Thus, the authorities the Commissioner cites support a result contrary to the one he advances.[23]

The termination of the Marital Trusts is similar to an appointment of the assets of the Marital Trusts to Sally—i.e., an assignment of ownership in the assets to her. *See, e.g.*, *Cal. Prob. Code § 610(f)* (West 2023) (defining a "power of appointment" as "a power that enables a powerholder . . . to designate a recipient of an ownership interest in . . . property"); *see also Power of Appointment, Black's Law Dictionary* (5th ed. 1979) (defining a "[p]ower of appointment" as "[a] power . . . to appoint, that is, to select and nominate, the person or persons who are to receive and enjoy an estate or an income therefrom"). Perhaps in recognition that it would make little sense to impose the gift tax when property owned (or deemed owned) by the surviving spouse is distributed to her for her own use, the governing regulations provide that appointment of the QTIP to the surviving spouse is not treated as a disposition under *section 2519*. *See Treas. Reg. § 25.2519-1(e)* ("The exercise by any person of a power to appoint [QTIP] to the donee spouse is not treated as a disposition under *section 2519*, even though **[*35]** the donee spouse subsequently disposes of the appointed property."); *cf. I.R.C. § 2056(b)(7)(B)(ii)(II)* (providing that a surviving spouse can hold a qualifying income interest for life in QTIP only when "no person has a power to appoint any part of the property to any person *other than the surviving spouse*" (emphasis added)). As a result, no gift tax applies

[23] In a continuation of this theme, at the February 21, 2024, hearing, the Commissioner highlighted an example from a Joint Committee report applying *section 2519* to a court-ordered termination of a QTIP trust. *See* Staff of J. Comm. on Tax'n, 97th Cong., General Explanation of the Economic Recovery Tax Act of 1981, JCS-71-81, at 235-36 (J. Comm. Print 1981). But, as in the Commissioner's other examples, the surviving spouse was treated as making a gift *because* the assets in the trust were distributed proportionately to the surviving spouse *and the remaindermen*. Again, this distinction proves fatal to the Commissioner's argument.


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in the event of an appointment.[24] We see no reason to reach a contrary result here, where as a result of the Superior Court's order the Marital Trusts distributed the QTIP to Sally by analogous means.[25]

2. *Treasury Regulation § 25.2519-1(a)*

The Commissioner cites *Treasury Regulation § 25.2519-1(a)* as confirming his view that gift tax is imposed anytime a surviving spouse disposes of a qualifying income interest in QTIP. That regulation states as follows:

> *Treas. Reg. § 25.2519-1(a)*. In general. If a donee spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under *section 2056(b)(7)* or *section 2523(f)* for the transfer creating the qualifying income interest, the donee spouse is treated for purposes of *chapters 11* and *12 of subtitle B of the Internal Revenue Code* as transferring all interests in property other than the qualifying income interest. For example, if the donee spouse makes a disposition of part of a qualifying income interest for life in **[*36]** trust corpus, the spouse is treated under *section 2519* as making a transfer subject to chapters 11 and 12 of the entire trust other than the qualifying income interest for life. Therefore, the donee spouse is treated as making a gift under *section 2519* of the entire trust less the qualifying income interest, and is treated for purposes of *section 2036* as having transferred the entire trust corpus, including that portion of the trust corpus from which the retained income interest is payable. A transfer of all or a portion of the income interest of the spouse is a transfer by the spouse under *section 2511*. See also *section 2702* for special rules applicable in valuing the gift made by the spouse under *section 2519*.

The Commissioner may be focused on the third sentence. But the third sentence does not say that transfers under *section 2519(a)* are always treated as gifts. Rather, it completes the example posited by the second sentence, in which the donee spouse has disposed of part of a qualifying income interest for life, presumably for no consideration or for consideration matching the value of the disposed-of partial interest. (That is why the third sentence refers to the "trust corpus" rather than "property" and the donee spouse's "retained income interest.") In the circumstance **[*37]** posited by the second sentence (which makes no mention of the donee spouse receiving anything in return in connection with the disposition), the third sentence correctly

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[24] Indeed, at the February 21, 2024, hearing, the Estate maintained that the case could be decided simply by applying *Treasury Regulation § 25.2519-1(e)*. In the Estate's view, the Superior Court's order that the Marital Trusts trustee "is directed to transfer all assets of said [Trusts] to Sally" should be interpreted as a court-ordered exercise of a power of appointment in favor of Sally. *See also* Pet'r's Reply to Resp't's Obj. to Pet'r's Mot. 5-7. In view of our analysis above, we need not rest our decision on this point, although we acknowledge the force of the argument.

[25] The Commissioner points out that a QTIP election is irrevocable. But Alvin's estate did not revoke its election. And our analysis applies the QTIP regime to Sally's transactions, respecting the election.


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recognizes that the donee spouse is treated as making a gift of the entire trust less the qualifying income interest.[26]

The third sentence, however, does not state a general rule for all *section 2519* purposes.[27] Rather, the general rule is found in the regulation's first sentence, which provides simply that "the donee spouse is treated . . . as *transferring* all interests in property other than the qualifying income interest." *Treas. Reg. § 25.2519-1(a)* (emphasis added). Other provisions of the regulations reiterate this point. *See, e.g., id. para. (c)* (describing how to determine "[t]he amount treated *as a transfer* under this section" (emphasis added)).

3. Estate of Kite

The Commissioner also makes much of *Estate of Kite, T.C. Memo. 2013-43*. In that case, we considered a surviving spouse (Mrs. Kite) who, like Sally, acquired an income interest in QTIP upon the death of her spouse. *Id. at *36*. The QTIP was held in a trust. Eventually that trust was terminated, and the entire interest in the trust property **[*38]** was distributed to another trust created for Mrs. Kite's benefit. *Id. at *39*. Two days later, Mrs. Kite's trust sold the entirety of the property to her spouse's children, receiving private annuity agreements in return. *Id. at *39-40*. In relevant part, the private annuity agreements were unsecured, and the first payments were not due until 10 years after the sale. *Id. at *40*. The annuities were structured in such a way that, if Mrs. Kite (who was in her 70s at the time and receiving in-home medical care) died before the first payments were due, then "her annuity interest would terminate" and the income from the annuities (which the Court determined were adequate and full consideration for the qualified terminable interest property) would no longer be part of her gross estate and would escape estate tax. *Id. at *13*. And in fact, Mrs. Kite did die before any annuity payments were made. *Id. at *17*.

On these facts and assuming the form of Mrs. Kite's transactions were respected, the value of the QTIP that was deemed to pass to Mrs. Kite (and for which a marital deduction had been taken) would have escaped estate and gift tax altogether. Observing that the form of the transaction would allow **[*39]** Mrs. Kite's estate to "circumvent the QTIP regime" and "avoid any transfer tax," this Court (at the Commissioner's urging) applied the substance over form doctrine to treat the transactions as one integrated transaction. *Id.*

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[26] Similarly, "[f]or those who consider legislative history relevant," *Warger v. Shauers, 574 U.S. 40, 48, 135 S. Ct. 521, 190 L. Ed. 2d 422 (2014)*, the legislative history the Commissioner cites confirms that gift tax applies when QTIP is transferred for limited or no consideration, *see* H.R. Rep. No. 97-201, at 161 (1981), *as reprinted in* ***1981-2 C.B. 352, 378*** ("If the property is subject to tax as a result of the spouse's lifetime transfer of the qualifying income interest, the entire value of the property, *less amounts received by the spouse upon disposition*, will be treated as a taxable gift by the spouse under new *Code sec. 2519*." (Emphasis added.)).

[27] Even if the third sentence did attempt to articulate a more general rule, the Supreme Court tells us that "self-serving regulations never 'justify departing from the statute's clear text.'" *Niz-Chavez v. Garland, 593 U.S. 155, 169, 141 S. Ct. 1474, 1485, 209 L. Ed. 2d 433 (2021)* (quoting *Pereira v. Sessions, 585 U.S. 198, 138 S. Ct. 2105, 2118, 201 L. Ed. 2d 433 (2018)*).


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*at *40-43*. And, in doing so, the Court concluded that the termination of the trust and subsequent sale of property was a disposition for purposes of *section 2519(a)*. *Estate of Kite, T.C. Memo. 2013-43, at *41*.

The case before us differs in material respects from *Estate of Kite*. To begin, the Commissioner has not asked that we apply the substance over form doctrine. Moreover, like the Commissioner's other authorities, *Estate of Kite* involved an apparent attempt to prevent estate or gift tax from ever being imposed on the residual value of the QTIP for which a marital deduction had been taken. Neither circumstance is present here, so *Estate of Kite* provides the Commissioner no help.

4. *No Consideration*

Citing *Commissioner v. Wemyss, 324 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958, 1945 C.B. 416 (1945)*, the Commissioner argues that, in the estate and gift tax context, "adequate and full consideration is that which replenishes, or augments, the donor's taxable estate." R. Memo. 31. We fully agree with this simple proposition. *See Commissioner v. Wemyss, 324 U.S. at 307* ("The section taxing as gifts transfers that **[*40]** are not made for 'adequate and full [money] consideration' aims to reach those transfers which are withdrawn from the donor's estate." (Alteration in original.)). But the Commissioner further contends that the receipt of the Al-Sal shares could not "enhance or augment [Sally's] taxable estate" and therefore could not constitute full and adequate consideration in her hands. R. Memo. 33. With respect to this second proposition, we could not disagree more.

The Commissioner reasons that, before the termination of the Marital Trusts, the value of the Al-Sal shares was already includible in Sally's taxable estate. *See I.R.C. § 2044*. Therefore, the Commissioner concludes, Sally's later receipt of the shares could not have constituted adequate and full consideration to her, because she already was deemed to own them. The Commissioner's position amounts to wanting to have your cake and eat it too.

To take a step back, it is true that, under the QTIP regime, the value of the Al-Sal shares was includible in Sally's gross estate before the Marital Trusts were terminated and the shares were distributed. But the Commissioner urges us to conclude (and for purposes of our decision we assume) that the termination **[*41]** of the Marital Trusts was a disposition that triggered *section 2519(a)*. So, when the Marital Trusts terminated, *section 2519(a)* deemed Sally to have transferred away all the interests in the Al-Sal shares other than her qualifying interest for life. Or, put another way, *section 2519(a)* deemed Sally as giving up the remainder interests that she previously was deemed to have received from Alvin. This in turn resulted in a (temporary, as we will momentarily see) diminution of her estate.

But the transaction did not stop there, and our analysis is not yet finished. The Superior Court ordered that all of the property held by the Marital Trusts be distributed to Sally. And that is what happened. Thus, promptly after Sally was deemed to have transferred away the remainder interests in the Al-Sal shares, she


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received right back outright ownership of the Al-Sal shares. The receipt of those shares "replenished" or "augmented" her (temporarily) diminished estate. In analyzing the tax consequences of the deemed transfer *section 2519* contemplates, we cannot ignore that, as part of the same transaction, Sally in fact wound up with the unencumbered Al-Sal shares. We therefore decline the Commissioner's invitation to decide the case by taking into account **[*42]** only half of the relevant transaction.[28]

The Commissioner would have us treat the circumstances here the same from a gift tax perspective as we would treat a termination of the Marital Trusts that was followed by a hypothetical distribution to Sally of the value of her qualifying income interest only, with the value of the remainder interests distributed to Steven and Neil. But the two situations are not remotely the same.[29] *See, e.g.,* *Merrill v. Fahs, 324 U.S. 308, 311, 65 S. Ct. 655, 89 L. Ed. 963, 1945 C.B. 418 (1945)* ("The guiding light is . . . [that] '[t]he gift tax [i]s supplementary to the estate tax. The two are in *pari materia* and must be construed together.'" (quoting *Estate of Sanford v. Commissioner, 308 U.S. at 44*)).

5. *Summary*

To summarize, in each of the Commissioner's cited sources, imposing the estate or gift tax resulted in one-time taxation of the value of the remainder interests in QTIP at the time that value left (or was deemed to leave) the surviving spouse's hands. This is fully consistent with the QTIP regime and the marital deduction, which, again, do not eliminate or reduce the tax on the transfer of marital assets out of the marital unit, but rather permit deferral until the death of or gift by the surviving spouse. *See* *Estate of Morgens, 133 T.C. at 410*. In short, the authorities the Commissioner cites do not support **[*43]** his position.

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[28] The Commissioner's arguments in this regard are similar to those the taxpayer offered in *Estate of Morgens*, where the taxpayer sought to take advantage of the QTIP regime while refusing to accept the consequences of the fiction the regime imposes. *See* *Estate of Morgens v. Commissioner, 678 F.3d at 776 n.7* (stating that the taxpayer "ignores the underlying premise of the QTIP regime, that the entire QTIP property . . . is deemed to pass to, and then from, the surviving spouse"). Both our Court and the Ninth Circuit found the taxpayer's arguments unavailing. *See id.* ("The [taxpayer] cannot first use that favorable tax deferral (the *§ 2056* marital deduction) and then claim that the property never actually passed to Mrs. Morgens."); *Estate of Morgens, 133 T.C. at 418-20* (same). We see no reason for the Commissioner's arguments to fare any better here.

[29] To reiterate, in both situations, before the termination of the Marital Trusts and distribution of the QTIP property, the fair market value of that property was $25,450,000, and the fair market value of Sally's income interest was $2,599,463. After the termination, in the case before us, Sally actually held all the interests in the property, preserving the full $25,450,000 of value in her estate for future taxation. The value of that property, in other words, did not leave the marital unit. *See* *Estate of Morgens v. Commissioner, 678 F.3d at 771* ("The purpose of the QTIP regime is to treat the two spouses as a single economic unit with respect to the QTIP property ....").

In the second, hypothetical scenario, Sally would receive only $2,599,463 from the Marital Trusts. Thus, there would be no consideration for Sally's deemed transfer of the remainder interests. And, if gift tax were not imposed, the value of those remainder interests ($22,850,537) would have left the marital unit without ever being subject to estate or gift tax. In this situation, imposing the gift tax is appropriate and required by the Code. But, in the case before us, no such requirement exists as the value of the QTIP does not leave the marital unit.


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IV. *Conclusion*

For the reasons discussed above, we will grant the Estate's Motion for Partial Summary Judgment and deny the Commissioner's Motion.

To reflect the foregoing,

*An appropriate order will be issued*.

Reviewed by the Court.

KERRIGAN, FOLEY, BUCH, NEGA, PUGH, ASHFORD, URDA, COPELAND, JONES, GREAVES, MARSHALL, and WEILER, *JJ.*, agree with this opinion of the Court.

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# *McDougall v. Comm'r*

United States Tax Court

September 17, 2024, Filed

Docket Nos. 2458-22, 2459-22, 2460-22

**Reporter**
2024 U.S. Tax Ct. LEXIS 2281 *; 163 T.C. No. 5

BRUCE E. MCDOUGALL, DONOR, ET AL.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

**Subsequent History:** Summary judgment granted by, in part, Summary judgment denied by, in part, Partial summary judgment granted by, in part, Partial summary judgment denied by, in part *McDougall v. Comm'r, 2024 U.S. Tax Ct. LEXIS 2357 (T.C., Sept. 23, 2024)*

**Disposition:** An appropriate order will be issued. Reviewed by the Court.

## Case Summary

### Overview

HOLDINGS: [1]-In a suit by taxpayer petitioners, a surviving spouse and his two children, challenging gift tax assessments by respondent IRS as to qualified terminable interest property (QTIP) property, under Estate of Anenberg, petitioners' implementation of a nonjudicial agreement resulted in no taxable gift made by the father, but did result in a taxable gift by the children, who could not invoke the QTIP fiction, and whose gifts were not reciprocal gifts that offset each other since, by its terms, *I.R.C. § 2519(a)* did not deem a gift, only a transfer, so there were no deemed gifts from the father to the children to offset the very real gifts from the children to the father since the children never actually obtained anything of value from the father as a result of the agreement.

### Outcome
Motions granted in part, denied in part.

## Syllabus

Upon D's death in 2011, the residuary of her estate passed, under the terms of her will, to a trust (Residuary Trust) in which S, her husband, had an income interest and their two children (C1 and C2) had remainder interests. S, as representative of D's estate, elected under *I.R.C. § 2056(b)(7)* to treat the Residuary Trust property as qualified terminable interest property. In 2016, S, C1, and C2 entered into an agreement under

[1] Cases of the following petitioners are consolidated herewith: Linda M. Lewis, Donor, Docket No. 2459-22; and Peter F. McDougall, Donor, Docket No. 2460-22.

which the Residuary Trust was commuted and all its assets were distributed to S. S promptly sold some of the assets he received from the Residuary Trust to other trusts established for the benefit of C1 and C2 and their children, in exchange for promissory notes.

S, C1, and C2 separately filed gift tax returns for 2016 and reported that the transactions described above resulted in offsetting reciprocal gifts and no gift tax.

R examined the gift tax returns and issued a Notice of Deficiency to each of S, C1, and C2 determining that (1) the commutation of the Residuary Trust resulted in gifts from S to C1 and C2 under *I.R.C. § 2519* and (2) the agreement resulted in gifts from C1 and C2 to S of the remainder interests in the Residuary Trust under *I.R.C. § 2511*. Timely Petitions for redetermination of the deficiencies followed.

S, C1, and C2 filed a Motion for Summary Judgment seeking a ruling that no taxable gifts occurred under the transactions described above. R filed a Motion for Partial Summary Judgment seeking rulings that (1) the agreement to commute the Residuary Trust was a disposition of S's qualifying income interest pursuant to *I.R.C. § 2519* and resulted in gift tax liability for S, (2) the agreement to commute the Residuary Trust resulted in gifts to S by C1 and C2 under *I.R.C. § 2511*, and (3) S's deemed gift under *I.R.C. § 2519* and C1's and C2's gifts to S are not offsetting reciprocal gifts. In the alternative to ruling (1), R requests a ruling that the commutation coupled with the transfer of the Residuary Trust property in exchange for promissory notes is a disposition of S's qualifying income interest under *I.R.C. § 2519* and resulted in gift tax liability for S.

*Held*: The consequences of the transactions here are governed by the principles set out in *Estate of Anenberg v. Commissioner, No. 856-21, 162 T.C. No. 9 (May 20, 2024)* (reviewed).

*Held, further*, following *Estate of Anenberg*, assuming there was a transfer of property under *I.R.C. § 2519* when the Residuary Trust was commuted, S is not liable for gift tax under *I.R.C. § 2501* because S made no gratuitous transfers, as required by *I.R.C. § 2501*.

*Held, further*, following *Estate of Anenberg*, the commutation of the Residuary Trust coupled with the transfer of the Residuary Trust property in exchange for promissory notes did not result in gifts from S to C1 and C2.

*Held, further*, the agreement to commute the Residuary Trust resulted in gifts to S by C1 and C2 under *I.R.C. § 2511*.

*Held, further*, Ps' Motion for Summary Judgment will be granted in part and denied in part.

*Held, further*, R's Motion for Partial Summary Judgment will be granted in part and denied in part.

**Counsel:** **[*1]** John W. Porter, Keri D. Brown, and Tyler R. Murray, for petitioners.

Amy Chang, Hannah E. Linsenmayer, Melanie E. Senick, and Melissa D. Lang, for respondent.

**Judges:** TORO, Judge. KERRIGAN, FOLEY, BUCH, NEGA, PUGH, ASHFORD, URDA, COPELAND, JONES, GREAVES, MARSHALL, and WEILER, JJ., agree with this opinion of the Court. HALPERN, J., concurs in the result.

**Opinion by:** TORO

## Opinion

TORO, *Judge*: In these gift tax cases, we return to a subject we considered only a few months ago: the qualified terminable interest property (QTIP) regime. *See* *Estate of Anenberg v. Commissioner, No. 856-21, 162 T.C. No. 9 (May 20, 2024)* (reviewed). As in *Estate of Anenberg*, we address the gift tax implications of (1) the termination of a QTIP marital trust (Residuary Trust), (2) the distribution of all the assets of the Residuary Trust to the surviving spouse pursuant to a nonjudicial agreement among the surviving spouse and his children who held remainder interests in the Residuary Trust, and (3) the subsequent sale of substantially all of those assets by the surviving spouse to trusts for the benefit of the children in exchange for promissory notes. Also as in *Estate of Anenberg*, we must decide whether the surviving spouse made gifts as a result of these transactions. In addition, we must decide whether the children's **[*2]** transfers of their remainder interests to the surviving spouse were gifts, a question we specifically left open in *Estate of Anenberg*.

Now before us are a Motion for Summary Judgment filed by petitioners, Bruce E. McDougall (Bruce), Linda M. Lewis (Linda), and Peter F. McDougall (Peter), and a Motion for Partial Summary Judgment filed by the Commissioner of Internal Revenue. Applying the principles set out in *Estate of Anenberg*, we conclude that Bruce (the surviving spouse) made no gifts, but that Linda and Peter (his children) did so. Accordingly, we will grant each Motion in part and deny each in part.

*Background*

The following facts are derived from the parties' pleadings, Motion papers, the Stipulation of Facts, and the attached Exhibits. They are stated solely for the purpose of ruling on the Motions before us and not as findings of fact in these cases. *See* *Rowen v. Comm'r, 156 T.C. 101, 103 (2021)* (reviewed).


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Clotilde McDougall died in December 2011, survived by her husband Bruce and their two adult children, Linda and Peter. At that time, Clotilde's gross estate was valued at $59.76 million. Bruce served as personal representative of Clotilde's estate.

Under her will, Clotilde left the residue of her estate to the Residuary **[*3]** Trust. Bruce was the trustee of the Residuary Trust.

The will provided for the distribution to Bruce, at least annually, of the Residuary Trust's net income. It also allowed the trustee to distribute principal to Bruce, in the trustee's discretion, "to provide for [Bruce's] health, maintenance and support in his accustomed manner of living." Stipulation of Facts Ex. 1-J, at ¶ 5.1.2.

The will granted Bruce a testamentary limited power to appoint the principal of the Residuary Trust "to or among [Clotilde's] descendants, equally or unequally, outright or in trust, on such terms and in such amounts as he shall determine." Stipulation of Facts Ex. 1-J, at ¶ 5.3. Upon Bruce's death, to the extent that he did not exercise his power of appointment, the remainder of the Residuary Trust was to be divided "into equal shares, one share for each of [Clotilde's] children who is then living and one share for each of [her] children who is then deceased with descendants then living." Stipulation of Facts Ex. 1-J, at ¶ 6.2.

Clotilde's will provided that, upon the termination of any trust created under the will, the trustee was to distribute the trust assets among its beneficiaries. The distributions did **[*4]** not have to be pro rata, "so long as the distributees receive assets of a value equal to the value of their respective interest in the trust as of the time of distribution." Stipulation of Facts Ex. 1-J, at ¶ 12.8.

The parties stipulated that Bruce, as personal representative of Clotilde's estate, "made a qualified terminable interest property (QTIP) election . . . with respect to the property that funded the Residuary Trust." As a result, Clotilde's estate claimed a marital deduction of about $54 million.

By 2016, the value of the assets in the Residuary Trust had more than doubled, and Bruce, Linda, and Peter agreed that those assets could be more effectively used if Bruce held them outright and free of trust. In October 2016, Bruce, Linda, and Peter entered into an agreement concerning the Residuary Trust assets (Nonjudicial Agreement). Section 2 of the Nonjudicial Agreement provides: "The parties hereby agree that the Trust shall be commuted and the entire remaining balance of the Trust shall be distributed outright and free of trust to Bruce." Stipulation of Facts Ex. 3-J, at 4.

Section 3 of the Nonjudicial Agreement provides:

> By signing this Agreement and by virtue of the QTIP election **[*5]** for the [Residuary] Trust, the commutation of the Trust results in a deemed gift, for federal gift tax purposes, of the remainder interest in the Trust assets from Bruce to Linda and Peter under *Section 2519* of the Code. By virtue of the distribution of all of the Trust assets to Bruce, the commutation of the Trust does not result in a deemed


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> gift of Bruce's income interest in the Trust under *Section 2511* of the Code. Additionally, by signing this Agreement and by virtue of the distribution of all of the Trust asset [sic] to Bruce, the commutation of the Trust results in a gift, for federal gift tax purposes, of the remainder interest in the Trust from Linda and Peter to Bruce. The deemed gift of the remainder interest from Bruce to Linda and Peter and the gift from Linda and Peter to Bruce results in a reciprocal gift transfer.

Stipulation of Facts Ex. 3-J, at 4.

On the same day that the last of the parties signed the Nonjudicial Agreement, Bruce transferred assets he received from the Residuary Trust to trusts established for the benefit of Linda, Peter, and their descendants (Children's Trusts). In exchange, Bruce received promissory notes.[2]

Bruce, Linda, and Peter each filed a 2016 Form 709, United States **[*6]** Gift (and Generation-Skipping Transfer) Tax Return. Each return includes an explanatory statement that describes the taxpayer's view of the transactions effected by section 2 of the Nonjudicial Agreement. Each statement accepts that the commutation of the Residuary Trust resulted in a disposition under *section 2519(a)*[3] of Bruce's qualifying income interest in the trust with the consequence that he was treated as having transferred to Linda and Peter the remainder interest in the trust. But each statement also advances the position that no taxable gifts resulted because Bruce's deemed transfers were offset by transfers of the same assets back to him by Linda and Peter. For example, like section 3 of the Nonjudicial Agreement, Bruce's Form 709 states:

> Under *IRC Section 2519 (a)* [sic], the commutation of the Trust results in a deemed gift for federal gift tax purposes of the remainder interest in the Trust assets . . . from Taxpayer [Bruce] to Daughter [Linda] and Son [Peter]. . . . Further, by the non-judicial agreement to distribute all assets to Taxpayer there is a transfer of the remainder interest from Daughter and Son to Taxpayer. Accordingly, the deemed gift of the remainder interest by Taxpayer to Daughter and Son, **[*7]** and the transfer of the same assets from Daughter and Son to Taxpayer results in a reciprocal gift transfer.

Stipulation of Facts Ex. 4-J, at 329.

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[2] The parties disagree about some of the details of Bruce's transfers to the Children's Trusts. For example, petitioners claim that the principal amount of the notes Bruce received equaled the value of the assets he transferred to the Children's Trusts. The Commissioner disputes that those transfers "were for adequate and full consideration." Resp't's Obj. to Pet'r's Mot. for Summ. J. (Resp't's Obj.) 12 n.20. In addition, the Commissioner contends that Bruce did not transfer to the Children's Trusts all the assets he received from the Residuary Trust. The Commissioner claims that "the record is devoid of facts as to what occurred with the other assets of the Residuary . . . Trust." Resp't's Obj. 13. He accepts, however, that Bruce transferred to the Children's Trusts "substantially all" the assets he received from the Residuary Trust. The disputed details concerning Bruce's transfers to the Children's Trusts are not material to the issues addressed in this Opinion.

[3] Unless otherwise indicated, statutory references are to the Internal Revenue Code, Title 26 U.S.C. (I.R.C. or Code), in effect at all relevant times, regulation references are to the *Code of Federal Regulations*, Title 26 (Treas. Reg.), in effect at all relevant times, and Rule references are to the Tax Court Rules of Practice and Procedure.


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Linda's and Peter's Forms 709 include statements that are identical except for the use of different labels (Father, Sister, Brother) for the parties.

In separate Notices of Deficiency issued on the same date, the Commissioner determined a deficiency in the gift tax liability of each of Bruce, Linda, and Peter for 2016. The Notice of Deficiency issued to Bruce stated the Commissioner's determination that the commutation of the Residuary Trust "resulted in a gift from the Taxpayer to the remainder beneficiaries under *Internal Revenue Code sec. 2519*." The Notices of Deficiency issued to Linda and Peter each stated the Commissioner's determination that the distribution to Bruce of all the property of the Residuary Trust "constitutes a transfer of the remainder interest in the . . . Trust and a gift by the remainder beneficiaries under *Internal Revenue Code sec. 2511*." Stipulation of Facts Ex. 8-J, at 9; *id.* Ex. 9-J, at 9.

Bruce, Linda, and Peter all filed timely Petitions with our Court for redetermination of the gift tax liabilities. They resided in the State of Washington at the **[*8]** time.

The Commissioner has moved for partial summary judgment seeking rulings that (1) "the October 31, 2016 Nonjudicial Agreement to commute and terminate the . . . Residuary Trust . . . was a disposition of [Bruce's] qualifying income interest pursuant to *section 2519*," (2) "the distribution of all trust property to Bruce pursuant to the October 31, 2016 Nonjudicial Agreement to commute and terminate the Residuary . . . Trust were gifts pursuant to *section 2511* to Bruce by [Linda] and [Peter] each of their right to receive a pro rata share of the assets allocable to the[ir] remainder interest," and (3) "Bruce's deemed gift pursuant to *section 2519* and Linda's and Peter's gifts to Bruce . . . do not constitute offsetting consideration for each other, and as such are not offsetting reciprocal gifts." Resp't's Mem. in Supp. of Mot. for Partial Summ. J. (Resp't's Mem.) 1-2. In the alternative to ruling (1), the Commissioner requests a ruling that "the October 31, 2016 Nonjudicial Agreement to commute and terminate the Residuary . . . Trust and distribute all trust property to Bruce coupled with Bruce's immediate transfer of substantially all the Residuary . . . Trust property to irrevocable trusts for the benefit of Linda **[*9]** and Peter and their descendants in exchange for promissory notes is a disposition of Bruce's qualifying income interest pursuant to *section 2519*." Resp't's Mem. 2.

Bruce, Linda, and Peter have moved for summary judgment "that no taxable gifts occurred and that no gift tax deficiencies exist." Pet'r's Mot. for Summ. J. 4.

*Discussion*

I. *Summary Judgment Standard*

The purpose of summary judgment is to expedite litigation and avoid costly, time-consuming, and unnecessary trials. *Fla. Peach Corp. v. Commissioner, 90 T.C. 678, 681 (1988)*. The Court may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered


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as a matter of law. *Rule 121(a)(2)*; *Sundstrand Corp. v. Commissioner, 98 T.C. 518, 520 (1992)*, *aff'd*, *17 F.3d 965 (7th Cir. 1994)*. In deciding whether to grant summary judgment, we construe factual materials and inferences drawn from them in the light most favorable to the adverse party. *Sundstrand Corp., 98 T.C. at 520*. The parties agree that summary adjudication is appropriate here.

II. *General Legal Principles: The Marital Deduction, the QTIP Regime, and the Gift Tax Rules*

Our opinion in *Estate of Anenberg* sets out an extensive discussion of the marital deduction available for estate tax purposes, the QTIP regime, and the QTIP regime's interaction with the gift tax rules. *Estate of Anenberg, 162 T.C. No. 9, slip op. at 8-12*. We see no need to repeat that discussion here and turn instead **[*10]** to considering how the principles laid out in *Estate of Anenberg* apply to the circumstances now before us.[4]

III. *Application of* Estate of Anenberg

A. *Lessons from* Estate of Anenberg

In *Estate of Anenberg, 162 T.C. No. 9, slip op. at 4*, we faced the question "what happens when taxpayers subject to the QTIP regime take steps to conform their actual legal arrangements to the regime's legal fiction?" As we explained, the cross-motions for partial summary judgment there addressed the treatment of interests in property designated to be treated as QTIP when Alvin Anenberg (Alvin), the husband of Sally J. Anenberg (Sally), passed away. *Id.* The underlying property was held in trust. *Id.* Following Alvin's death, Sally obtained a qualifying income interest for life, and, upon her death, the remainder interests in the corpus would contingently go to trusts for the benefit of Alvin's children. *Id.* Eventually, with the consent of both Alvin's children and Sally, the trusts holding the underlying property were terminated by a state court and all the property held by the trusts was distributed to Sally, putting her in the position she would have been in if all that property had originally passed from Alvin to her. *Id.* Sally later made **[*11]** gifts of and sold different pieces of the underlying property to Alvin's children and grandchildren. *Id.* Sally passed away, leaving the gift tax consequences of these transactions to be resolved by her estate. *Id.*

Sally's estate argued that the transactions just described did not result in any gift tax liability for Sally. The Commissioner disagreed, relying on *section 2519*. We sided with Sally's estate, concluding Sally made no gift.

We began by examining the text of *section 2519*. It provides that, "[f]or purposes of [the chapter imposing the gift tax] and [the chapter imposing the estate tax], any disposition of all or part of a qualifying income interest for life in any [QTIP] shall be treated as a transfer of all interests in such [QTIP] other than the

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[4] In Part IV.A below, we address certain arguments about the scope of the QTIP fiction that we had no occasion to consider in *Estate of Anenberg*.


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qualifying income interest." *I.R.C. § 2519(a)*. We read the Code to say that, "for gift and estate tax purposes, *section 2519* treats any disposition of the surviving spouse's income interest in QTIP as if the surviving spouse transferred 100% of the remainder interests in QTIP." *Estate of Anenberg, 162 T.C. No. 9, slip op. at 11*. We then assumed (without deciding) that the termination of the trusts through which Sally held her qualifying income interest in the QTIP and the distribution of the QTIP to Sally by order of the court was **[*12]** a disposition within the meaning of *section 2519(a)*. *162 T.C. No. 9, slip op. at 13-14*. But, as we observed,

> [a] transfer alone, however, is insufficient to create a gift tax liability. Rather, *section 2501* tells us that gift tax applies "on the *transfer* of property *by gift* during [the] calendar year." *I.R.C. § 2501(a)(1)* (emphasis added); *[United States v.] Irvine, 511 U.S. [224,] 232, 114 S. Ct. 1473, 128 L. Ed. 2d 168 [(1994)]*; *see also* *Estate of Howard v. Commissioner, 910 F.2d 633, 636 (9th Cir. 1990)* (construing the provisions governing QTIPs and observing that "[i]n a statute so carefully crafted every difference counts"), *rev'g* *91 T.C. 329 (1988)*. And, as the Supreme Court observed in *Irvine*, "[w]e have repeatedly emphasized that [the Code's] comprehensive language was chosen to embrace all *gratuitous* transfers." *Irvine, 511 U.S. at 232-33* (emphasis added); *id. at 235* ("[T]he capacious language of *Internal Revenue Code §§ 2501(a)(1)* and *2511(a)* . . . encompasses all *gratuitous* transfers of property and property rights of significant value." (Emphasis added.)). In other words, a gratuitous transfer—not just a transfer—is required to impose gift tax.

*162 T.C. No. 9, slip op. at 14*.

And, under the facts in *Estate of Anenberg*, no gratuitous transfer had occurred. As we noted:

> To determine whether Sally made a gift, in connection with the deemed transfer, we compare what she had before and after the transaction. When doing so, we find that, after the transaction, Sally had full ownership of the [QTIP]. As **[*13]** a result of the Superior Court's order, she received free and clear the underlying property that *section 2056(b)(7)* deemed her to have received from Alvin to start with and with respect to which (we assume) *section 2519(a)* deemed her to have transferred remainder interests upon the termination of the Marital Trusts. Put another way, Sally's deemed transfer of the remainder interests in the [QTIP] held in trust (other than her qualifying income interest) resulted in her actual receipt of all the [QTIP] unencumbered (other than those attributable to her qualifying income interest). At the end of the day, she gave away nothing of value as a result of the deemed transfer. Accordingly, the termination of the Marital Trusts did not result in any "gratuitous transfers" by Sally, deemed or otherwise. *See* *Irvine, 511 U.S. at 232*. Because there was no gratuitous transfer, she made no gift. A long line of cases echoes this principle. *See, e.g.,* *Turman v. Commissioner, 35 T.C. 1123, 1129 (1961)* (holding that a surviving spouse made no gift when she took under her husband's will and thereby gave up her one-half interest in their community property because the value of property she


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> gave up (the one-half interest) was less than what she received in return (a life estate in all the community property)); **[*14]** *Siegel v. Commissioner, 26 T.C. 743, 747 (1956)* (stating on similar facts that "[i]f [the taxpayer] received more than she surrendered then, of course, no gift has been made"), *aff'd*, *250 F.2d 339 (9th Cir. 1957)*.

*162 T.C. No. 9, slip op. at 14-15*.

We went on to reject several arguments the Commissioner made in resisting this conclusion, *162 T.C. No. 9, slip op. at 19-27*, as well as the Commissioner's alternative argument that a subsequent sale of the QTIP for promissory notes triggered *section 2519(a)*, *162 T.C. No. 9, slip op. at 18-19*.

Importantly for these cases, however, while concluding that Sally had made no gift, "[w]e express[ed] no view on whether the other beneficiaries of the Marital Trust could be treated as making a gift to Sally for gift tax purposes." *162 T.C. No. 9, slip op. at 18 n.18*.

B. *Consequences of* Estate of Anenberg *Holding for Cases Now Before Us*

The parties' positions in the Motions now before us are both similar to and different from those we faced in *Estate of Anenberg*.

As in *Estate of Anenberg*, the Commissioner maintains that the implementation of the Nonjudicial Agreement resulted in a gift made by Bruce or, in the alternative, that the implementation of the Nonjudicial Agreement coupled with the subsequent sale of the trust property for promissory notes resulted in a gift made by Bruce. We **[*15]** reject these arguments for the reasons we set out in *Estate of Anenberg*. *See* *162 T.C. No. 9, slip op. at 14-19*; *see also* *162 T.C. No. 9, slip op. at 20-27* (addressing the Commissioner's counterarguments). As with respect to Sally in that case, we conclude that Bruce made no gifts to Linda or Peter.[5]

Unlike in *Estate of Anenberg*, however, here the Commissioner also determined deficiencies against the holders of the remainder interests, Linda and Peter. The Commissioner argues that "[w]ith regard to Linda and Peter, there is no [QTIP] tax fiction at work." Resp't's Mem. 72. Rather, he says, "[t]hey received a remainder interest in the Residuary QTIP Trust assets at Clotilde's death." *Id.* The Commissioner observes

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[5] In view of this conclusion with respect to Bruce, we (again) need not decide whether the implementation of the Nonjudicial Agreement gave rise to "any disposition" of Bruce's qualifying income interest in the QTIP. *See* *Estate of Anenberg, 162 T.C. No. 9, slip op. at 13-14*. For purposes of our analysis we can assume (without deciding) that the commutation of the Residual Trust resulted in a disposition of Bruce's qualifying income interest. Moreover, the analysis with respect to Linda and Peter set out below would not change even if we were to conclude that the transactions at issue did *not* give rise to "any disposition" (and therefore that no transfer under *section 2519(a)* occurred with respect to Bruce). Accordingly, as in *Estate of Anenberg*, we leave for another day the complicated question of whether implementing the Nonjudicial Agreement gave rise to "any disposition" of Bruce's qualifying income interest for purposes of *section 2519(a)*.


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that "[t]his is a valuable property interest that became part of their estates at that time, and with respect to which they agreed to an immediate transfer to Bruce pursuant to the Nonjudicial Agreement." *Id.* The Commissioner reminds us "that federal gift tax is an excise tax on the transfer of property," and he concludes that "the transfers of Linda['s] and Peter's rights to a pro rata share of the Residuary QTIP Trust assets are taxable gifts." *Id.* He reasons that, "[b]ecause **[*16]** the assets are no longer part of either of their taxable estates and cannot be further transferred by Linda and Peter, they are no longer subject to further transfer taxation therein." *Id.* at 72-73.

The Commissioner's argument is well taken. Under the "gratuitous transfer" framework described in *Estate of Anenberg*, Linda and Peter plainly made gratuitous transfers. Before the implementation of the Nonjudicial Agreement, they held valuable rights, i.e., the remainder interests in the QTIP.[6] After the implementation of that agreement, which required their consent, Linda and Peter had given up those valuable rights by agreeing that all of the Residuary Trust assets would be transferred to Bruce. And they received nothing in return. By giving up something for nothing, Linda and Peter engaged in quintessential gratuitous transfers and are therefore subject to gift tax under *sections 2501* and *2511*. *See Estate of Anenberg, 162 T.C. No. 9, slip op. at 14-15*; *see also Jewett v. Commissioner, 455 U.S. 305, 310, 102 S. Ct. 1082, 71 L. Ed. 2d 170 (1982)* ("Our expansive reading of the statutory language [of *section 2501*] in *Smith [v. Shaughnessy, 318 U.S. 176, 180, 63 S. Ct. 545, 87 L. Ed. 690, 1943 C.B. 1144 (1943)]* unquestionably encompasses an indirect transfer, effected by means of a disclaimer, of a contingent future interest in a trust.").[7]

IV. *Petitioners' Arguments*

Petitioners' efforts to refute the conclusion that Linda and Peter made gifts to **[*17]** Bruce are unavailing.

A. *Scope of the QTIP Fiction*

We begin with a preliminary point. The fundamental premise of petitioners' argument seems to be that the QTIP fiction should apply with equal force to the children, not just the surviving spouse. And, moreover, that the fiction that the surviving spouse owns the property persists for all purposes of the Code. In essence, in petitioners' view, for gift tax purposes, the children simply had nothing that they could give away. Petitioners' arguments would have us apply the QTIP fiction too broadly, as the Commissioner points out.

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[6] To review, the QTIP assets that funded the Residuary Trust initially were worth approximately $54 million and had more than doubled in value by 2016. While Bruce was entitled to the income generated by the assets during his life, he could receive distributions of principal only to provide for his "health, maintenance and support in his accustomed manner of living." The remainder interests belonged to Linda and Peter.

[7] Given the procedural posture of the case, we do not of course decide here the value of the gifts Linda and Peter made to Bruce. That factual issue remains open for decision in future proceedings.


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We have already recognized that the QTIP fiction does not apply for all purposes. *See Estate of Mellinger v. Commissioner, 112 T.C. 26, 36-37 (1999)* ("Neither *section 2044* nor the legislative history indicates that decedent should be treated as the owner of QTIP property for [purposes of aggregating stock ownership in connection with valuing the stock]."). This principle is entirely consistent with the function of the QTIP regime—"namely, not eliminating or reducing tax on the transfer of marital assets out of the marital unit, but rather permitting deferral [of that transfer tax] until the death of or gift by the surviving spouse." *Estate of Anenberg, 162 T.C. No. 9, slip op. at 20*. All the provisions through which Congress enacted the **[*18]** QTIP regime are focused on deferring, imposing, and collecting that single tax. *See, e.g.*, *I.R.C. § 2056(b)(7)* (permitting through an estate tax deduction deferral of the transfer tax on assets leaving the marital unit); *I.R.C. § 2519* (triggering the deferred transfer tax if the surviving spouse makes an inter vivos gift of a portion of the QTIP); *I.R.C. § 2044* (triggering the deferred transfer tax on the QTIP when the surviving spouse dies); *I.R.C. § 2207A* (providing rules for the collection of the deferred transfer tax once it is triggered). Again, the focus of these rules is on the transfer of marital assets outside the marital unit. As the Commissioner points out, they say nothing about, and do not apply to, transactions that transferees outside the marital unit, such as Linda and Peter, may undertake with respect to their own interests in QTIP.

In short, Linda and Peter cannot invoke the QTIP fiction, which applies for the limited purpose of determining Bruce's transfer tax liability when marital assets leave the marital unit, to escape transfer tax on their own transactions.

B. *Reciprocal Gifts*

As noted above, petitioners' primary position is that Bruce, Linda, and Peter made reciprocal gifts that offset each other. The position is unpersuasive. **[*19]**

Petitioners' argument is based on the premise that "the commutation of the Trust results in a deemed gift, for federal gift tax purposes, of the remainder interest in the Trust assets from Bruce to Linda and Peter under *Section 2519* of the Code," as the Nonjudicial Agreement puts it. But this premise is incorrect. As we have already held (in concluding that Bruce made no gifts), by its terms, *section 2519(a)* does not deem a gift; it merely deems a transfer. Thus, there are no deemed gifts from Bruce to Linda and Peter to offset the very real gifts from Linda and Peter to Bruce.[8]

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[8] In view of this conclusion, we need not decide whether *United States v. Estate of Grace, 395 U.S. 316, 89 S. Ct. 1730, 23 L. Ed. 2d 332 (1969)*, and *Revenue Ruling 69-505, 1969-2 C.B. 179, Rev. Rul. 1969-505*, bear the reading petitioners give to those authorities. *See Stromme v. Comm'r, 138 T.C. 213, 218 n.8 (2012)* (observing that we should decide only what is needed to dispose of the case before us); *see also PDK Labs Inc. v. DEA, 362 F.3d 786, 799, 360 U.S. App. D.C. 344 (D.C. Cir. 2004)* (Roberts, J., concurring in part and concurring in the judgment) (same).

Nor did Linda and Peter ever actually obtain anything of value from Bruce as a result of the Nonjudicial Agreement. Under state law, they already had the remainder rights with respect to the Residuary Trust.[9] And a deemed transfer under *section 2519(a)* added nothing to their bundle of sticks. In other words, no matter the outcome under *section 2519(a)*, nothing of value passed to Linda and Peter that offset the value they gave up by relinquishing their remainder rights.

C. *Bruce's Existing Interest in the QTIP*

Petitioners also argue that Linda and Peter cannot have transferred anything to Bruce because, under the QTIP regime, Bruce was **[*20]** already deemed to own all of the QTIP. The argument is misplaced as well. Any rights Bruce may have been deemed to hold because of the QTIP fiction do not negate the very real interests Linda and Peter held because of Clotilde's will. And their decision to transfer those rights to Bruce gives rise to the potential gift tax consequences here. The focus of the analysis is whether Linda and Peter transferred valuable rights gratuitously. That Bruce may have already been deemed to hold those rights for purposes of determining *his* transfer tax liability is of no moment. As the governing regulations note:

> The gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

*Treas. Reg. § 25.2511-2(a)*.

The Commissioner correctly points **[*21]** out that "[i]f Linda and Peter were to transfer their remainder interests to a third party, the transfers would clearly be a gift and Petitioners admit as much." Resp't's Resp. to Pet'r's Resp. to Ct. Order 20-21, Dec. 22, 2023 (citing Pet'r's Resp. to Ct. Order 14 n.19, Nov. 27, 2023). That Bruce was the recipient of Linda's and Peter's largesse does not change this conclusion.

D. *Economic Positions of the Parties*

Petitioners also maintain no gift occurred because the economic positions of the parties were unchanged. That is simply not so. Before the implementation of the Nonjudicial Agreement, despite the QTIP fiction, Bruce did not own the assets of the Residuary Trust outright and could not do with them what he wished. After the implementation of the Nonjudicial Agreement, he did and could.

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[9] For rules governing the allocation of principal and income for purposes of the Residuary Trust, see the *Principal and Income Act, 2002 Wash. Legis. Serv. ch. 345 (West) (codified at Wash. Rev. Code Ann. ch. 11.104A* (West 2003)), *repealed and replaced by Uniform Fiduciary Income and Principal Act, 2021 Wash. Legis. Serv. ch. 140, §§ 2101-2809 (West) (codified at Wash. Rev. Code Ann. ch. 11.104B* (West 2022)).


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On the other hand, before the implementation of the Nonjudicial Agreement, Linda and Peter had remainder rights with respect to the Residuary Trust. After, they did not. Of course, under the terms of Clotilde's will, Bruce could have decided in his own will to reduce one of the children's share significantly.[10] But the Nonjudicial Agreement reduced both children's rights with respect to the Residuary **[*22]** Trust to nothing. And, as far as we can tell, going forward nothing in the Nonjudicial Agreement precluded Bruce from excluding Linda and Peter from a future will altogether. Moreover, while trusts established for their benefit (the Children's Trusts) eventually acquired assets transferred to Bruce from the Residuary Trusts, that was in exchange for issuing secured promissory notes to Bruce. Thus, the Children's Trusts would have to pay (albeit in the future) for the assets they received. Nothing came to those trusts simply as a result of the provisions of Clotilde's will (as might have occurred in the absence the Nonjudicial Agreement).

In short, the economic positions of the parties were indeed altered by the Nonjudicial Agreement.

V. *Conclusion*

In view of the foregoing, petitioners' Motion for Summary Judgment will be granted to the extent it asks us to conclude that Bruce did not make any gifts as a result of the transactions at issue. But that Motion will be denied to the extent it asks us to conclude that Linda and Peter did not make any gifts as a result of the transactions at issue either.

Relatedly, the Commissioner's Motion for Partial Summary Judgment will be granted **[*23]** to the extent that it asks us to conclude that Linda and Peter made gifts as a result of the transactions at issue. But that Motion will be denied to the extent it asks us to conclude that Bruce made gifts as a result of the transactions at issue.

We have considered all of the parties' arguments and, to the extent not discussed above, conclude they are irrelevant, moot, or without merit.[11]

To reflect the foregoing,

*An appropriate order will be issued*.

Reviewed by the Court.

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[10] The import (if any) of these terms for the value of Linda's and Peter's remainder rights remains to be decided. *See supra* note 7.

[11] The analysis in the Opinion Concurring in the Result misreads the holding of *Estate of Anenberg* and our holdings in these cases. *See* *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll., 600 U.S. 181, 230, 143 S. Ct. 2141, 216 L. Ed. 2d 857 (2023)* (An opinion that concurs only in the result "is generally not the best source of legal advice on how to comply with the majority opinion."). And the analytical path it offers is neither more straightforward nor sounder than the one we adopt. *See* concurring op. pp. 18, 29-30.


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KERRIGAN, FOLEY, BUCH, NEGA, PUGH, ASHFORD, URDA, COPELAND, JONES, GREAVES, MARSHALL, and WEILER, *JJ.*, agree with this opinion of the Court.

HALPERN, *J.*, concurs in the result.

**Concur by:** HALPERN

## Concur

HALPERN, *J.*, concurring in the result: While I agree with the results the majority reaches, I believe an alternative analysis to reach those results would have been preferable. The majority's analysis raises questions it does not adequately address. I therefore offer an alternative analysis that avoids those questions and, in my judgment, provides a sounder basis for the Court's conclusions.

I. *Questions Raised by the Majority's Analysis*

A. Estate of Anenberg*'s Alternative Rationales*

The majority suggests that its conclusion **[*24]** that "Bruce . . . made no gifts" can be reached by "[a]pplying the principles set out in *Estate of Anenberg*." Op. Ct. p. 3. In *Estate of Anenberg v. Commissioner, No. 856-21, 162 T.C. No. 9 (May 20, 2024)*, we addressed the consequences under *section 2519(a)* of the distribution to a surviving spouse of all the property in two QTIP trusts upon the trusts' termination. We concluded that, even if the termination of the trusts and the distribution to the surviving spouse of the trust property effected a "disposition," within the meaning of *section 2519(a)*, the resulting deemed transfer was not a taxable gift.

We offered two alternative rationales for our conclusion in *Estate of Anenberg* that any deemed transfer under *section 2519(a)* would not have been a gift. First, Sally Anenberg, the surviving spouse, "received free and clear the underlying property that *section 2056(b)(7)* deemed her to have received from Alvin [her deceased husband] to start with and with respect to which (we assume) *section 2519(a)* deemed her to have transferred remainder interests upon the termination of the Marital Trusts." *Estate of Anenberg, 162 T.C. No. 9, slip op. at 15*.

We observed that "[a] long line of cases echoes th[e] principle" that transfers that are not gratuitous are not gifts. *Id.* We cited two cases as examples: *Siegel v. Commissioner, 26 T.C. 743 (1956)*, *aff'd*, *250 F.2d 339 (9th Cir. 1957)*, and *Turman v. Commissioner, 35 T.C. 1123 (1961)*. Each case addressed a situation in which a wife gave up her share of community **[*25]** property to take under her deceased husband's will. The husband's will provided for the creation of a trust in which the wife received a life interest. The trust was funded with the couple's community property. By taking under her husband's will, the wife gave up the remainder interest in her share of the community property. And she received a life interest in the property


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that came from her husband. In each case, we concluded that the wife made a gift only to the extent that the value of what she gave up exceeded the value of what she received. We viewed what she received as consideration for what she gave up. As the U.S. Court of Appeals for the Ninth Circuit explained in affirming our decision in *Siegel*: "When the husband makes a testamentary disposition of more than half of the community property and the wife chooses to take under the will, the half interest in the estate which she surrenders is a contract supported by adequate consideration." *Commissioner v. Siegel, 250 F.2d at 345*.

Our opinion in *Estate of Anenberg, 162 T.C. No. 9, slip op. at 17*, invoked *section 2512* as "further confirm[ation]" that what Sally received in exchange for any deemed transfer under *section 2519(a)* made that transfer not gratuitous. *Section 2512(b)* provides: "Where property is transferred for less than an adequate and full consideration **[*26]** in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift . . . ." We noted that "[a] necessary corollary" of the rule stated in *section 2512(b)* "is that no taxable gift results to the extent the value of transferred property is equal to or less than the value of the consideration received." *Estate of Anenberg, 162 T.C. No. 9, slip op. at 17*. "[T]o the extent *section 2519* viewed Sally as transferring away the interests in property that the QTIP regime treated her as holding in the first place," we reasoned, "it is hard to understand why Sally would not have received full and adequate consideration in return when she was also at the receiving end of the transfer of the property unencumbered." *Id.*

As an alternative rationale for our conclusion that any deemed transfer by Sally under *section 2519(a)* was not a taxable gift, we observed that, under *Treasury Regulation § 25.2511-2*, "any gift by Sally would appear to be viewed as wholly incomplete." *Estate of Anenberg, 162 T.C. No. 9, slip op. at 16*. "[E]ven if we deem Sally to have transferred the remainder interests," we noted, "no value would appear to have passed from her to anyone else because she ultimately received all the property held by the Marital Trusts as part of the same transaction, leaving nothing on which the 'excise' **[*27]** could operate." *Id.* (citing *Treas. Reg. § 25.2511-2(a)*). "[A]fter the termination of the Marital Trusts," we observed, Sally "had full control over the disposition of the assets previously held in trust." *Id.* Sally was in the same position as if she had reserved and "promptly exercised" a "power to revest title in the property in herself." *Id.*, slip op. at 17.

*Estate of Anenberg*'s "adequate and full consideration" rationale and its "wholly incomplete gift" rationale are necessarily alternatives to each other. Either rationale could justify the conclusion that any deemed transfer by Sally under *section 2519* was not a taxable gift. But they cannot *both* support that conclusion simultaneously. Sally may have made a complete transfer for which she received adequate and full consideration. Or she might have made a wholly incomplete transfer for which she was not entitled to consideration. She cannot have done both at the same time.

In *Estate of Anenberg*, we had no reason to choose between the alternative rationales we offered. Either rationale supported our resolution of the only issue in that case.


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B. *Implications of* Estate of Anenberg*'s Alternative Rationales for Linda and Peter*

The cases now before us, however, raise an additional **[*28]** issue: whether Linda and Peter made taxable gifts to their father when they allowed him to receive the shares of Residuary Trust property that would otherwise have gone to them. Resolving that issue requires us to choose between *Estate of Anenberg*'s alternative rationales. Even if the choice of rationales does not affect our resolution of the additional issue now before us, that choice will at least affect the relevant analysis.

Under *Estate of Anenberg*'s wholly incomplete gift rationale, we could readily conclude that Linda's and Peter's transfers to Bruce were taxable gifts. Bruce's deemed transfer under *section 2519(a)* could not be viewed as having provided Linda and Peter with adequate and full consideration—regardless of the scope of the fiction underlying the QTIP rules—if Bruce's deemed transfer were wholly incomplete.

The majority's discussion of the scope of the QTIP fiction, however, suggests that it relies primarily on *Estate of Anenberg*'s adequate and full consideration rationale. Linda's and Peter's transfers to Bruce provided him with adequate and full consideration for any deemed transfer by him under *section 2519(a)*, but his deemed transfer cannot be viewed as having provided adequate and full consideration **[*29]** for Linda's and Peter's transfers to him. As the majority writes: "Linda and Peter cannot invoke the QTIP fiction" because that fiction (that Bruce owned, and could transfer, the interests in the QTIP other than his qualifying income interest) "applies for the limited purpose of determining Bruce's transfer tax liability when marital assets leave the marital unit." Op. Ct. pp. 13-14. Linda and Peter thus cannot "escape transfer tax" on their "very real" transfers to Bruce by claiming that a deemed transfer by Bruce under *section 2519(a)* provided them with adequate and full consideration. Op. Ct. p. 14.

The majority, as I understand it, thus treats the same transfers differently in determining the transfer tax consequences for the transferors (Linda and Peter) and the transferee (Bruce). Linda's and Peter's "very real" transfers to Bruce were, from his perspective, consideration for any deemed transfer he may have made under *section 2519(a)* but, from Linda's and Peter's perspective, their transfers were wholly gratuitous and thus taxable gifts.[1] I question whether the bounds of the QTIP fiction are so clearly delineated as to justify that differential treatment.

C. *The Scope of the QTIP Fiction*

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[1] Linda and Peter did not actually transfer any of the Residuary Trust property to their father. Instead, upon its termination, the trust distributed all its property directly to Bruce. Under a longstanding principle of tax law, however, if a taxpayer entitled to a payment directs the payor to make the payment to a third party, the taxpayer constructively receives the payment and then transfers the property so received to the ultimate recipient. *See, e.g., Old Colony Tr. Co. v. Commissioner, 279 U.S. 716, 49 S. Ct. 499, 73 L. Ed. 918, 1929-2 C.B. 222 (1929)*. The majority, in describing Linda and Peter as having made "very real" transfers to their father, apparently accepts the application of that principle in the present cases. So do I.


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As the majority **[*30]** observes, Linda and Peter did not "actually obtain anything of value from Bruce as a result of the Nonjudicial Agreement." Op. Ct. p. 14. In particular, any "deemed transfer [by Bruce] under *section 2519(a)* added nothing to [Linda's and Peter's] bundle of sticks." *Id.* Therefore, "nothing of value passed to Linda and Peter that offset the value they gave up by relinquishing their remainder rights." *Id.* I agree with all of that. Given that Bruce provided "nothing of value" to Linda and Peter, how can they be viewed as having provided consideration for nothing? Precisely because Linda and Peter received nothing of value from Bruce, they had no cause to provide him consideration.

*Estate of Anenberg*'s adequate and full consideration rationale thus posits that a surviving spouse can receive consideration for a transfer of property that the surviving spouse does not actually own—a deemed transfer that provides nothing of value to any transferee. That proposition lacks a clear statutory basis. *Section 2519(a)* requires that a "disposition" of a surviving spouse's qualifying income interest in QTIP "be treated as a transfer of all interests in [the QTIP] other than the qualifying income interest." But neither *section 2519(a)* nor any of **[*31]** the other provisions addressing QTIP expressly provide that the surviving spouse can be treated as having received consideration for a deemed transfer of interests in property that the surviving spouse does not actually own. The adequate and full consideration rationale thus extends the QTIP fiction beyond what the relevant statutory provisions expressly provide.

How far, then, does the QTIP fiction extend *beyond* the express terms of the relevant statutory provisions? The majority views petitioners as asking that we "apply the QTIP fiction too broadly." Op. Ct. p. 13. It describes petitioners as contending that "the fiction that the surviving spouse owns the [QTIP outright] persists for all purposes of the Code." *Id.* If that is what petitioners contend, and if that contention were correct, Linda and Peter could not have made taxable gifts of any interest in the QTIP. If Bruce were treated for all purposes as owing the QTIP outright, as the majority says, it would follow that Linda and Peter "simply had nothing [that is, no interest in the QTIP] that they could give away." *Id.*

But the majority mischaracterizes petitioners' argument, knocking down a straw man. Petitioners do *not* argue **[*32]** that Bruce has to be treated as the owner of all of the Residuary Trust property for all purposes relevant under the Code. As the majority acknowledges, petitioners "admit" that gratuitous transfers by Linda and Peter to a third party of their remainder interests in the Residuary Trust would be taxable gifts. Op. Ct. p. 15.

Similarly, the majority seizes on petitioners' use of what I would view as an infelicitous label to reject petitioners' "primary position." Op. Ct. p. 14. Petitioners sometimes refer to the transfers between Bruce and his children as "reciprocal gifts."

The phrase "reciprocal gift" is a misnomer. Offsetting, reciprocal transfers are not gifts. I am unaware of any "reciprocal gift" doctrine.

The authorities petitioners cite when they refer to reciprocal gifts or transfers, *United States v. Estate of Grace, 395 U.S. 316, 89 S. Ct. 1730, 23 L. Ed. 2d 332 (1969)*, and *Revenue Ruling 69-505, Rev. Rul. 1969-505, 1969-2 C.B. 179*, deal with the "reciprocal *trust*" doctrine, which applies when each of two settlors creates a trust for the other's benefit. To prevent the avoidance of *section 2036*, which includes in a decedent's estate property transferred subject to a retained life estate, the courts may treat each settlor as the grantor of the other's trust.

The reciprocal trust doctrine has no bearing on the present cases. The Residuary **[*33]** Trust is the only trust relevant to the issues before us. We have no occasion to "uncross" transfers to reciprocal trusts.

Thus, the majority sees no need to "decide whether *United States v. Estate of Grace* . . . and *Revenue Ruling 69-505, 1969-2 C.B. 179, Rev. Rul. 1969-505* . . . bear the reading petitioners give to those authorities." Op. Ct. p. 14 n.8. As I understand petitioners, they rely on *Revenue Ruling 69-505, Rev. Rul. 1969-505, 1969-2 C.B. 179* only for the general proposition that offsetting transfers result in a taxable gift only to the extent that the value of one transfer exceeds the other. (The ruling illustrates how that principle applies to the creation of a trust by joint tenants.)

I agree with the majority that, if any deemed *section 2519(a)* transfer is not a gift, that transfer and Linda's and Peter's transfers cannot be reciprocal gifts, whatever that might mean. But I would not dismiss petitioners' primary position on the basis of their occasional use of an anomalous phrase. While petitioners sometimes refer to reciprocal gifts, they more often describe Bruce, Linda, and Peter as having made "reciprocal transfers." They argue that Bruce made a deemed transfer under *section 2519(a)* and that that transfer and Linda's and Peter's transfers to him offset so that none of the transfers were **[*34]** taxable gifts.

The majority does not dispute that any deemed transfer by Bruce under *section 2519(a)* and Linda's and Peter's transfers to him were of equal value. That point is obvious: The offsetting transfers were of the same property (all of the interests in the Residuary Trust property other than Bruce's qualifying income interest). Instead, the majority recognizes the offsetting transfers only for the purpose of determining Bruce's transfer tax liability and not for the purpose of determining the transfer tax owed by Linda and Peter. It justifies that selective recognition of offsetting transfers by perceived limits on the scope of the QTIP fiction.

Returning to that question, for petitioners to prevail in their claim that Linda's and Peter's transfers to Bruce were not gifts because they were made for adequate and full consideration, petitioners need not establish that Bruce must be treated, for all purposes, as the owner of all the interests in the Residuary Trust property. Instead, their position can rest on a simple point of transactional consistency. If Linda's and Peter's transfers to Bruce provided him with adequate and full consideration for his deemed transfer under *section 2519(a)*, then their transfers **[*35]** cannot have been gratuitous. Transfers that, from Bruce's perspective, were consideration paid *to him* should be viewed, from Linda's and Peter's perspectives, as consideration paid *by them*.


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II. *An Alternative Analysis*

A. *Following* Estate of Anenberg*'s Wholly Incomplete Gift Rationale*

Questions about how far beyond the express terms of the relevant statutes the QTIP fiction extends could be avoided by choosing *Estate of Anenberg*'s wholly incomplete gift rationale over its adequate and full consideration rationale. Whether the QTIP fiction can, in some instances, treat a surviving spouse as receiving consideration for a deemed transfer of interests in property that the surviving spouse does not actually own, that treatment is inappropriate when the deemed transfer is, under the principles of *Treasury Regulation § 25.2511-2*, a wholly incomplete gift. A transferor who makes a wholly incomplete transfer is not entitled to any consideration. And any deemed transfer by Bruce under *section 2519(a)* would properly be characterized as wholly incomplete because, after that transfer, he owned all of the property he would be deemed to have transferred. *Section 2519(a)*, if applicable, would treat Bruce as having transferred "all interests in [the Residuary Trust] **[*36]** property other than [his] qualifying income interest." But after that deemed transfer, Bruce owned *all* the interests in the Residuary Trust property. As noted above, if any deemed transfer by Bruce under *section 2519(a)* was a wholly incomplete gift, it cannot have provided adequate and full consideration to Linda and Peter for their transfers to him.

The wholly incomplete gift analysis, however, may prove too much. It calls into question whether a disposition of Bruce's qualifying income interest in the Residuary Trust property occurred in the first instance. Bruce cannot have disposed of all or part of his qualifying income interest in the Residuary Trust property when he was left owning all the interests in that property.

B. *No Disposition Under Section 2519(a)*

Citing a 1981 edition of *Webster's Third New International Dictionary*, respondent advises us that "[t]he ordinary meaning of the noun 'disposition' is a placing elsewhere, a giving over to the care or possession of another, or a relinquishing; the transfer of property from one to another (as by gift, barter, or sale or by will) or the scheme or arrangement by which such transfer is effected."

Accepting respondent's proposed definition, Bruce **[*37]** obviously did not "plac[e]" his qualifying income interest "elsewhere." Both before and after the commutation of the Residuary Trust and the distribution of all the trust property to him, Bruce was solely entitled to the income produced by the trust property. Similarly, Bruce did not "giv[e] over" his qualifying income interest "to the care or possession of another." He did not "transfer" his qualifying income interest "to another," by "gift, barter, . . . sale . . . by will," or any other means. Therefore, whether the distribution of all the Residuary Trust property to Bruce effected a "disposition" of his qualifying income interest, within the ordinary meaning of the word, depends on whether he can be viewed as having "relinquished" that interest.


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That Bruce could be viewed as having relinquished his beneficial interest in the Residuary Trust is of no moment. By its terms, *section 2519(a)* applies to "any disposition of all or part of a qualifying income interest in property to which this section applies." In the present cases, the property to which *section 2519* applies is the property for which Clotilde's estate was allowed a deduction "under *section 2056* by reason of *subsection (b)(7)* thereof." *§ 2519(b)(1)*. In other words, *section 2519* applies to the property **[*38]** that, under the terms of Clotilde's will, funded the Residuary Trust. Bruce's beneficial interest in the trust is not the property to which *section 2519* applies. Therefore, the question before us is not whether Bruce disposed of his beneficial interest in the trust but whether he disposed of his qualifying income interest in the trust property. *Cf. Estate of Anenberg, 162 T.C. No. 9, slip op. at 13 n.14* (describing Sally, the surviving spouse, as having relinquished her interests in the Marital Trusts).

The proper framing of the question makes the answer clear: After the commutation of the Residuary Trust and the distribution of all the trust property to Bruce, he owned *all* the interests in the property. He might have relinquished his beneficial interest in the Residuary Trust, but he cannot have relinquished *any* interest in the property held in trust.

I accept that the distribution of all the Residuary Trust property to Bruce terminated his qualifying income interest for life. The right to income from property is one of the rights inherent in fee simple ownership. But the right to income inherent in fee simple title is not limited to the owner's life. Therefore, if "termination" were an acceptable synonym for "disposition," the distribution of the **[*39]** Residuary Trust property to Bruce could be viewed as a disposition of his qualifying income interest for life.

In *Revenue Ruling 98-8, 1998-1 C.B. 541, 542*, the Internal Revenue Service took the position that "[t]he term 'disposition,' as used in *§ 2519*, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means." The ruling purports to rely on H.R. Rep. No. 97-201, at 161 (1981), *as reprinted in 1981-2 C.B. 352, 378*, which states that property subject to a QTIP election is subject to transfer taxes if the surviving spouse "disposes (either by gift, sale, or otherwise) of all or part of the qualifying income interest." The committee report does not support the broad reading that Revenue Ruling 98-8 gives to the term "disposition." It indicates only that the term is not limited to gifts and sales. It does not follow that any termination of a qualifying income interest, by any means, is a disposition.

I thus conclude that, while the distribution of all the Residuary Trust property to Bruce *terminated* his qualifying income interest in the property, he did not *relinquish* that right. The termination of Bruce's qualifying income interest in the Residuary Trust property **[*40]** occurred without Bruce's having surrendered his right to the income from the trust property. He simply accepted the interests in the property that he had not beneficially owned before the commutation of the trust. He did not give up or surrender any interest in the trust property. Acceptance of additional rights to property that add to those previously owned cannot be viewed as a relinquishment of the previously owned rights. Because Bruce owned the trust


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property outright after the commutation of the trust and the distribution of all trust property to him, he cannot be viewed as having relinquished any interest in the property.

The conclusion that the distribution of all the Residuary Trust property to Bruce did not effect a disposition of his qualifying income interest in the trust property is fully consistent with the policies underlying the marital deduction rules in general and the QTIP rules in particular. The trust property would have been included in Bruce's gross estate under *section 2033* unless consumed or transferred by inter vivos gift.[2] In that event, *section 2033* would have served the role that would otherwise have been served by *section 2044(a)*.[3] It is thus unobjectionable that Bruce's acquisition of full ownership **[*41]** of the Residuary Trust property terminated his qualifying income interest in that property and negated the application of *section 2044(a)*. *Section 2519(a)* need not serve as a backstop to *section 2044(a)*.[4]

If the Residuary Trust had been commuted in accordance with the terms of Clotilde's will, with each beneficiary receiving a share of the trust assets with a value equal to his or her interest in the trust, the trust's termination would have effected a disposition of Bruce's qualifying income interest in the trust assets. In that event, Bruce would have relinquished any interest in the trust assets distributed to Linda or Peter. As explained above, however, the policies of the marital deduction rules would not justify ignoring that, pursuant to the Nonjudicial Agreement, Linda and Peter allowed their father to receive the shares of trust property that would otherwise have been distributed to them.[5]

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[2] *Section 2033* includes in a decedent's gross estate "the value of all property to the extent of the interest therein of the decedent at the time of his death."

[3] *Section 2044(a)* requires the value of QTIP in which a surviving spouse has a qualifying income interest to be included in his gross estate.

[4] In fact, Bruce transferred to the Children's Trusts, in exchange for promissory notes, at least some, and perhaps substantially all, of the property he received from the Residuary Trust. To the extent that the value of the property Bruce transferred exceeded the value of the notes, the transfer was a taxable gift. To the extent that the value of the transferred property did not exceed the value of the notes, the notes simply replaced the property for which Bruce received them, resulting in no diminution in Bruce's estate.

[5] Respondent argues that section 2 of the Nonjudicial Agreement effected "two discrete transactions." First, "Bruce, Linda, and Peter each received a right to a share of the trust assets in the form of a terminating distribution." And second, Linda and Peter transferred to Bruce "their right to receive their terminating distributions." Respondent would have us give "independent significance" to those two transactions. Even if section 2 of the Nonjudicial Agreement were viewed as effecting two transactions, those transactions were not independent. They were effected by a single provision of a single agreement. As noted in the text, the policies of the relevant statutory provisions do not require viewing the transactions as separate, finding a disposition of Bruce's qualifying income interest by viewing the first step by itself, without taking into account the effects of the second step. *Cf. Estate of Anenberg, 162 T.C. No. 9, slip op. at 26-27* ("In analyzing the tax consequences of the deemed transfer *section 2519* contemplates, we cannot ignore that, as part of the same transaction, Sally in fact wound up with the unencumbered Al-Sal shares."). That said, viewing the steps as part of a single plan does not justify collapsing them and thus disregarding the constructive transfers from Linda and Peter to Bruce that resulted from their agreement to allow their father to receive their shares of the Residuary Trust property.


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Under their primary position, consistent with their reporting, petitioners accept that the Bruce made a *section 2519* disposition of his qualifying income interest in the Residuary Trust assets. They contend that "the fair market value of Bruce's deemed *§ 2519* transfer is offset by Linda's and Peter's simultaneous 'transfer' of the same assets to Bruce." **[*42]**

But petitioners also advance an alternative argument. They question how Bruce can be viewed as having "relinquished anything as a result of the NJA [Nonjudicial Agreement], including a 'qualifying income interest' in the assets formerly held in the Residuary Trust, since he was entitled to all of the income from those assets both before and after the execution of the NJA." "If Bruce did not relinquish his income interest in the properties of the Residuary Trust," they observe, "then *§ 2519* has not been triggered."

Petitioners invoke *Treasury Regulation § 25.2519-1(e)* in support of the conclusion that Bruce did not dispose of his qualifying income interest in the Residuary Trust property. *Treasury Regulation § 25.2519-1(e)* provides: "The exercise by any person of a power to appoint [QTIP] to the donee spouse is not treated as a disposition under *section 2519*, even though the donee spouse subsequently disposes of the appointed property."[6]

As explained above, Bruce did not relinquish any interest in the Residuary Trust property and thus cannot be viewed as having disposed of his qualifying income interest in the property. But I agree with petitioners that *Treasury Regulation § 25.2519-1(e)* provides further support for that conclusion. The commutation of the Residuary Trust and the distribution of all trust **[*43]** property to Bruce had the same effect as the exercise of a power to appoint the Residuary Trust property to Bruce.

Respondent contends that any analogy of the transactions in issue to the exercise of a power of appointment fails both factually and legally. As a factual matter, he observes, "the parties . . . structured their transaction as a commutation and termination of the Residuary QTIP Trust and not as the exercise of a power of appointment." As a legal matter, Clotilde's will did not give anyone an unlimited "power to appoint all the Residuary QTIP Trust assets to Bruce."

I agree that Bruce did not actually receive the Residuary Trust assets by exercise of a power of appointment. Therefore, *Treasury Regulation § 25.2519-1(e)* does not apply to the transactions in issue. Nonetheless, the regulation provides further support for a conclusion that can readily be reached on the basis of the statutory text alone: Because the exercise of a power of appointment in Bruce's favor would not have been a

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[6] A surviving spouse does not hold a qualifying income interest for life in property if any person "has a power to appoint any part of the property to any person other than the surviving spouse." *§ 2056(b)(7)(B)(ii)(II)*. A power to appoint the property to the surviving spouse, however, does not disqualify the surviving spouse's qualifying income interest for life. *Treasury Regulation § 25.2519-1(e)* simply draws out the obvious implication of *section 2056(b)(7)(B)(ii)(II)*.


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disposition, the transactions effected by section 2 of the Nonjudicial Agreement should not have effected a disposition either.

III. *Conclusion*

If the commutation of the Residuary Trust and the distribution of all trust property **[*44]** to Bruce did not effect a "disposition," within the meaning of *section 2519(a)*, of Bruce's qualifying income interest in the Residuary Trust property, then Bruce cannot be treated under that section as having transferred all the interests in that property other than his qualifying income interest. Linda's and Peter's constructive transfers to Bruce cannot have provided adequate and full consideration to Bruce for a transfer he did not make. If *section 2519(a)* did not apply, we would have no occasion to impose asymmetrical treatment on a single exchange, treating Linda's and Peter's constructive transfers to Bruce as, simultaneously, (1) adequate and full consideration to him for a deemed transfer by him to Linda and Peter, and (2) wholly gratuitous, and thus taxable gifts by them to him. If Bruce made no deemed transfer under *section 2519(a)* to Linda and Peter, then, as the majority concludes, he made no taxable gifts to them, and their "very real" transfers to him stand alone as taxable gifts.

Again, concluding that Bruce made no *section 2519(a)* disposition of his qualifying income interest in the Residuary Trust property, in my judgment, provides a sounder basis for the conclusions the majority reaches. The analysis I suggest does not depend **[*45]** on treating a surviving spouse as receiving consideration for a deemed transfer for property he does not actually own—a transfer that is entirely a fiction created by the QTIP rules. Moreover, that analysis does not depend on treating a single exchange differently from the perspective of the transferors and the transferee. The majority views as "complicated" the "question of whether implementing the Nonjudicial Agreement gave rise to 'any disposition' of Bruce's qualifying income interest for purposes of *section 2519(a)*." Op. Ct. p. 11 n.5. I do not share the majority's reluctance to answer that question. Instead, I view the questions the majority takes on as more complicated than the disposition question. Concluding that the implementation of the Nonjudicial Agreement did not effect a disposition of Bruce's qualifying income interest provides a more straightforward justification for the conclusions that Bruce did not make a taxable gift but Linda and Peter made taxable gifts to him.

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**End of Document**

***89 FR 104915***

Vol. 89, No. 247, Thursday, December 26, 2024

Proposed Rules

**Reporter**
89 FR 104915 *

***Federal Register > 2024 > December > Thursday, December 26, 2024 > Proposed Rules > DEPARTMENT OF THE TREASURY - Office of the Secretary***

**Title: Regulations Governing Practice Before the Internal Revenue Service**

**Action:** Notice of proposed rulemaking, notice of public hearing, and withdrawal of notice of proposed rulemaking.

## Agency

Office of the Secretary, Treasury.

**Identifier: [REG-116610-20] > RIN 1545-BQ12**

## Administrative Code Citation

**31 CFR Part 10**

## Synopsis

**SUMMARY:** This document contains proposed amendments to the regulations governing practice before the ***IRS***. These regulations propose to eliminate provisions related to **[*104916]** registered tax return preparers, classify the use of certain contingent fee arrangements by practitioners as disreputable conduct, establish new standards for appraisals and the disqualification of appraisers, and update certain provisions as appropriate. This document also provides notice of a public hearing on the proposed regulations and withdraws the notice of proposed rulemaking published on July 28, 2009. The regulations would affect registered tax return preparers, enrolled agents (EAs), enrolled retirement plan agents, enrolled actuaries, Annual Filing Season Program (AFSP) participants, attorneys, certified public accountants (CPAs), appraisers, and other practitioners.

## Text

**SUPPLEMENTARY INFORMATION:**

## Authority

This document contains proposed regulations that would amend the regulations under *31 U.S.C. 330* relating to the regulation of practice before the ***IRS***, which are codified at 31 CFR part 10 and reprinted as Treasury Department ***Circular*** No. ***230*** (***Circular 230***). Since 1884, Federal law (now codified at *31 U.S.C. 330*), has expressly authorized the Secretary of the Treasury (Secretary) to regulate practice before the Treasury Department. Specifically, *31 U.S.C. 330(a)* provides that subject to section 500 of title 5, the Secretary may "regulate the practice of representatives of persons before the Department of the Treasury." In addition, before admitting a representative to practice, the Secretary may require that the representative demonstrate "good character," "good reputation," the "necessary qualifications to enable the representative to provide to persons valuable service," and "competency to advise and assist persons in presenting their cases." *See* *31 U.S.C. 330(a)*. The Secretary may delegate these duties and powers to another officer or employee of the Treasury Department under *31 U.S.C. 321(b)*.

## Background

The provisions of 31 CFR part 10 are currently designated as §§ 10.0 through 10.93 and a section of the current regulations is referred to as, as an example, "current § 10.0" in this Background and the Explanation of Provisions. ***Circular 230***, which contains current §§ 10.0 through 10.93 related to governing practice before the ***IRS***, has been amended periodically since it was first published in 1921.

### A. Tax Return Preparation

Prior to 2011, individual tax return preparers were generally not subject to ***Circular 230*** unless the tax return preparer was an attorney, certified public accountant (CPA), enrolled agent (EA), or other type of practitioner identified in ***Circular 230***. On June 3, 2011, the Treasury Department and the ***IRS*** published final regulations (*TD 9527*) in the **Federal Register** (*76 FR 32286*) to establish qualifications for tax return preparers, which required them to become registered tax return preparers subject to the requirements under ***Circular 230*** and describing the allowable scope of a registered tax return preparer's practice before the ***IRS*** (2011 amendments).

The 2011 amendments were challenged in *Loving v. IRS, 917 F.Supp.2d 67 (D.D.C. 2013)*, in which case the plaintiffs argued that the Treasury Department and the ***IRS*** did not have authority under *31 U.S.C. 330* to regulate tax return preparation because return preparation was not practice before the ***IRS***. The United States District Court for the District of Columbia (District Court for the District of Columbia or district court) concluded that under *31 U.S.C. 330(a)*, practice before the ***IRS*** is limited to representing taxpayers before the ***IRS*** by assisting them in presenting their cases. Because the district court considered preparing and filing tax returns as falling short of "presenting a case," it held that the Treasury Department and the ***IRS*** lacked statutory authority to regulate tax return preparation as practice before the ***IRS*** under *31 U.S.C. 330(a)* and enjoined the Treasury Department and the ***IRS*** from enforcing the 2011 amendments to ***Circular 230*** related to registered tax return preparers. The United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit or court of appeals) affirmed the district court's opinion and order for injunction. The court of appeals upheld the district court's statutory construction, explaining that, while tax return preparers

assist taxpayers, they do not represent taxpayers before the ***IRS*** or formally act as their agent. *Loving v. **IRS**, 742 F.3d 1013 (D.C. Cir. 2014)*.

**B. Contingent Fees**

Final regulations (*TD 9359*) published in the **Federal Register** (*72 FR 54540*) on September 26, 2007, amended the rules under ***Circular 230*** regarding charging contingent fees in current § 10.27 (2007 amendments). The 2007 amendments amended the exceptions to the general prohibition on contingent fees, which prohibited practitioners from charging contingent fees for original returns, to permit practitioners to charge a contingent fee for services rendered in connection with the ***IRS***'s examination of, or challenge to, (i) an original tax return or (ii) an amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination or a written challenge to the original tax return. The Treasury Department and the ***IRS*** subsequently clarified the 2007 amendments in *Notice 2008-43, 2008-1 C.B. 748 (March 26, 2008)* to provide that a practitioner may charge a contingent fee for services rendered in connection with the ***IRS***'s examination of, or challenge to, an amended return or claim for **[*104917]** refund or credit filed (1) before the taxpayer received a written notice of examination of, or a written challenge to, the original tax return or (2) no later than 120 days after the receipt of such written notice or written challenge. *Notice 2008-43* also provided an exception that allows practitioners to charge a contingent fee with respect to whistleblower claims under *section 7623 of the Internal Revenue Code* (Code). Current § 10.27 also permits practitioners to charge contingent fees in connection with the determination of statutory interest and penalties and for services rendered in connection with judicial proceedings arising under the Code. Current § 10.27 prohibits contingent fee arrangements for services rendered in connection with any other matter before the ***IRS***, including the preparation of original returns, amended returns, and claims for refund or credit.

On July 28, 2009, the Treasury Department and the ***IRS*** published in the **Federal Register** (*74 FR 37183*) a notice of proposed rulemaking (REG-113289-08) proposing modifications to the rules relating to contingent fees under ***Circular 230*** (2009 proposed regulations). The 2009 proposed regulations have not been finalized.

In 2014, the District Court for the District of Columbia held that preparing and filing ordinary refund claims, like preparing original tax returns, did not involve representing taxpayers or practice before the ***IRS***. *Ridgely v. Lew, 55 F. Supp.3d 89 (D.D.C. 2014)*. As a result, according to the district court, the ***IRS*** lacked authority to treat the preparation of ordinary refund claims as practice before the ***IRS*** as described under *31 U.S.C. 330(a)*. *Id.* Thus, the district court concluded that the ***IRS*** cannot prohibit charging contingent fees for ordinary refund claims based on its authority to regulate practice before the ***IRS*** under *31 U.S.C. 330(a)*.

**C. Written Tax Advice**

***Circular 230*** was most recently amended in *TD 9668*, which was published in the **Federal Register** (*79 FR 33685*) on June 12, 2014, to, among other changes, revise rules relating to written tax advice and eliminate the covered opinion rules (in former § 10.35) that previously governed written tax advice.

**Explanation of Provisions**

The proposed regulations contained in this notice of proposed rulemaking would amend ***Circular 230*** by eliminating provisions related to registered tax return preparers or that imposed standards on tax return preparation that are unrelated to representation before the Treasury Department and the ***IRS***. The proposed regulations would also amend ***Circular 230*** by eliminating current § 10.27, which, among other things, treats the preparation of tax returns and claims for refund or credit as matters before the ***IRS*** for which contingent fees may not be charged, and defining certain contingent fee arrangements as disreputable conduct. Specifically, the proposed regulations would establish that contingent fee arrangements for services in connection with preparing an original tax return, amended tax return, or claim for refund or credit constitute disreputable conduct subject to sanction. Because the proposed regulations would make substantial changes to the regulation of contingent fees under ***Circular 230***, this document also proposes to withdraw the 2009 proposed regulations.

The proposed regulations would also revise or eliminate provisions that are out of date and incorporate new provisions to better align ***Circular 230*** with the modern practice environment. The scope of the proposed regulations is limited to practice before the ***IRS***. Therefore, the proposed regulations would not alter or supplant other ethical standards applicable to practitioners.

A section of the proposed regulations is referred to as, as an example, "proposed § 10.0" in this Explanation of Provisions and the Special Analyses.

**A. Amendments Regarding Tax Return Preparation**

**1. Elimination of Regulation of Registered Tax Return Preparers as Practitioners**

As a result of the decision and injunction order in *Loving,* the 2011 amendments that relate to registered tax return preparers are no longer enforceable. Therefore, the proposed regulations would eliminate rules regarding registered tax return preparers under current §§ 10.3 through 10.6. The proposed regulations would also remove references to registered tax return preparers under current §§ 10.0, 10.2, 10.30, 10.38, and 10.90 and redesignate current § 10.90 as § 10.110.

**2. Revision of Standards Relating to Tax Return Preparation**

***Circular 230*** contains provisions that are unrelated to the registered tax return preparer program but impose specific standards on tax return preparation. Consistent with the holding in *Loving,* the proposed regulations would eliminate or revise these provisions to impose standards related to tax returns prepared, approved, or submitted in connection with representing a client in a matter before the ***IRS***. This distinction would be also incorporated under the amended definition of "practice before the ***IRS***" under proposed § 10.2(a)(4), which would clarify that practice before the ***IRS*** includes the preparation and submission of tax returns in connection with representing a client in a matter before the ***IRS***.

Current § 10.8 provides rules related to tax return preparation, describes actions that individuals who did not prepare all, or substantially all, of a tax return can take before the ***IRS***, and prohibits non-practitioners from preparing all, or substantially all, of a tax return. The proposed regulations would eliminate the


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current language under § 10.8 in its entirety. However, guidance regarding what actions non-practitioners may take in response to ***IRS*** inquiries is still necessary and authorized under *31 U.S.C. 330*. Therefore, the proposed regulations would retitle current § 10.8 as "Participation in ***IRS*** proceedings by non-practitioners" and would provide that, except for appraisers who have been disqualified pursuant to proposed § 10.61(a), any individual may appear as a witness before the ***IRS*** or furnish information at the request of the ***IRS***.

Current § 10.22 imposes standards related to diligence as to accuracy, including standards related to the preparation or approval of tax returns, documents, affidavits, and other papers. The proposed regulations would revise current § 10.22 to specify that the diligence as to the accuracy requirement for tax returns is limited to tax returns prepared, approved, or submitted in connection with representing a client in a matter before the ***IRS***. The proposed regulations would not revise existing diligence standards related to documents, affidavits, and other papers that are not tax returns. The diligence requirements in the proposed regulations would also apply to a practitioner's preparation of a tax return prior to representing a client in a matter before the ***IRS*** when the subsequent representation involves the tax return. When the representation involves a tax return prepared by a practitioner, the practitioner's diligence with respect to preparing the tax return would be treated under the proposed regulations as related to the practitioner's practice before the ***IRS*** under *31 U.S.C. 330(a)*.

Current § 10.34 imposes standards with respect to a practitioner's preparation of tax returns and other documents. The current regulations incorporate standards under the Code relating to tax return positions, describe standards for advising clients with **[*104918]** respect to potential penalties, and address the ability of a practitioner to rely on information furnished by a client. The proposed regulations would maintain these standards but clarify that the standards only apply to a tax return either when the tax return is prepared while representing a client before the ***IRS*** or when the tax return prepared prior to representation is submitted while representing a client before the ***IRS***, regardless of whether the tax return was filed with the ***IRS*** before the representation begins. With respect to tax returns prepared prior to representation, the current standards relate to a practitioner's duty to not further an unreasonable return position taken on a previously prepared return while representing a client in a matter before the ***IRS***. The proposed regulations would not impose the standards on the preparation of a tax return in the absence of a practitioner's representation of a client.

**B. Amendments Regarding the Regulation of Contingent Fees**

Current § 10.27 prohibits practitioners from entering into contingent fee arrangements for services rendered in connection with a "matter before the ***IRS***," which § 10.27(c)(2) defines to include assisting with filing tax returns or claims for refund or credit and "all matters connected with a presentation to the [***IRS***] . . . relating to a taxpayer's rights, privileges, or liabilities under the laws and regulations administered by the [***IRS***]." Current § 10.27 was intended to restrict contingent fee arrangements based on their potential to encourage practitioners and their clients to take aggressive positions with the hope that they will not be audited.

As described in the Background, the District Court for the District of Columbia held in *Ridgely* that practitioners do not act in a representative capacity when they assist clients with "ordinary refund claims," which are defined as refund claims, including amended returns, filed prior to the

examination of a tax return for that taxable year or period. The district court also concluded that preparing an ordinary refund claim is not an activity that constitutes practice before the ***IRS*** under *31 U.S.C. 330(a)*. Thus, the court concluded that the ***IRS*** cannot prohibit charging contingent fees for ordinary refund claims based on its authority to regulate practice before the ***IRS*** under *31 U.S.C. 330(a)*. The court did not otherwise address the propriety of contingent fees.

The proposed regulations would remove current § 10.27 and, under subpart C, define disreputable conduct under proposed § 10.51 to include both charging contingent fees in connection with the preparation of an original or amended tax return or claim for refund or credit, and charging fees that, under the facts and circumstances, are unconscionable fees.

Charging a contingent fee for the preparation of an original return, amended return, or claim for refund or credit prepared prior to the examination of a tax return is disreputable conduct because these circumstances encourage evasion or abuse of Federal tax laws by incentivizing practitioners to take unduly aggressive tax positions for their clients, which would increase their clients' reported tax benefits, thus resulting in personal gain for the practitioner. A practitioner with a direct, financial interest in the tax benefits of a client may be incentivized to increase such tax benefits. Therefore, these contingent fee arrangements reflect conduct that is incompatible with ethical practice before the Treasury Department or the ***IRS*** under ***Circular 230***.

Under *31 U.S.C. 330(c)*, the Treasury Department and the ***IRS*** have the authority to censure or suspend or disbar from practice before the Treasury Department or the ***IRS*** practitioners who engage in disreputable conduct whether or not the conduct constitutes representation of a client. Unlike the contingent fee standards under current § 10.27, proposed § 10.51 is not dependent upon the preparation of a tax return or claim for refund or credit constituting practice before the ***IRS***. Charging contingent fees for preparing tax returns, amended returns, and claims for refund or credit is prohibited under the rules of professional conduct applicable to many accountants. The American Institute for Certified Public Accountants (AICPA) Code of Professional Conduct, for example, acknowledges the disreputable nature of contingent fees and prohibits CPAs from charging contingent fees for the preparation of original returns, amended returns, and ordinary refund claims because of the risk that these contingent fee arrangements would allow a CPA to benefit improperly from an interest in, or relationship with, a client. *See* AICPA Code of Professional Conduct 1.000.010.14(c); 1.510.001.01(b). Many state accountancy board rules also prohibit contingent fee arrangements for preparing an original or amended return or claim for refund or credit. *See, e.g.,* N.J. Admin. Code section 13:29-3.8(e) (2019); *Tenn. Code Ann. section 62-1-123(b)(1)(B)* (2016) (prohibiting contingent fees for preparation of an original return); Cal. Code Regs. Tit. 16 section 62(a)(2) & (3) (2021); *cf.* New York Society of Certified Public Accountants Code of Professional Conduct Rule 302 (March 2013).

**C. Enrolled Retirement Plan Agent and Enrolled Agent Procedures**

Current § 10.3(e)(1) provides that enrolled retirement plan agents (ERPAs) may practice before the ***IRS***. Current § 10.4(b) authorizes the ***IRS*** to grant status as ERPAs to individuals who demonstrate special competence in qualified retirement plan matters by passing a written examination and who have not engaged in any conduct that would justify suspension or disbarment under ***Circular 230***. The ***IRS*** stopped offering the Enrolled Retirement Plan Agent Special Enrollment Examination (ERPA-

SEE) on February 12, 2016, and no longer accepts applications for new enrollment as an ERPA. Because of a steady decline in ERPA-SEE test-takers, the cost to administer the ERPA-SEE no longer warranted offering the test. *See* *83 FR 58202*, published in the **Federal Register** on November 19, 2018. Individuals who had passed the ERPA-SEE before February 12, 2016, and are currently enrolled as ERPAs can maintain their status. Therefore, the proposed regulations would clarify that ERPAs who passed the ERPA-SEE prior to February 12, 2016, remain authorized to practice before the ***IRS*** if they continue to pay the annual user fee described under *26 CFR 300.10(b)* and complete the continuing education described in § 10.6(e). The proposed regulations would also remove current § 10.4(b), which describes the process to become an ERPA by special examination.

Current § 10.4(d) provides that a former ***IRS*** employee, based on past service and technical experience in the ***IRS***, may be granted enrollment as an EA or ERPA without testing if certain criteria are met. There is no statutory requirement that the ***IRS*** provide this exemption to former employees and administering requests for this waiver has consumed substantial ***IRS*** resources. Accordingly, the proposed regulations would eliminate the opportunity for former ***IRS*** employees to apply for a waiver of enrollment requirements as of 30 days after the date these regulations are published in the **Federal Register** as final regulations. Applications from former ***IRS*** employees submitted on or before that date would be processed according to the procedures under current § 10.4(d).

Current § 10.5 includes ERPAs in the description of application procedures to become a practitioner under ***Circular 230***. Because the ***IRS*** no longer offers **[*104919]** the special enrollment examination to become an ERPA and no longer accepts applications for new enrollment as an ERPA, these procedures are no longer relevant and references to ERPAs would be removed under proposed § 10.5. The renewal period and procedures for existing ERPAs remains unchanged under current § 10.6.

Current § 10.6(b) states that the ***IRS*** will provide confirmation of enrollment to EAs and ERPAs by issuing a registration card or certificate. Instead of specifying the form of confirmation, proposed § 10.6(b) would provide that the ***IRS*** will issue a document, which may be an enrollment card or other document. This revision would give the ***IRS*** flexibility as to the form of enrollment confirmation provided to practitioners in the future without requiring an amendment to the regulations.

Current § 10.6(d)(2) provides an explanation of the renewal period for EAs. Proposed § 10.6(d)(2) would make minor revisions to this description but makes no substantive changes to the renewal period or renewal process for EAs.

**D. Limited Practice and Annual Filing Season Program (AFSP) Participants**

Proposed § 10.7(c)(1)(viii) would provide that individuals who possess a current Annual Filing Season Program (AFSP) Record of Completion may engage in limited practice, by representing taxpayers before the ***IRS*** with respect to tax returns or claims for refund or credit the individuals prepared and signed during a calendar year for which a Record of Completion was issued. The individual must have a valid Record of Completion for the calendar year in which the tax return or claim for refund or credit was prepared and signed and a valid Record of Completion for the year or years in which the representation occurs. AFSP participants generally are otherwise unenrolled preparers who, pursuant to

*Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (July 14, 2014)*, voluntarily consent to be subject to ***Circular 230*** duties and restrictions to participate in the AFSP, including prohibitions on incompetence or disreputable conduct, and must comply with the duties and restrictions to the extent they represent taxpayers before the ***IRS*** under the AFSP. The authority for the Treasury Department and the ***IRS*** to implement the AFSP was upheld by the D.C. Circuit, in *AICPA v. **IRS**, 746 Fed. Appx. 1 (D.C. Cir. 2018)*.

**E. Continuing Education Provider Fees**

Under current § 10.9(a)(2), continuing education providers that provide education to practitioners on subject matters described under current § 10.6(f) must be approved by the ***IRS***, obtain a continuing education number, and pay any applicable user fee. Continuing education providers must follow the procedures outlined under *Rev. Proc. 2012-12, 2012-2 I.R.B. 275 (January 9, 2012)* to become an accredited provider and obtain a continuing education provider number. Continuing education providers must renew their status annually by renewing their provider number and paying a user fee. Under current § 10.9(a)(4), continuing education providers must seek approval for individual continuing education programs and obtain a program number.

The continuing education program is administered by a third-party vendor through a five-year contract with the ***IRS***. The vendor will charge continuing education providers a $650 application and renewal fee through 2025. Continuing education providers must renew for the upcoming calendar year before midnight on December 31 or incur late fees ranging between $100 and $200. Under the vendor's contract with the ***IRS***, the vendor's fee is reviewed and approved by the ***IRS***.

Because the ***IRS*** does not incur any direct costs to administer the continuing education program, it does not currently charge a separate user fee to recover costs. In the future, however, the ***IRS*** may charge a user fee if circumstances change. Any future user fee will be calculated pursuant to the Independent Offices Appropriation Act of 1952 (*31 U.S.C. 9701*) and OMB ***Circular*** A-25, *User Charges.* New proposed § 10.9(c) explains that a potential user fee may be charged in addition to the current vendor fee for approval of continuing education providers and their programs.

**F. Knowledge of Error or Omission**

Current § 10.21 requires practitioners to advise a client of any noncompliance with internal revenue laws or any error or omission on a tax return or other document submitted to the ***IRS*** and the consequences under the Code and regulations of the noncompliance, error, or omission. Proposed § 10.21 would clarify that the noncompliance, error, or omission may have been made by either the client or the practitioner or a prior practitioner, such as if the practitioner or prior practitioner made an inadvertent mistake on a tax return prepared and filed for the client that the practitioner later discovers.

Proposed § 10.21 would expand the current guidance by requiring practitioners to explain actions the client should take to correct the noncompliance, error, or omission. Knowingly failing to inform a client of the noncompliance, error, or omission is disreputable conduct under *31 U.S.C. 330(c)* because it causes practitioners to perpetuate false or misleading information to the ***IRS*** and potentially exposes the client to penalties and other adverse consequences. Proposed § 10.21 would also instruct


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practitioners to consider whether they can continue to meet their obligation to exercise diligence under proposed § 10.22(a) as to the accuracy of tax returns and other documents if the client refuses to take corrective action during the course of the practitioner's representation. A practitioner's obligation under proposed § 10.22(a) applies only to tax returns that are prepared, approved, or submitted in connection with representing a client in a matter before the ***IRS***. Under those circumstances, the failure to correct inaccurate or unsupportable return positions would result in their perpetuation in submissions to the ***IRS*** during the course of the practitioner's representation. These changes would align ***Circular 230*** with similar professional standards relating to knowledge of a client's error. *See* AICPA Statement on Standards for Tax Services No. 6 (Knowledge of Error: Return Preparation and Administrative Proceedings) (Rev. April 30, 2018); *see also Schmitz* v. *Crotty,* 528 NW 112 (Iowa 1995) (holding that in a civil malpractice action, an attorney was negligent for, in part, failing to correct an error on tax returns that he was aware of).

**G. Negotiation of Payments to Clients**

Current § 10.31 provides that a practitioner may not endorse or otherwise negotiate any check issued to a client by the Government in respect of a Federal tax liability, including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with which the practitioner is associated. When it was last amended in 2014, this regulation was revised to clarify that the prohibition on practitioner negotiation of taxpayer tax refunds applied to the electronic environment in which both the ***IRS*** and practitioners operated. Proposed § 10.31 would maintain this prohibition and broaden it to apply to all electronic payments to clients with respect to a Federal tax liability, including prepaid debit cards, phone or mobile payments, or other forms of electronic payments, even if that payment method is not currently used by the Treasury Department. These changes **[*104920]** acknowledge the evolving electronic environment in which tax refunds and other payments to taxpayers are processed through a variety of means.

**H. Best Practices for Tax Practitioners**

Current § 10.33 provides best practices for practitioners related to client representation. Proposed § 10.33 would replace references to "tax advisors" with "tax practitioners" to better align § 10.33 with descriptions used elsewhere in ***Circular 230***.

Proposed § 10.33(a)(4) would provide that it is a best practice for practitioners to create a data security policy to maintain safeguards with respect to client information and establish a plan and procedures for responding to data breaches. Practitioners who also prepare returns have a legal obligation to comply with the Federal Trade Commission's Safeguards Rule under the Gramm-Leach Bliley Act, which requires businesses to implement safeguards, including a written information security plan, to protect the security, confidentiality and integrity of customer information. 16 CFR part 314 (2002). This ***proposed change*** acknowledges this duty and complements the newly proposed duty to maintain technological competence under proposed § 10.35 and better aligns ***Circular 230*** with other professional standards. *See* American Bar Association Formal Ethics Opinion 18-483; ***IRS*** Publication 4557, *Safeguarding Taxpayer Data;* ***IRS*** Publication 5708, *Creating a Written Information Security Plan for Your Tax & Accounting Practice.*


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Proposed § 10.33(a)(5) would provide that it is a best practice for practitioners to identify, evaluate, and address a mental impairment arising out of, or related to, age, substance abuse, a physical or mental health condition, or some other circumstance that could adversely impact a practitioner's ability to effectively represent a client before the ***IRS***. An impairment, left untreated, can have adverse consequences on a client's representation and to the health and well-being of a practitioner. The purpose of proposed § 10.33(a)(5) is to encourage practitioners who are suffering from a mental impairment to seek and obtain assistance or treatment. *See, e.g.,* DC Legal Ethics Opinion 377.

Proposed § 10.33(a)(6) would provide that it is a best practice for practitioners to establish a business continuity and succession plan that includes procedures and safeguards related to both the cessation of a practitioner's practice or the occurrence of an outside event, such as a natural disaster or cyberattack. Business continuity and succession planning are essential because they proactively protect clients in the event of a practitioner's death or disability or from the occurrence of an unforeseen event.

Finally, proposed § 10.33 would eliminate current § 10.33(b), which provides steps to ensure that a firm's procedures are consistent with best practices. Current § 10.33(b) would be duplicative of procedures under proposed § 10.36 to ensure compliance with subparts A, B, and C of part 10, which instructs practitioners to take reasonable steps to ensure that the firm's procedures are consistent with the best practices under proposed § 10.33(a).

**I. Duty To Maintain Technological Competence**

Current § 10.35 provides that a practitioner must be competent when engaged in practice before the ***IRS***. Specifically, practitioners are required to have the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter in which the practitioner is engaged. Increasingly, competence also includes maintaining familiarity with technological tools used to represent a client. A similar standard for technological competency is included in the American Bar Association (ABA) Model Rules of Professional Conduct. Proposed § 10.35 is based on Comment 8 to ABA Model Rule 1.1 and would define competency to include understanding the benefits and risks associated with relevant technology used by the practitioner to provide services to clients or to store or transmit confidential information, including tax return information.

**J. Regulation of Written Tax Advice**

Current § 10.37 provides basic principles to which all practitioners must adhere when giving written tax advice. ***Circular 230*** was amended in 2014 to eliminate the covered opinion rules (in former § 10.35) and replace them with broad standards for written tax advice under a current § 10.37. *See* *TD 9668*. Proposed § 10.37 would maintain these principles-based standards and make minor wording changes. Current § 10.37(d) defines a "Federal tax matter," for purposes of that section, as the application or interpretation of a revenue provision defined under section 6110(i)(1)(B) of the Code, any provision of law impacting a person's obligations under the internal revenue laws and regulations, and any other law or regulation administered by the ***IRS***. Proposed § 10.37 would amend this definition of a Federal tax matter under proposed § 10.37(d) to clarify that it encompasses any transaction, plan, arrangement, or other matter (whether prospective or completed), which is of the type that the ***IRS*** determines has the potential for tax avoidance or evasion.


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This ***proposed change*** aligns standards for written tax advice under proposed § 10.37 more closely with the statutory language of *31 U.S.C. 330(e)*, which acknowledges that the Treasury Department may "impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion."

Current § 10.37(c)(1) imposes a reasonable practitioner standard, considering all of the facts and circumstances, to determine whether a practitioner has complied with the written advice standards under this section. Current § 10.37(c)(2) imposes the same reasonable practitioner standard in the case of an opinion the practitioner knows or has reason to know will be used by another person to promote, market, or recommend to one or more taxpayers a partnership or other entity, investment plan, or arrangement a significant purpose of which is the avoidance or evasion of any tax (Significant Purpose Transactions). Current § 10.37(c)(2) adds that, under the facts-and-circumstances analysis for Significant Purpose Transactions, emphasis will be "given to the additional risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances." Considering a practitioner's knowledge of the taxpayer's circumstances is generally relevant to whether a practitioner has satisfied written tax advice standards. Therefore, the proposed regulations would remove paragraph (c)(2) in current § 10.37 and proposed § 10.37(c) would include consideration of the practitioner's knowledge of the client's particular circumstances under the reasonable practitioner standard.

**K. Incompetence or Disreputable Conduct**

Current § 10.51 defines disreputable conduct for which a practitioner may be sanctioned. Incompetence or disreputable conduct under current § 10.51 is a basis for imposing sanctions against practitioners that is separate from a failure to meet the duties and abide by the restrictions relating to practice before the ***IRS*** under subpart B. Subpart C, retitled to relate to **[*104921]** incompetence and disreputable conduct, would redesignate current § 10.51 as proposed § 10.50 and, as described in part B of this Explanation of Provisions, proposed § 10.51 would define certain fee arrangements that constitute disreputable conduct.

Proposed § 10.50(a) would explain that a practitioner can be sanctioned for conduct that relates to the practitioner's overall fitness to practice and is not limited to actions taken while representing clients in a matter before the ***IRS***. Proposed § 10.50(a)(12) would clarify that contemptuous conduct subject to sanction includes conduct in connection with practice before the ***IRS***, any proceeding pursuant to redesignated proposed § 10.80 or any investigation by the Treasury Inspector General for Tax Administration. New proposed § 10.50(a)(19) would provide that the willful failure to follow any Federal tax law is disreputable conduct because knowingly violating a Federal tax law reflects a lack of due regard for the tax laws.

New proposed § 10.50(b) would provide that any assessment against a practitioner of penalties relating to a willful attempt to understate tax liabilities under section 6694(b); aiding or abetting in the understatement of tax liabilities under section 6701; careless, reckless, or intentional disregard for the rules or regulations (within the meaning of *26 CFR 1.6662-3(b)(2)* and 1.6694-3(c)) under section 6662(b)(1); or promotion of abusive tax shelters under section 6700 will be considered a violation of

proposed § 10.50(a)(7). The assessment of any of these penalties, however, would not be required to show a violation of proposed § 10.50(a)(7).

**L. Appraiser Standards**

The proposed regulations would incorporate new subpart D, which provides definitions related to appraisers and standards for the disqualification of appraisers. Current § 10.50(b) references the authority of the Secretary, or her delegate, and the ***IRS*** to disqualify appraisers from presenting evidence or testimony in any administrative proceeding before the Treasury Department or the ***IRS***. Current ***Circular 230***, however, does not provide a separate definition of appraisers or what constitutes an administrative proceeding for purposes of disqualification. The proposed regulations would provide separate definitions for both appraisers and administrative proceedings and explain how they would relate to the new appraiser standards. Current § 10.60(b) provides that proceedings to disqualify appraisers can be instituted whenever a penalty has been assessed against an appraiser under the Code and the ***IRS*** determines that the appraiser acted willfully, recklessly, or through gross incompetence with respect to the conduct at issue.

This penalty prerequisite limits the ***IRS***'s ability to respond to misconduct under ***Circular 230*** when the misconduct is not covered by a specific penalty, an applicable penalty is not imposed, or a proposed penalty assessment has not yet been made. There is no penalty prerequisite for appraiser disqualification under *31 U.S.C. 330*, and the only procedural requirement for the disqualification of appraisers under *31 U.S.C. 330(d)* is notice and an opportunity for a hearing. An appraiser's conduct may be disreputable or fail to conform to appraisal standards even when the ***IRS*** has not assessed a penalty or when no penalty under the Code is applicable. Therefore, the proposed regulations would eliminate the penalty prerequisite under current § 10.60(b) because it provides an unnecessary barrier to address misconduct.

Proposed § 10.61, under new subpart D, would require appraisals submitted in an administrative proceeding before the ***IRS*** to conform to the substance and principles of the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation or the International Valuation Standards (IVS) promulgated by the International Valuation Standards Council. Proposed § 10.61 would thus ensure that appraisals submitted in an administrative proceeding generally conform to broadly applicable standards without requiring strict compliance with such standards. Appraisers who willfully fail to meet these standards may be subject to disqualification under ***Circular 230***. A failure to conform to the substance and principles of either USPAP or IVS standards that is not the result of willful, reckless, or grossly incompetent conduct is not sanctionable. In contrast, appraisers who recklessly or through gross incompetence engage in a pattern of submitting appraisals that do not conform to the substance and principles of USPAP or IVS standards may be subject to disqualification under the proposed regulations. The ***IRS***'s Office of Professional Responsibility (OPR) would determine whether an appraisal conforms to the substance and principles of these general appraisal guidelines during the ***Circular 230*** investigatory and disciplinary process, prior to instituting any formal disciplinary proceeding under subpart F of 31 CFR part 10. An opinion by a court, such as the United States Tax Court (Tax Court), finding that an appraiser failed to comply with the substance and principles of USPAP (or otherwise violated the standards for appraisers) may be considered when making that determination. *See, e.g., Oconee Landing Property, LLC v. Commissioner, T.C. Memo. 2024-25* (finding that the appraisers had reached an advance

agreement with the donors to appraise the subject property "in the neighborhood of" a pre-determined overvalued price).

Using the substance and principles of the USPAP or IVS appraisal standards as a basis for disqualification would enable the ***IRS*** to proactively address inadequate appraisals submitted in administrative proceedings. Both USPAP and IVS provide broad standards for general appraisal methodology. USPAP and IVS appraisal standards also provide a generally accepted standard of care that is widely followed in U.S. and international valuation matters for real property, personal property, and businesses. As such, they form a "floor" for appraiser competency, similar to how the ABA's Model Rules of Professional Conduct provide general standards for attorneys. Like state bars, other professional appraiser organizations and state licensing boards elaborate on and are free to impose stricter standards on appraisers. Further, USPAP is required for state-licensed and state-certified real property appraisers and has been widely adopted by professional appraisal societies. Internal Revenue Service Advisory Council Annual Report at 118-28 (November 2017). *Under Notice 2006-96, 2006-46 I.R.B. 902 (November 13, 2006)*, the ***IRS*** already recognizes USPAP as generally accepted appraisal standards relating to charitable contribution deductions under section 170(f)(11)(E)(i) of the Code. The Tax Court has also looked to adherence to USPAP as a measure of the credibility of an appraisal. *See, e.g., Estate of Cecil v. Commissioner, T.C. Memo. 2023-24* (giving no weight to a valuation that was inconsistent with USPAP). Therefore, the proposed regulations would provide additional clarity to appraisers with respect to the standard for appraisals submitted in an ***IRS*** administrative proceeding.

Proposed § 10.61(b)(2) would also provide that appraisers who know or reasonably should know that an appraisal will be used in an administrative proceeding by taxpayers to support a substantial valuation misstatement under section 6662(e), a substantial estate or gift tax valuation **[*104922]** understatement within the meaning of section 6662(g), or a gross valuation misstatement pursuant to section 6662(h), would be subject to disqualification if they act willfully, recklessly, or through gross incompetence. This standard would allow the ***IRS*** to address common appraiser misconduct related to tax return positions.

Consistent with current § 10.60(b), new proposed § 10.61(c) would provide that an appraiser who has been assessed a penalty under section 6694, 6695A, 6700, or 6701 of the Code, for which it is determined that the appraiser acted willfully, recklessly, or through gross incompetence with respect to the proscribed conduct may be disqualified for engaging in disreputable conduct, although this assessment is not a prerequisite to disqualification. Appraisers who have been assessed penalties as a result of their willful, reckless, or grossly incompetent conduct have engaged in disreputable conduct that should disqualify them from presenting evidence or testimony in an administrative proceeding before the Treasury Department or the ***IRS*** and should result in the appraiser's appraisals having no probative effect in an administrative proceeding. If the penalty is later abated, an appraiser can petition for reinstatement under redesignated proposed § 10.101.

The proposed regulations also provide that an appraiser may show adherence to USPAP standards when issuing the relevant appraisal, which will be taken into account as a defense in determining whether an appraiser acted willfully, recklessly, or through gross incompetence with respect to potential disqualification under proposed § 10.61(b)(2) or (c).


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Because appraisers are not practitioners under ***Circular 230***, it is appropriate to include standards relating to their disqualification under a separate subpart from standards relating to practitioners. However, because appraisers are subject to the same notice and opportunity for a hearing as practitioners under ***Circular 230***, disqualification procedures for appraisers would remain the same as those for practitioners under new subpart F (Rules Applicable to Disciplinary Proceedings).

**M. Effect of Disbarment, Suspension, or Censure**

In 2017, the United States District Court for the District of Nevada held in *Sexton v. Hawkins, 119 A.F.T.R. 2d 2017-1187 (D. Nev. 2017)*, that the Treasury Department and the ***IRS*** did not have jurisdiction to investigate whether suspended practitioners have violated the terms of their suspension because suspended individuals were not considered practitioners under ***Circular 230***. The Treasury Department and the ***IRS*** disagree with this holding. The ***IRS*** has continuing jurisdiction to investigate suspended practitioners under *31 U.S.C. 330(c)*, which provides authority to suspend, disbar, or censure practitioners under ***Circular 230***. The ability to investigate compliance by practitioners with the terms of their censure or suspension is critical to ensure compliance and maintain the integrity of practitioner discipline under ***Circular 230***. Practitioners who do not comply with requests for information from OPR or who violate the terms of their suspension may face further sanctions, such as monetary penalties or disbarment.

Proposed § 10.99(e) would clarify that suspended practitioners remain practitioners under ***Circular 230*** for the purposes of investigating and acting on any violation of a suspension or any violation of the law or regulations governing practice before the ***IRS*** while suspended. It is also important to the enforcement of *31 U.S.C. 330* and the integrity of ***Circular 230*** for the ***IRS*** to ensure that individuals who are not authorized to practice before the ***IRS***, either because they have been disbarred or because they do not have the required credentials, do not claim authority to practice. Proposed § 10.99(f), therefore, would clarify that the ***IRS*** has jurisdiction to make inquiries to determine whether an individual has wrongly held themselves out as a practitioner.

**N. Expedited Suspension**

Current § 10.81 provides guidance on how practitioners can petition OPR for reinstatement, but it does not address practitioners or appraisers who have been suspended or disqualified through the expedited procedures under current § 10.82. Moreover, while current § 10.82 authorizes the immediate suspension of a practitioner who has engaged in certain conduct, it does not include expedited procedures for appraisers or address the voluntary forfeiture of a license or certification by practitioners or appraisers. Current § 10.81, which is proposed to be redesignated as § 10.101, would allow practitioners or appraisers who have received an expedited suspension or disqualification to petition for reinstatement at any time upon a showing of good cause.

The ***proposed changes*** to current § 10.82, which is proposed to be redesignated as § 10.102, explain that practitioners can establish good cause by showing that the conditions giving rise to their expedited suspension or disqualification no longer apply. For example, the restoration of a suspended license, the reversal of a conviction, or the removal of a sanction may be sufficient to show good cause. Proposed § 10.102 would also extend expedited disciplinary proceedings to appraisers who have had a license or


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certification revoked or suspended by a state licensing or certification board or who have voluntarily forfeited their license or certification. Finally, proposed § 10.102(e)(1)(iii) would clarify that, when a practitioner or appraiser responds to a show cause order but does not request a conference, the ***IRS*** will issue a written notice of expedited suspension immediately following consideration of a practitioner or appraiser's response.

Proposed § 10.102(a)(7)(i) and (ii), redesignated from § 10.82(b)(5)(i) and (ii), would only update the cross-references in those provisions. They are otherwise not proposed to be revised, though they are set out in their entirety below for the convenience of the reader. The Treasury Department and ***IRS*** do not seek comments on the substance of these provisions, and any such comments would be outside the scope of the proposed regulations.

**O. Comments Requested**

The Treasury Department and the ***IRS*** request comments on all aspects of the proposed regulations. Comments are also specifically requested on whether, in a future regulation, the definition of practitioners eligible to practice before the ***IRS*** should be proposed to be expanded to include individuals admitted to practice law in a Tribal court.

**Proposed Applicability Date**

The proposed regulations are proposed to apply 30 days after date of publication of final regulations in the **Federal Register** .

**Special Analyses**

**I. Regulatory Planning and Review**

The Office of Information and Regulatory Affairs has determined that this regulation is not significant and not subject to review under Executive Order 12866 (June 9, 2023). Therefore, a regulatory impact assessment is not required.

**II. Initial Regulatory Flexibility Analysis**

When the ***IRS*** issues a general notice of proposed rulemaking, the Regulatory Flexibility Act (RFA) requires the agency to "prepare and make available **[*104923]** for public comment an initial regulatory flexibility analysis," which will "describe the impact of the proposed rule on small entities." *5 U.S.C. 603(a)*. Unless an agency determines that a proposal is not likely to have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis (IRFA) of the proposed rule. The proposed regulations will affect a substantial number of small entities. Because the proposed regulations do not impose new requirements on practitioners or appraisers, the Treasury Department and the ***IRS*** do not anticipate that the proposed regulations, if promulgated, would have a significant economic impact on any of the regulated entities. The Treasury Department and the ***IRS***, however, request comments on the potential economic impact of the proposed regulations and include an IRFA.

Description of the reasons why action by the agency is being considered and succinct statement of the objectives of, and the legal basis for, the proposed rule.

As discussed in this preamble, current ***Circular 230*** has not been amended since 2014 and many of its provisions have been made obsolete by current law or need to be updated to reflect the current practice environment. Accordingly, the proposed regulations would eliminate provisions related to tax return preparation outside of practice before the ***IRS***, revise contingent fee rules, and update various standards and procedures. In addition, the definition of appraiser and the procedures for disqualifying appraisers from submitting appraisals in an administrative proceeding before the Treasury Department or the ***IRS*** are being amended and updated. Thus, the general objective of the proposed regulations is to align ***Circular 230*** with current law and to clarify or update its standards. None of the revisions, however, propose to impose new standards or burdens on practitioners or appraisers. The proposed regulations would either update long-standing ***Circular 230*** standards or incorporate standards that practitioners or appraisers comply with outside of practice before the ***IRS***. For example, the proposed contingent fee restrictions are also incorporated in other widely applicable rules of professional conduct. Likewise, appraisers are generally already required to meet the broad appraisal standards referenced by the proposed regulations.

The legal basis for the proposed regulations is *31 U.S.C. 330*.

Description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply.

The proposed regulations would affect EAs, ERPAs, attorneys, CPAs, and AFSP participants who practice before the ***IRS***. The proposed regulations would also affect appraisers who submit appraisals in an administrative proceeding before the Treasury Department or the ***IRS***. ***Circular 230*** affects both individual practitioners and firms. For example, the flush language of *31 U.S.C. 330(c)* authorizes the Secretary, or her delegate, to impose a monetary penalty on a firm if the firm knew or should have known that a representative acting on its behalf intended to defraud a client. Further, proposed § 10.36(a) would require practitioners who oversee a firm's practice to take reasonable steps to ensure that the firm has adequate procedures to comply with ***Circular 230***. However, because the proposed regulations would only affect individual practitioners and appraisers, the economic impact of these regulations on any small entity generally will be the result of an individual practitioner or appraiser owning a small business, or a small business employing a practitioner or appraiser, and the business paying for the individual to maintain its status or to comply with other requirements in the ***Circular***. Because an estimate of the number of small entities to which the proposed rule will apply is not available, the Treasury Department and the ***IRS*** considered the estimated number of practitioners and appraisers who will be affected by the proposed rule. Based on ***IRS*** records, the total number of impacted practitioners and appraisers is approximately 451,405. Specifically, Centralized Authorization File records, which reflect practitioners who filed third-party authorizations with the ***IRS***, reflect approximately 200,000 unique CPAs, 65,000 unique attorneys, and 40,000 unique practitioners who identify as both attorneys and CPAs as of May 17, 2024. Further, ***IRS*** Return Preparer Office (RPO) registration records show approximately 62,383 EAs, 608 ERPAs, 3,402 enrolled actuaries, and 75,357 AFSP participants. Finally, in 2022, the most recent year for which complete data are available, approximately 4,200 unique appraisers signed the "Declaration of Appraiser" on a Form 8283, *Noncash Charitable Contributions.*

Appraisers sign Forms 8283 for appraisals that are used in connection with a tax return or claim of refund. Thus, the forms represent a reasonable approximation of appraisers who are likely to be covered by these proposed rules.

A description of the projected recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to such requirements that the type of professional skills necessary for preparation of the report or record.

No reporting or recordkeeping requirements are projected to be associated with the proposed regulations.

Identification, to the extent practicable, of all relevant Federal rules that may duplicate, overlap, or conflict with the proposed rule.

The ***IRS*** is not aware of any Federal rules that duplicate, overlap, or conflict with the proposed rule.

Description of any significant alternatives to the proposed rule that accomplish the stated objectives of applicable statutes and that minimize any significant economic impact of the proposed rule on small entities, including a discussion of significant alternatives.

Section 330 of title 31, United States Code authorizes the Secretary, or her delegate, to impose standards on individuals who practice before the Treasury Department and the ***IRS***; to suspend or disbar from practice certain individuals; and to bar certain appraisers from submitting evidence or testimony in any administrative proceeding before the Treasury Department or the ***IRS***. The Treasury Department and the ***IRS*** have issued regulations under ***Circular 230*** for these purposes since 1921 and have regularly updated them to reflect changing law and current standards of practice. These updates, including those found in the proposed regulations, are essential to ensure that practitioners and appraisers are competent, reputable and have the necessary requirements to provide taxpayers with valuable service. The proposed regulations could have created a new standard for appraisals submitted in an administrative proceeding before the ***IRS***, but that would have been more burdensome to appraisers. Instead, requiring appraisals to conform in substance and principles to the USPAP or IVS is less costly and burdensome because appraisers are already required to abide by these standards. Further, the proposed regulations could have implemented case law to preclude regulating contingent fee arrangements for preparing original or amended returns and ordinary refund claims, but this position would not have met the objective to discourage unduly **[*104924]** aggressive tax positions that result in evasion or abuse of the Federal tax laws. Therefore, the proposed regulations would adopt a straightforward standard: charging a contingent fee for the preparation of an original return, amended return, or claim for refund or credit prepared prior to the examination of a tax return is disreputable conduct.

## III. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.


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## IV. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

## V. Executive Order 13175: Consultation and Coordination With Indian Tribal Governments

Executive Order 13175 (Consultation and Coordination With Indian Tribal Governments) prohibits an agency from publishing any rule that has Tribal implications if the rule either imposes substantial, direct compliance costs on Indian Tribal governments, and is not required by statute, or preempts Tribal law, unless the agency meets the consultation and funding requirements of section 5 of the Executive order.

The Treasury Department and the ***IRS*** will hold a consultation with Tribal leaders to receive Tribal feedback on whether practitioners eligible to practice before the ***IRS*** should include individuals admitted to practice law in a Tribal court, which will inform the development of future regulations.

## Statement of Availability of *IRS* Documents

***IRS*** Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the ***IRS*** website at *https://www.**irs**.gov.*

## Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are timely submitted to the Treasury Department and the ***IRS*** as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the ***IRS*** request comments on all aspects of the proposed regulations. Any electronic and paper comments submitted will be available at *https://www.regulations.gov* or upon request. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn.

A public hearing is being held on March 6, 2025, beginning at 10 a.m. ET, in the Auditorium at the Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. Participants may alternatively attend the public hearing by telephone.

The rules of *26 CFR 601.601(a)(3)* apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed as well as the time to be devoted to each topic by February 24, 2025. A period of ten minutes will be allocated to each person for making comments. After the deadline for receiving outlines has passed, the ***IRS*** will prepare an agenda


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containing the schedule of speakers. Copies of the agenda will be made available free of charge at the hearing. If no outlines of the topics to be discussed at the hearing are received by February 24, 2025, the public hearing will be cancelled. If the public hearing is cancelled, a notification of cancellation of the public hearing will be published in the **Federal Register** .

Individuals who want to testify in person at the public hearing must send an email to *publichearings@**irs**.gov* to have your name added to the building access list. The subject line of the email must contain the regulation number REG-116610-20 and, the language TESTIFY In Person. For example, the subject line may say: Request to TESTIFY In Person at Hearing for REG-116610-20.

Individuals who want to testify by telephone at the public hearing must send an email to *publichearings@**irs**.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-116610-20 and the language TESTIFY Telephonically. For example, the subject line may say: Request to TESTIFY Telephonically at Hearing for REG-116610-20.

Individuals who want to attend the public hearing in person without testifying must also send an email to *publichearings@**irs**.gov* to have your name added to the building access list. The subject line of the email must contain the regulation number (REG-116610-20) and the language ATTEND In Person. For example, the subject line may say: Request to ATTEND Hearing In Person for REG-116610-20. Requests to attend the public hearing must be received by 5 p.m. ET on March 4, 2025.

Individuals who want to attend the public hearing telephonically without testifying must also send an email to *publichearings@**irs**.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number (REG-116610-20) and the language ATTEND Hearing Telephonically. For example, the subject line may say: Request to ATTEND Hearing Telephonically for REG-116610-20. Requests to attend the public hearing must be received by 5 p.m. ET on March 4, 2025.

Hearings will be made accessible to people with disabilities. To request special assistance during the hearing, contact the Publications and Regulations Branch of the Office of Associate Chief Counsel (Procedure and Administration) by sending an email to *publichearings@**irs**.gov* (preferred) or by telephone at (202) 317-6901 (not a toll-free number) by at least March 3, 2025.

**Drafting Information**

The principal author of these regulations is William J. Prater of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the ***IRS*** participated in the development of the regulations. **[*104925]**

**Withdrawal of Notice of Proposed Rulemaking**

The Treasury Department and the ***IRS*** withdraw the notice of proposed rulemaking (REG-113289-08) that was published in the **Federal Register** on July 28, 2009 (*74 FR 37183*) under the authority of *31 U.S.C. 330*.

## Regulations

### List of Subjects in 31 CFR Part 10

Accountants, Administrative practice and procedure, Lawyers, Reporting and recordkeeping requirements, Taxes.

**Proposed Amendments to the Regulations**

Accordingly, the Treasury Department and the ***IRS*** propose to amend 31 CFR part 10 as follows:

**PART 10 — PRACTICE BEFORE THE INTERNAL REVENUE SERVICE**

**Paragraph 1.** The authority for 31 CFR part 10 continues to read as follows:

**Authority:** Sec. 3, 23 Stat. 258, secs. 2-12, *60 Stat. 237 et seq.; 5 U.S.C. 301*, 500, 551-559; *31 U.S.C. 321*; *31 U.S.C. 330*; Reorg. Plan No. 26 of 1950, *15 FR 4935*, *64 Stat. 1280*, 3 CFR, 1949-1953 Comp., P. 1017.

**Par. 2.** Part 10 is amended by removing the language "taxpayer", "taxpayers", and "taxpayer's" wherever they appear and adding the language "client", "clients", and "client's" in their places, respectively.

**Par. 3.** Section 10.0 is revised to read as follows:

**§ 10.0 Scope of part.**

(a) *In general.* This part contains rules governing the recognition of attorneys, certified public accountants, enrolled agents, enrolled retirement plan agents, enrolled actuaries, and other persons representing clients before the Internal Revenue Service. This part also establishes standards for appraisers who submit appraisals or present evidence or testimony to the Department of the Treasury or the Internal Revenue Service (***IRS***). Subpart A of this part sets forth rules relating to the authority to practice before the ***IRS***; subpart B of this part prescribes the duties and restrictions relating to subpart A; subpart C of this part prescribes incompetence and disreputable conduct; subpart D of this part sets forth standards relating to the disqualification of appraisers and prescribes sanctions for violating the standards; subpart E of this part prescribes the sanctions for violating the standards in subparts B through D; subpart F of this part contains the rules applicable to disciplinary proceedings and general provisions relating to the availability of official records.

(b) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 4.** Section 10.2 is amended by:

1. Revising paragraphs (a)(4) through (6).
2. Removing paragraphs (a)(7) and (8).
3. Revising paragraph (b).

The revisions read as follows:

**§ 10.2 Definitions.**

(a) * * *

(4) *Practice before the Internal Revenue Service* comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a client's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing documents; filing documents; corresponding and communicating with the Internal Revenue Service; rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and representing a client at conferences, hearings, and meetings. Any action that supports a presentation to the Internal Revenue Service, including the preparation and submission of tax returns in connection with representing a client in a matter before the Internal Revenue Service, may constitute practice before the Internal Revenue Service.

(5) *Practitioner* means any individual described in § 10.3(a), (b), (c), (d), or (e).

(6) A *tax return* includes an amended tax return and a claim for refund or credit within the meaning of section 6696(e)(2) of the Internal Revenue Code, such as a claim for refund or credit made on ***IRS*** Form 843, *Claim for Refund and Request for Abatement.*

(b) This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 5.** Section 10.3 is amended by:

1. Revising paragraphs (c), (d)(3), and (e)(1) and (3).
2. Removing paragraph (f).
3. Redesignating paragraphs (g) through (j) as paragraphs (f) through (i).
4. Revising newly redesignated paragraph (i).

The revisions read as follows:

**§ 10.3 Who may practice.**

* * * * *

(c) *Enrolled agents.* Any individual enrolled as an agent pursuant to this part who is not currently under suspension or disbarment from practice before the Internal Revenue Service, and whose valid enrollment is active and has not been terminated under § 10.6, may practice before the Internal Revenue Service.

(d) * * *

(3) An individual who practices before the Internal Revenue Service pursuant to paragraph (d)(1) of this section is subject to the provisions of this part in the same manner as attorneys, certified public accountants, enrolled agents, and enrolled retirement plan agents.

(e) * * *



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(1) Any individual enrolled prior to February 12, 2016, as a retirement plan agent pursuant to this part who is not currently under suspension or disbarment from practice before the Internal Revenue Service, and whose enrollment is not in inactive status or has not been terminated under § 10.6, may practice before the Internal Revenue Service.

* * * * *

(3) An individual who practices before the Internal Revenue Service pursuant to paragraph (e)(1) of this section is subject to the provisions of this part in the same manner as attorneys, certified public accountants, enrolled agents, and enrolled actuaries.

* * * * *

(i) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 6.** Section 10.4 is amended by:

1. Revising the section heading.
2. Removing paragraphs (b) through (d).
3. Redesignating paragraphs (e) and (f) as paragraphs (b) and (c).
4. Revising newly redesignated paragraph (c).

The revisions read as follows:

**§ 10.4 Eligibility to become an enrolled agent.**

* * * * *

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ]. Former ***IRS*** employees must apply for special enrollment in accordance with *31 CFR 10.4(d)*, revised as of July 1, [year to be determined], on or before [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 7.** Section 10.5 is amended by revising the section heading and paragraphs (a), (b), (d)(2), (e), and (g) to read as follows:

**§ 10.5 Application to become an enrolled agent.[*104926]**

(a) *Form; address.* An applicant to become an enrolled agent must apply as required by forms or procedures established and published by the Internal Revenue Service, including proper execution of required forms under oath or affirmation. The address on the application will be the address under which a successful applicant is enrolled and is the address to which all correspondence concerning enrollment will be sent.

(b) *Fee.* A reasonable nonrefundable fee may be charged for each application to become an enrolled agent. *See* 26 CFR part 300.

* * * * *

(d) * * *

(2) If the applicant does not pass the tax compliance or suitability check, the applicant will not be issued a confirmation of enrollment pursuant to § 10.6(b). An applicant who is initially denied enrollment for failure to pass a tax compliance check may reapply after the initial denial if the applicant becomes current with respect to the applicant's tax liabilities.

(e) *Temporary recognition.* On receipt of a properly executed application, the Commissioner, or delegate, may grant the applicant temporary recognition to practice pending a determination as to whether status as an enrolled agent should be granted. Temporary recognition will be granted only in unusual circumstances and it will not be granted, in any circumstance, if the application is not regular on its face, if the information stated in the application, if true, is not sufficient to warrant granting the application to practice, or if the Commissioner, or delegate, has information indicating that the statements in the application are untrue or that the applicant would not otherwise qualify to become an enrolled agent. Issuance of temporary recognition does not constitute either a designation or a finding of eligibility as an enrolled agent, and the temporary recognition may be withdrawn at any time.

* * * * *

(g) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 8.** Section 10.6 is amended by:

1. Revising the section heading and paragraphs (a), (b), (c), and (d)(1) and (2).
2. Removing paragraph (d)(4).
3. Redesignating paragraphs (d)(5) through (7) as paragraphs (d)(4) through (6).
4. Revising newly redesignated paragraphs (d)(4) and (6) and paragraph (e) introductory text.
5. Removing paragraph (e)(1)(iii).
6. Redesignating paragraph (e)(1)(iv) as paragraph (e)(1)(iii).
7. Removing paragraphs (e)(3) and (f)(1)(iii).
8. Revising paragraphs (f)(2)(ii) heading, (f)(2)(iii)(C), (i)(4) and (5), and (j)(2).
9. In paragraph (j)(3), removing the language “or inactive registered individuals” from the end of the first sentence.
10. Revising paragraphs (j)(4) through (6), (k), (l), and (n).

The revisions read as follows:

**§ 10.6 Term and renewal of status as an enrolled agent or enrolled retirement plan agent.**

(a) *Term.* Each individual authorized to practice before the Internal Revenue Service as an enrolled agent or enrolled retirement plan agent will be accorded active enrollment status subject to renewal of enrollment as provided in this part.

(b) *Confirmation of enrollment.* The Internal Revenue Service will issue an enrollment document (such as an enrollment card or other document) to an individual who meets the enrollment requirements in this paragraph (b) and whose application to

practice before the Internal Revenue Service is approved. This approval will be valid for the period stated on the enrollment document. An enrolled agent or enrolled retirement plan agent may not practice before the Internal Revenue Service without a valid approval. The enrollment document is in addition to any notification that may be provided to each individual who obtains a preparer tax identification number.

(c) *Change of address.* An enrolled agent or enrolled retirement plan agent must send notification of any change of address to the address specified by the Internal Revenue Service within 60 days of the change of address. This notification must include the enrolled agent's or enrolled retirement plan agent's name, prior address, new address, tax identification number(s) (including preparer tax identification number), and the date the change of address is effective. Unless this notification is sent, the address for purposes of any correspondence from the appropriate Internal Revenue Service office responsible for administering this part will be the address reflected on the practitioner's most recent application for enrollment, or application for renewal of enrollment. A practitioner's change of address notification under this part will not constitute a change of the practitioner's last known address for purposes of *section 6212 of the Internal Revenue Code*.

(d) * * *

(1) *In general.* Enrolled agents or enrolled retirement plan agents must renew their status with the Internal Revenue Service to maintain eligibility to practice before the Internal Revenue Service. Failure to receive notification from the Internal Revenue Service of the renewal requirement will not be justification for the individual's failure to satisfy the requirement of this paragraph (d).

(2) *Renewal period for enrolled agents.* (i) Applications for renewal of status as an enrolled agent will be required between November 1 and January 31 every three years according to the last digit of the individual's Social Security number or tax identification number. Those individuals who receive initial enrollment as an enrolled agent after November 1 and before April 2 of the applicable renewal period will not be required to renew their enrollment before the first full renewal period following the receipt of their initial enrollment.

(ii) Enrolled agents who have a Social Security number or tax identification number that ends with the numbers 0, 1, 2, or 3, except for those individuals who received their initial enrollment after November 1, 2024, must apply for renewal between November 1, 2024, and January 31, 2025. The renewal will be effective April 1, 2025.

(iii) Enrolled agents who have a Social Security number or tax identification number that ends with the numbers 4, 5, or 6, except for those individuals who received their initial enrollment after November 1, 2025, must apply for renewal between November 1, 2025, and January 31, 2026. The renewal will be effective April 1, 2026.

(iv) Enrolled agents who have a Social Security number or tax identification number that ends with the numbers 7, 8, or 9, or who do not have a Social Security number, except for those individuals who received their initial enrollment after November 1, 2026, must apply for renewal between November 1, 2026, and January 31, 2027. The renewal will be effective April 1, 2027.

* * * * *



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(4) *Notification of renewal.* After review and approval, the Internal Revenue Service will notify the individual of the renewal and will issue the individual a document evidencing **[*104927]** current status as an enrolled agent or enrolled retirement plan agent.

* * * * *

(6) *Forms.* Forms required for renewal may be obtained by sending a written request to the address specified by the Internal Revenue Service or from such other source as the Internal Revenue Service will publish in the Internal Revenue Bulletin ( *see* 26 CFR 601.601(d)(2)(ii)( *b* )) and on the Internal Revenue Service website.

(e) *Condition for renewal: continuing education.* To qualify for renewal as an enrolled agent or enrolled retirement plan agent an individual must certify in the manner prescribed by the Internal Revenue Service that the individual has satisfied the requisite number of continuing education hours.

* * * * *

(f) * * *

(2) * * *

(ii) *Correspondence or individual study programs (including recorded programs).* * * *

(iii) * * *

(C) The maximum continuing education credit for instruction and preparation may not exceed six hours annually for enrolled agents and enrolled retirement plan agents.

* * * * *

(i) * * *

(4) If a request for waiver is not approved, the individual will be placed in inactive status. The individual will be notified that the waiver was not approved and that the individual has been placed on a roster of inactive enrolled agents or enrolled retirement plan agents.

(5) If the request for waiver is not approved, the individual may file a protest as prescribed by the Internal Revenue Service in forms, instructions, or other appropriate guidance. A protest filed under this section is not governed by subpart F of this part.

* * * * *

(j) * * *

(2) The continuing education records of an enrolled agent or enrolled retirement plan agent may be reviewed to determine compliance with the requirements and standards for renewal as provided in paragraph (f) of this section. As part of this review, the enrolled agent or enrolled retirement plan agent may be required to provide the Internal Revenue Service with copies of any continuing education records required to be maintained under this part. If the enrolled agent or enrolled retirement plan agent fails to comply with the requirement in this paragraph (j)(2), any continuing education hours claimed may be disallowed.

* * * * *



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(4) Individuals in inactive status and individuals who are ineligible to practice before the Internal Revenue Service may not state or imply that they are eligible to practice before the Internal Revenue Service, or use the terms enrolled agent or enrolled retirement plan agent, the designations *EA* or *ERPA,* or other form of reference to eligibility to practice before the Internal Revenue Service.

(5) An individual placed in inactive status may be reinstated to an active status by filing an application for renewal and providing evidence of the completion of all required continuing education hours for the enrollment cycle. Continuing education credit under this paragraph (j)(5) may not be used to satisfy the requirements of the enrollment cycle in which the individual has been placed back on the active roster.

(6) An individual placed in inactive status must file an application for renewal and satisfy the requirements for renewal as set forth in this section within three years of being placed in inactive status. Otherwise, the name of such individual will be removed from the inactive status roster and the individual's status as an enrolled agent or enrolled retirement plan agent will terminate. Future eligibility for active status must then be reestablished by the individual as provided in this section.

* * * * *

(k) *Inactive retirement status.* An individual who no longer practices before the Internal Revenue Service may request to be placed in an inactive retirement status at any time and such individual will be placed in an inactive retirement status. The individual will be ineligible to practice before the Internal Revenue Service. An individual who is placed in an inactive retirement status may be reinstated to an active status by filing an application for renewal and providing evidence of the completion of the required continuing education hours for the enrollment cycle. Inactive retirement status is not available to an individual who is ineligible to practice before the Internal Revenue Service or an individual who is the subject of a pending disciplinary matter under this part.

(l) *Renewal while under suspension or disbarment.* An individual who is ineligible to practice before the Internal Revenue Service by virtue of disciplinary action under this part is required to conform to the requirements for renewal of enrollment before the individual's eligibility is restored.

* * * * *

(n) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 9.** Section 10.7 is amended by adding paragraph (c)(1)(viii) and revising paragraph (f) to read as follows:

**§ 10.7 Representing oneself; participating in rulemaking; limited practice; and special appearances.**

* * * * *

(c) * * *

(1) * * *





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(viii) An individual who possesses a current Annual Filing Season Program (AFSP) Record of Completion may represent a client before revenue agents, customer service representatives, or similar officers and employees of the Internal Revenue Service, including the Taxpayer Advocate Service, during an examination of a tax return or claim for refund or credit that the individual prepared and signed. The individual must have: a valid Record of Completion for the calendar year in which the tax return or claim for refund or credit was prepared and signed and a valid Record of Completion for the year or years in which the representation occurs.

* * * * *

(f) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 10.** Section 10.8 is revised to read as follows:

***§ 10.8 Participation in IRS proceedings by non-practitioners.***

(a) *Furnishing Information.* Any individual, except appraisers who have been disqualified pursuant to § 10.61(a), including non-practitioners, may appear as a witness before the Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of its officers or employees.

(b) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 11.** Section 10.9 is amended by:

1. In paragraph (a)(2)(i), removing the language "and pay any applicable user fee" from the end of the paragraph.

2. In paragraph (a)(2)(ii), removing the language "and paying any applicable user fee" from the end of the paragraph.

3. In paragraph (a)(4)(i), removing the language "and pay any applicable user fee" from the first sentence in the paragraph.

4. Revising paragraph (c). **[*104928]**

5. Adding paragraph (d).

The revision and addition read as follows:

**§ 10.9 Continuing education providers and continuing education programs.**

* * * * *

(c) *Fee.* In addition to any vendor fees that are charged, a continuing education provider may be required to pay a user fee to obtain or renew a continuing education provider number or continuing education provider program number.

(d) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].



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**Par. 12.** Section 10.21 is revised to read as follows:

**§ 10.21 Knowledge of error or omission.**

(a) *In general.* A practitioner who, while representing a client in a matter before the Internal Revenue Service, knows that either the client, the practitioner, or a prior practitioner has not complied with the revenue laws of the United States and regulations, or has made an error in or omission from any return, document, affidavit, or other paper that the client submitted or executed under the revenue laws of the United States and regulations, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences of the noncompliance, error, or omission, as provided under the internal revenue laws of the United States and regulations, and recommend the corrective actions, such as disclosure, to be taken.

(b) *Disclosure and continued representation.* If a practitioner is representing a client in a matter before the Internal Revenue Service, the practitioner should request the client's agreement to disclose the noncompliance, error, or omission to the Internal Revenue Service. The practitioner must also take reasonable steps to ensure that the noncompliance, error, or omission is not repeated in subsequent submissions to the Internal Revenue Service. If the client does not agree to disclose the noncompliance, error, or omission, the practitioner should consider whether the practitioner can continue to represent the client before the Internal Revenue Service and meet the obligation to ensure diligence as to accuracy under § 10.22.

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 13.** Section 10.22 is amended by revising paragraphs (a)(1) through (3) and (c) to read as follows:

**§ 10.22 Diligence as to accuracy.**

(a) * * *

(1) In preparing or assisting in the preparation of, approving, or submitting documents, affidavits, and other papers, including tax returns prepared, approved or submitted in connection with representing a client in a matter before the Internal Revenue Service;

(2) In determining the correctness of oral or written representations made by the practitioner when representing a client in a matter before the Internal Revenue Service; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients when representing clients in a matter before the Internal Revenue Service.

* * * * *

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**§ 10.27 [Removed]**

**Par. 14.** Section 10.27 is removed.



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**Par. 15.** Section 10.30 is amended by revising paragraphs (a)(1) and (e) to read as follows:

**§ 10.30 Solicitation.**

(a) * * *

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. Enrolled agents and enrolled retirement plan agents, in describing their professional designation, may not utilize the term *certified* or imply an employer-employee relationship with the Internal Revenue Service. Examples of acceptable descriptions for enrolled agents are "enrolled to represent clients before the Internal Revenue Service," "enrolled to practice before the Internal Revenue Service," "admitted to practice before the Internal Revenue Service," *EA,* or *E.A.* Similarly, examples of acceptable descriptions for enrolled retirement plan agents are "enrolled to represent clients before the Internal Revenue Service as a retirement plan agent" and "enrolled to practice before the Internal Revenue Service as a retirement plan agent," *ERPA,* or *E.R.P.A.*

* * * * *

(e) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

* * * * *

**Par. 16.** Section 10.31 is revised to read as follows:

**§ 10.31 Negotiation of payments to clients.**

(a) *In general.* A practitioner may not endorse or otherwise negotiate or transfer any paper or electronic check, prepaid or debit card, phone or mobile payment, or other form of payment issued to a client by the government in respect of a Federal tax liability. *Negotiate or transfer* includes directing or accepting payment by any means, electronic or otherwise, into an account owned, controlled by, or held for the benefit of the practitioner or any firm or other entity with which the practitioner is associated.

(b) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 17.** Section 10.33 is amended by:

1. Revising the section heading and paragraphs (a) introductory text and (a)(1).
2. Redesignating paragraph (a)(4) as paragraph (a)(7).
3. Adding new paragraph (a)(4) and paragraphs (a)(5) and (6).
4. Revising paragraph (b).
5. Removing paragraph (c).



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The revisions and additions read as follows:

**§ 10.33 Best practices for tax practitioners.**

(a) *Best practices.* Tax practitioners should provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. In addition to compliance with the standards of practice provided elsewhere in this part, best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement, including those relating to fees, expenses, and payment. For example, the practitioner should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

* * * * *

(4) Maintaining a policy related to data security safeguards with respect to a client's tax return or other confidential information. Practitioners should also consider developing an incident response plan with specific procedures for responding to a data breach and for disclosure of data breaches to clients. **[*104929]**

(5) Identifying, evaluating, and addressing a mental impairment, whether chronic or temporary, arising out of or related to age, substance abuse, a physical or mental health condition, or other circumstance that may have an adverse impact on a tax practitioner's ability to provide the highest quality representation of a client before the Internal Revenue Service.

(6) Establishing a business continuity and succession plan that addresses procedures and safeguards in the event of the sale or cessation of the practitioner's practice, the practitioner's death or disability, or the occurrence of extraordinary events such as a natural disaster, cyberattack, or pandemic.

* * * * *

(b) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 18.** Section 10.34 is amended by revising the section heading and paragraphs (a) heading, (a)(1)(i) introductory text, (c)(1)(i) and (ii), and (d) and (e) to read as follows:

**§ 10.34 Standards with respect to tax returns, documents, affidavits, and other papers prepared or submitted while representing a client before the Internal Revenue Service.**

(a) *Tax returns prepared or submitted while representing a client in a matter before the* ***IRS***. (1) * * *

(i) Prepare, while representing a client in a matter before the Internal Revenue Service or, for tax returns prepared by the practitioner prior to the representation, including returns already filed with the Internal Revenue Service, submit a tax return or claim for refund or a claim for a credit that the practitioner knows or reasonably should know contains a position that—

* * * * *

(c) * * *

(1) * * *

(i) A position taken on a tax return that is relevant to the representation of a client in a matter before the Internal Revenue Service if—

(A) The practitioner provided written advice, as defined under § 10.37, to the client with respect to the position; or

(B) The practitioner prepared and submitted the tax return while representing the client in a matter before the ***IRS***.

(ii) Any document, affidavit or other paper submitted in a matter before the Internal Revenue Service.

* * * * *

(d) *Relying on information furnished by clients.* A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted in a matter before the Internal Revenue Service, generally may rely in good faith without verification upon information furnished by the client. However, the practitioner may not ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 19.** Section 10.35 is amended by adding a sentence at the end of paragraph (a) and revising paragraph (b) to read as follows:

**§ 10.35 Competence.**

(a) * * * Competency includes understanding the benefits and risks associated with relevant technology that is used by the practitioner to provide services to clients or to store and transmit tax return and other confidential information.

(b) This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 20.** Section 10.36 is amended by revising paragraphs (a) and (c) to read as follows:

**§ 10.36 Procedures to ensure compliance.**

(a) Any individual subject to the provisions of this part who has (or individuals who have or share) principal authority and responsibility for overseeing a firm's practice governed by this part, including, while representing a client, the provision of advice concerning Federal tax matters or the preparation or submission of documents in a matter before the Internal Revenue Service, must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees (whether or not those individuals are otherwise subject to this part) for purposes of complying with subparts A through C of this part, as applicable (including the best practices described in § 10.33(a)). In the absence of a person or persons identified by the firm as having the principal authority and responsibility described in this paragraph (a), the Internal

Revenue Service may identify one or more individuals subject to the provisions of this part responsible for compliance with the requirements of this section.

* * * * *

(c) This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 21.** Section 10.37 is amended by revising the section heading and paragraphs (b)(2), (c), (d) introductory text, (d)(2), and (e) to read as follows:

**§ 10.37 Requirements for written tax advice.**

* * * * *

(b) * * *

(2) The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice, or is unaware of all relevant facts and circumstances; or

* * * * *

(c) *Standard of review.* In evaluating whether a practitioner giving written advice concerning one or more Federal tax matters complied with the requirements of this section, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, including, but not limited to, the scope of the engagement, the practitioner's knowledge of the client's particular circumstances, and the type and specificity of the advice sought by the client.

(d) *Federal tax matter.* A Federal tax matter, as used in this section, is any transaction, plan, arrangement, or other matter (whether prospective or completed), which is of a type that the Internal Revenue Service determines as having a potential for tax avoidance or evasion, concerning the application or interpretation of—

* * * * *

(2) Any provision of law impacting a person's obligations under the internal revenue laws and regulations, including but not limited to the person's liability to pay tax, ability to take a specific return position (whether prospective or completed), or obligation to file returns; or

* * * * *

(e) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**§§ 10.38, 10.91, and 10.93 [Removed]**

**Par. 22.** Sections 10.38, 10.91, and 10.93 are removed.

**§§ 10.50, 10.51, 10.52, 10.53, 10.60, 10.61, 10.62, 10.63, 10.64, 10.65, 10.66, 10.67, 10.68, 10.69, 10.70, 10.71, 10.72, 10.73, 10.74, 10.75, 10.76, 10.77, 10.78, 10.79, 10.80, 10.81, 10.82, 10.90, and 10.92 [Redesignated as §§ 10.70, 10.50, 10.71, 10.72, 10.80, 10.81, 10.82, 10.83, 10.84, 10.85, 10.86, 10.87, 10.88, 10.89, 10.90, 10.91, 10.92, 10.93, 10.94, 10.95, 10.96, 10.97, 10.98, 10.99, 10.100, 10.101, 10.102, 10.100, and 10.113][*104930]**

**Par. 23.** Redesignate the sections in the first column as the sections in the second column:

| Current section: | New section: |
|---|---|
| 10.50 | 10.70 |
| 10.51 | 10.50 |
| 10.52 | 10.71 |
| 10.53 | 10.72 |
| 10.60 | 10.80 |
| 10.61 | 10.81 |
| 10.62 | 10.82 |





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10.63 10.83

10.64 10.84

10.65 10.85

10.66 10.86

10.67 10.87

10.68 10.88

10.69 10.89

10.70 10.90

10.71 10.91

10.72 10.9



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2

10.73 10.93

10.74 10.94

10.75 10.95

10.76 10.96

10.77 10.97

10.78 10.98

10.79 10.99

10.80 10.100

10.81 10.101

10.82 1

| | |
|---|---|
| | 0.102 |
| 10.90 | 10.110 |
| 10.92 | 10.113 |

**Par. 24.** Revise the heading for subpart C to read as follows:

**Subpart C — Incompetence or Disreputable Conduct**

**Par. 25.** Newly redesignated § 10.50 is amended by:

1. Revising paragraphs (a) introductory text and (a)(12).
2. Adding paragraph (a)(19).
3. Revising paragraph (b).
4. Adding paragraph (c).

The revisions and additions read as follows:

**§ 10.50 Incompetence or disreputable conduct.**

(a) *Incompetence or disreputable conduct.* Incompetence or disreputable conduct for which a practitioner may be sanctioned under § 10.70 includes actions that relate to a practitioner's fitness to practice before the Internal Revenue Service, regardless of whether those actions are connected to a presentation to the Internal Revenue Service as defined under § 10.2(a)(4). Incompetence or disreputable conduct includes, but is not limited to—

* * * * *

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service (or during any proceeding pursuant to § 10.80 or an investigation by the Treasury Inspector General for Tax Administration), including the use of abusive or otherwise contemptuous acts or language, making false accusations or statements, knowing them to be false, or circulating or publishing malicious or libelous matter.

* * * * *

(19) Willfully failing to follow any Federal tax law.

(b) *Assessment of certain penalties.* Assessment against a practitioner of a penalty related to a willful attempt to understate tax liabilities under





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section 6694(b) of the Internal Revenue Code (Code); aiding or abetting in the understatement of tax liabilities under section 6701 of the Code; careless, reckless, or intentional disregard for applicable rules or regulations (within the meaning of *26 CFR 1.6662-3(b)(2)* and 1.6694-3(c)) under section 6662(b)(1) of the Code; or promotion of abusive tax shelters under section 6700 of the Code will be considered a violation of paragraph (a)(7) of this section. The assessment of any of these penalties, however, is not required to show a violation of paragraph (a)(7) of this section.

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 26.** New § 10.51 is added to subpart C to read as follows:

**§ 10.51 Fees that constitute disreputable conduct.**

(a) *Unconscionable fees.* Charging an unconscionable fee is disreputable conduct.

(b) *Contingent fees.* Charging a contingent fee in connection with the preparation of an original or amended tax return or claim for refund or credit prepared prior to the examination of the tax return is disreputable conduct.

(1) *Preparation of an original or amended tax return or claim for refund or credit* includes providing advice that is directly relevant to determining the existence, character, or amount of an item, entry, or another portion of a tax return or claim for refund, including any schedules that are part of the tax return or claim for refund or credit.

(2) *Contingent fee* is any fee that is based in whole or in part on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a tax return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific tax result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 27.** Revise the heading for subpart D to read as follows:

**Subpart D — Appraisers**

**Par. 28.** Add new §§ 10.60 through 10.62 to subpart D to read as follows:

* * * * *

Sec.

10.60 Definitions.

10.61 Disqualification of appraisers.

10.62 Receipt of information concerning appraisers.

**§ 10.60 Definitions.**

(a) *Appraiser.* The term *appraiser* means any individual who determines the market value of any asset to support a position taken on a tax return or in an administrative proceeding. Appraisers include, but are not limited to, individuals who meet the definition of a "qualified appraiser" under section 170(f)(11)(E) of the Internal Revenue Code.

(b) *Administrative proceeding.* An administrative proceeding for purposes of this subpart, includes any matter or other action before the Department of the Treasury or the Internal Revenue Service that involves the presentation of documents, testimony, or other evidence. Administrative proceedings include, but are not limited to, investigations, examinations, appeals, and collection actions.

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**§ 10.61 Disqualification of appraisers.**

(a) *Authority to disqualify appraisers.* The Commissioner, or delegate, after due notice and an opportunity for a **[*104931]** hearing, may disqualify an appraiser for violations of any of the standards under paragraph (b) of this section or for the disreputable conduct described under paragraph (c) of this section. Disqualification may include a finding that appraisals by such appraiser will have no probative effect in an administrative proceeding or barring an appraiser from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service.

(1) The disqualification of an appraiser will remain in effect until the appraiser is authorized to present evidence or testimony pursuant to § 10.101. The prohibition applies to appraisals, evidence, and testimony submitted or presented by the appraiser and is not limited to a specific appraisal or client. The prohibition also applies to appraisals made before the effective date of disqualification.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the client's reliance in good faith on such appraisal.

(b) *Appraisal standards and prohibited conduct.* (1) All appraisals submitted in an administrative proceeding should conform to the substance and principles of generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation or the International Valuation Standards (IVS) promulgated by the International Valuation Standards Council (IVSC).

(2) An appraiser may not prepare an appraisal, where the appraiser knew or reasonably should have known that it would be submitted during an administrative proceeding and used to support a substantial valuation misstatement as defined in section 6662(e) of the Internal Revenue Code (Code), a substantial estate or gift tax valuation understatement as defined in section 6662(g), or a gross valuation misstatement as defined in section 6662(h).

(c) *Disreputable conduct.* An appraiser who has been assessed a penalty under section 6694, 6695A, 6700, or 6701 of the Code, for which it is determined that the appraiser acted willfully, recklessly, or through gross incompetence with respect to the proscribed conduct may be disqualified for engaging in disreputable conduct.

(d) *Misconduct triggering disqualification.* An appraiser may be disqualified under § 10.61(a) if the appraiser:

(1) Willfully violates any of the standards described in paragraphs (b)(1) and (2) of this section.

(2) Recklessly or through gross incompetence engages in a pattern of submitting appraisals that violate the standards described in paragraph (b)(1) of this section.

(3) Recklessly or through gross incompetence violates the standard described in paragraph (b)(2) of this section.

(4) Engages in the disreputable conduct described in paragraph (c) of this section.

(e) *Defenses to disqualification.* If an appraiser shows compliance with the substance and principles of USPAP standards or IVS with all relevant appraisals, the showing will be taken into account as a defense in determining whether the appraiser acted willfully, recklessly, or though gross incompetence with respect to a violation of paragraph (b)(2) or (c) of this section.

(f) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**§ 10.62 Receipt of information concerning appraisers.**

(a) *Officer or employee of the Internal Revenue Service.* If an officer or employee of the Internal Revenue Service has reason to believe an appraiser has violated § 10.61(b)(1) or (2) or has been assessed a penalty under section 6694, 6695A, 6700, or 6701 of the Internal Revenue Code, the officer or employee will promptly make a written report of the suspected violation. The report will explain the facts and reasons upon which the officer's or employee's belief rests and must be submitted to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

(b) *Other persons.* Any person other than an officer or employee of the Internal Revenue Service having information of misconduct described in § 10.61(d) may make an oral or written report of the alleged misconduct to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part or any officer or employee of the Internal Revenue Service. If the report is made to an officer or employee of the Internal Revenue Service, the officer or employee will make a written report of the suspected misconduct and submit the report to the office(s) of the Internal Revenue Service responsible for administering and enforcing this part.



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(c) *Destruction of report.* No report made under paragraph (a) or (b) of this section will be maintained unless retention of the report is permissible under the applicable records control schedule as approved by the National Archives and Records Administration and designated in the Internal Revenue Manual. Reports must be destroyed as soon as permissible under the applicable records control schedule.

(d) *Effect on proceedings under subpart E of this part.* The destruction of any report will not bar any proceeding under subpart E but will preclude the use of a copy of the report in a proceeding under subpart E.

(e) *Applicability date.* This section is applicable to conduct occurring on or after [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 29.** Revise the heading for subpart E to read as follows:

**Subpart E — Sanctions for Violation of the Regulations**

**§§ 10.70, 10.71, and 10.72 [Transferred to Subpart E]**

**Par. 30.** Newly redesignated §§ 10.70, 10.71, and 10.72 are transferred to subpart E.

**Par. 31.** Newly redesignated § 10.70 is amended by:

1. Removing paragraph (b).
2. Redesignating paragraphs (c) through (f) as paragraphs (b) through (e).
3. Revising newly redesignated paragraph (e).

The revision reads as follows:

**§ 10.70 Sanctions.**

* * * * *

(e) *Applicability date.* This section is applicable to conduct occurring on or after [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 32.** Newly redesignated § 10.71 is revised to read as follows:

**§ 10.71 Violations subject to sanction.**

(a) A practitioner may be sanctioned under § 10.70 if the practitioner—

(1) Willfully violates any of the regulations (other than § 10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of § 10.50(a)(13)) violates § 10.34, § 10.35, § 10.36, or § 10.37.

(b) This section is applicable to conduct occurring on or after [date 30 **[*104932]** days after date of publication of final regulations in the **Federal Register** ].

**Par. 33.** Newly redesignated § 10.72 is amended by revising paragraphs (d) and (e) to read as follows:

**§ 10.72 Receipt of information concerning practitioner.**



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* * * * *

(d) *Effect on proceedings under subpart F of this part.* The destruction of any report will not bar any proceeding under subpart F but will preclude the use of a copy of the report in a proceeding under subpart F.

(e) *Applicability date.* This section is applicable to conduct occurring on or after [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 34.** Add subpart F to read as follows:

**Subpart F — Rules Applicable to Disciplinary Proceedings and General Provisions**

**§§ 10.80 through 10.102, 10.110, and 10.113 [Transferred to Subpart F]**

**Par. 35.** Newly redesignated §§ 10.80 through 10.102, 10.110, and 10.113 are transferred to subpart F.

**Par. 36.** Newly redesignated § 10.80 is amended by revising paragraphs (b) and (d) to read as follows:

**§ 10.80 Institution of proceeding.**

* * * * *

(b) Whenever the Secretary of the Treasury, or delegate, determines that the appraiser acted willfully, recklessly, or through gross incompetence, or engaged in disreputable conduct, as defined under § 10.61(d)(1) through (4), with respect to the proscribed conduct, the appraiser may, in accordance with this section, be subject to a proceeding for disqualification. A proceeding for disqualification of an appraiser is instituted by the filing of a complaint, the contents of which are more fully described in § 10.82.

* * * * *

(d) This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 37.** Newly redesignated § 10.85 is amended by:

1. Revising paragraph (a)(2).
2. Adding paragraph (a)(3).
3. Revising paragraph (c).

The revisions and addition read as follows:

**§ 10.85 Supplemental charges.**

(a) * * *

(2) It appears that the respondent has knowingly introduced false testimony during the proceedings against the respondent; or

(3) It appears that the respondent has engaged in contemptuous conduct within the meaning of § 10.50(a)(12) during the proceedings against the respondent.

* * * * *



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(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 38.** Newly redesignated § 10.99 is amended by revising paragraph (e) and adding paragraphs (f) and (g) to read as follows:

**§ 10.99 Effect of disbarment, suspension, or censure.**

* * * * *

(e) *Jurisdiction to investigate compliance with censure, suspension, or disqualification.* A practitioner or appraiser who is censured, suspended, or disqualified under § 10.61(a), § 10.70, or § 10.102 will be considered a practitioner or appraiser for the purpose of investigating whether the practitioner or appraiser is in compliance with the terms of their censure, suspension, or disqualification. Censured, suspended, or disqualified practitioners or appraisers may face additional sanctions or disbarment for any violation.

(f) *Jurisdiction to investigate disbarred practitioners and non-practitioners.* The ***IRS*** may investigate a practitioner disbarred under § 10.70 or a non-practitioner to determine whether they are wrongly holding themselves out as practitioners.

(g) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 39.** Newly redesignated § 10.101 is revised to read as follows:

**§ 10.101 Petition for reinstatement.**

(a) *In general.* A practitioner disbarred or suspended under § 10.70, or an appraiser disqualified under § 10.61, may petition for reinstatement before the Internal Revenue Service after the expiration of 5 years following such disbarment, suspension, or disqualification (or immediately following the expiration of the suspension or disqualification period, if shorter than 5 years). A practitioner or appraiser suspended or disqualified under § 10.102 may petition for reinstatement at any time upon a showing of good cause as described in § 10.102(f)(2). Reinstatement will not be granted unless the Internal Revenue Service determines that the petitioner is not likely to engage thereafter in conduct contrary to the regulations in this part, and that granting such reinstatement would not be contrary to the public interest.

(b) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 40.** Newly redesignated § 10.102 is amended by:

1. Revising the section heading.

2. Removing paragraph (a).

3. Redesignating paragraphs (b) through (h) as paragraphs (a) through (g).

4. Revising newly redesignated paragraphs (a), (b) introductory text, (b)(2) and (4), and (e) through (g).



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The revisions and additions read as follows:

**§ 10.102 Expedited suspension or disqualification.**

(a) *When applicable.* The expedited suspension procedures in this section are initiated by issuing the show cause order described under paragraph (d) of this section. A show cause order will be issued to any practitioner or appraiser for whom paragraph (a)(1), (2), (3), (4), (5), (6), or (7) of this section is true within the 5 years prior to the date that the show cause order was issued. The expedited procedures described in this section may be used to suspend the practitioner from practice before the Internal Revenue Service, disqualify an appraiser from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service, or find that any appraisal made by a disqualified appraiser after the effective date of disqualification will not have probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service.

(1) A practitioner has a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause (not including failure to pay a professional licensing fee) by any authority or court, agency, body, or board described in § 10.50(a)(10).

(2) An appraiser has a license or certification to conduct appraisals revoked or suspended by any state licensing or certification board.

(3) A practitioner or appraiser has voluntarily forfeited a practitioner's or appraiser's license or certification after any authority described in paragraph (a)(1) or (2) of this section initiated an investigation of, or proceeding against, the practitioner or appraiser for alleged violations of applicable standards or rules of conduct for which the practitioner's or appraiser's license or certification could be suspended or **[*104933]** revoked for cause, if proven. Voluntary forfeiture includes retirement, resignation, consensual permanent inactivation, or similar action.

(4) A practitioner has, irrespective of whether an appeal has been taken, been convicted of any crime under title 26, United States Code, any crime involving dishonesty or breach of trust, or any felony for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(5) A practitioner has violated conditions imposed on the practitioner pursuant to § 10.99(d).

(6) A practitioner has been sanctioned by a court of competent jurisdiction, whether in a civil or criminal proceeding (including suits for injunctive relief), relating to any client's tax liability or relating to the practitioner's own tax liability, for—

(i) Instituting or maintaining proceedings primarily for delay;

(ii) Advancing frivolous or groundless arguments; or

(iii) Failing to pursue available administrative remedies.

(7) A practitioner has demonstrated a pattern of willful disreputable conduct by—

(i) Failing to make an annual Federal tax return, in violation of the Federal tax laws, during 4 of the 5 tax years immediately preceding the institution of a proceeding under paragraph (b) of this section and remains noncompliant with any of the practitioner's Federal tax filing obligations at the time the notice of suspension is issued under paragraph (e) of this section; or



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(ii) Failing to make a return required more frequently than annually, in violation of the Federal tax laws, during 5 of the 7 tax periods immediately preceding the institution of a proceeding under paragraph (b) of this section and remains noncompliant with any of the practitioner's Federal tax filing obligations at the time the notice of suspension is issued under paragraph (e) of this section.

(b) *Expedited suspension or disqualification procedures.* A suspension or disqualification under this section will be proposed by a show cause order that names the respondent, is signed by an authorized representative of the Internal Revenue Service under § 10.89(a)(1), and is served according to the rules set forth in § 10.83(a). The show cause order must give a plain and concise description of the allegations that constitute the basis for the proposed suspension or disqualification. The show cause order must notify the respondent—

* * * * *

(2) That an expedited suspension or disqualification decision by default may be rendered if the respondent fails to file a response as required;

* * * * *

(4) That the respondent may be suspended or disqualified either immediately following the expiration of the period within which a response must be filed or, if a conference is requested, immediately following the conference.

* * * * *

(e) *Suspension or disqualification* —(1) *In general.* The Commissioner, or delegate, may suspend the respondent from practice before the Internal Revenue Service or disqualify an appraiser from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or Internal Revenue Service by a written notice of expedited suspension or disqualification immediately following:

(i) The expiration of the period within which a response to a show cause order must be filed if the respondent does not file a response as required by paragraph (c) of this section;

(ii) The conference described in paragraph (d) of this section if the Internal Revenue Service finds that the respondent is described in paragraph (a) of this section;

(iii) If the respondent has not requested a conference, upon consideration of any response described in paragraph (c) of this section; or

(iv) The respondent's failure to appear, either personally or through an authorized representative, at a conference scheduled by the Internal Revenue Service under paragraph (d) of this section.

(2) *Duration of suspension or disqualification.* A suspension or disqualification under this section will commence on the date that the written notice of expedited suspension or disqualification is served on the practitioner or appraiser, either personally or through an authorized representative. The suspension or disqualification will remain effective until the earlier of:

(i) The date the Internal Revenue Service lifts the suspension or disqualification upon receipt of a petition for reinstatement under § 10.101 and after determining that the practitioner or appraiser has shown good cause based on all the relevant facts and circumstances why the suspension or disqualification should be lifted and the individual reinstated to practice; or



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(ii) The date the suspension or disqualification is lifted or otherwise modified by an Administrative Law Judge or the Secretary of the Treasury, or delegate deciding appeals, in a proceeding referred to in paragraph (f) of this section and instituted under § 10.80.

(3) *Good cause.* For purposes of this paragraph (e), a suspended practitioner or disqualified appraiser may show good cause when, for example, the individual was suspended or disqualified:

(i) Under paragraphs (a)(1) through (3) of this section, and the individual's license or certificate to practice as an attorney, certified public accountant, actuary, or appraiser has been restored;

(ii) Under paragraph (a)(4) of this section, and the conviction was reversed on appeal, with no retrial underway or pending;

(iii) Under paragraph (a)(5) of this section, and the individual is no longer in violation of the conditions imposed on the individual under § 10.99(d) and the individual either fully satisfied the conditions or is compliant with them if they are still in effect;

(iv) Under paragraph (a)(6) of this section, and the individual has satisfied any terms of the court-imposed sanction, such as payment of a monetary sanction or completion of mandated hours of pro bono work; has not been sanctioned again for the same or substantially similar conduct by a court or any other authority described in § 10.50(a)(10); and has ceased the conduct that resulted in the sanction (for example, ceased advancing frivolous or groundless arguments in matters before the Internal Revenue Service and courts or other tribunals); or

(v) Under paragraph (a)(7) of this section, and the individual is fully compliant with the individual's tax filing and payment obligations, including any installment agreement or other payment arrangement entered into with the Internal Revenue Service.

(f) *Demand for § 10.80 proceeding.* If the Internal Revenue Service suspends a practitioner or disqualifies an appraiser under the expedited suspension procedures described in this section, the practitioner or appraiser may demand that the Internal Revenue Service institute a proceeding under § 10.80 and issue the complaint described in § 10.82. The demand must be in writing, specifically reference the suspension or disqualification action under § 10.82, and be made within 2 years from the date on which the practitioner's suspension or appraiser's disqualification commenced. The Internal Revenue Service must issue a complaint demanded under this paragraph (f) within 60 calendar days of **[*104934]** receiving the demand. If the Internal Revenue Service does not issue such complaint within 60 days of receiving the demand, the suspension or disqualification is lifted automatically. The preceding sentence does not, however, preclude the Commissioner, or delegate, from instituting a regular proceeding under § 10.80.

(g) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 41.** Newly redesignated § 10.110 is amended by:

1. Removing paragraph (a)(4).

2. Redesignating paragraphs (a)(5) and (6) as paragraphs (a)(4) and (5).

3. Revising paragraph (c).



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The revision reads as follows:

**§ 10.110 Records.**

* * * * *

(c) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Par. 42.** Sections 10.111 and 10.112 are added to read as follows:

**§ 10.111 Establishment of advisory committees.**

(a) *Advisory committees.* To promote and maintain the public's confidence in tax advisors, the Internal Revenue Service is authorized to establish one or more advisory committees composed of at least six individuals authorized to practice before the Internal Revenue Service. Membership of an advisory committee must be balanced among those who practice as attorneys, accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents. Under procedures prescribed by the Internal Revenue Service, an advisory committee may review and make general recommendations regarding the practices, procedures, and policies of the offices described in § 10.1.

(b) *Applicability date.* This section is applicable beginning on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**§ 10.112 Saving provision.**

Any proceeding instituted under this part prior to [date 30 days after date of publication of final regulations in the **Federal Register** ], for which a final decision has not been reached or for which judicial review is still available is not affected by the revisions to this part effective [effective date of final regulations]. Any proceeding under this part based on conduct engaged in prior to [date 30 days after date of publication of final regulations in the **Federal Register** ], which is instituted after that date, will apply this subpart, but the conduct engaged in prior to [effective date of final regulations], will be judged by the regulations in effect at the time the conduct occurred.

**Par. 43.** Section 10.114 is added to read as follows:

**§ 10.114 Applicability date.**

Except as otherwise provided in any section of this part and subject to § 10.112, the provisions of this part are applicable on [date 30 days after date of publication of final regulations in the **Federal Register** ].

**Douglas W. O'Donnell,**

*Deputy Commissioner.*

**Aviva R. Aron-Dine,**

*Deputy Assistant Secretary of the Treasury (Tax Policy).*



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**Douglas W. O'Donnell,**

*Deputy Commissioner.*

**Aviva R. Aron-Dine,**

*Deputy Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. 2024-29371 Filed 12-20-24; 4:15 pm]

BILLING CODE 4830-01-P

## Dates

**DATES:** Electronic or written comments must be received by February 24, 2025. The public hearing is being held on March 6, 2025, at 10 a.m. Eastern Time (ET). Requests to speak and outlines of topics to be discussed at the public hearing must be submitted as prescribed in the "Comments and Public Hearing" section. The ***IRS*** must receive speakers' outlines of the topics to be discussed at the public hearing by February 24, 2025. If no outlines are received by February 24, 2025, the public hearing will be cancelled. Requests to attend the public hearing must be received by 5 p.m. ET on March 4, 2025. As of December 26, 2024, the notice of proposed rulemaking (REG-113289-08) published on July 28, 2009 (*74 FR 37183*), is withdrawn.

## Contacts

**ADDRESSES:** Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate ***IRS*** and REG-116610-20) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the ***IRS*** will publish for public availability any comment submitted electronically or on paper to the public docket. *Send paper submissions to:* CC:PA:01:PR (REG-116610-20), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, William J. Prater at (202) 317-6251; concerning submissions of comments or the public hearing, The Publications and Regulations Section at (202) 317-6901 (not toll-free numbers) or by sending an email to *publichearings@**irs**.gov* (preferred).

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