ESTATE PLANNING WITH RESPECT TO QUALIFIED RETIREMENT PLANS AND IRAs, INCLUDING NAMING TRUSTS AS BENEFICIARIES OF QUALIFIED RETIREMENT PLANS AND IRAs

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Estate Planning for Qualified Retirement Plans and IRAs

I. OVERVIEW OF FINAL REGULATIONS

A. Disclaimer And Scope Of Outline. This paper is not intended to be an exhaustive treatise on the various tax and other aspects of all qualified plans and Individual Retirement Accounts, or "IRAs" (hereinafter sometimes referred to collectively as "retirement plans" where a distinction between the two is not necessary). The rules discussed in this outline will relate primarily to minimum distributions from defined contribution plans and traditional IRAs. The Treasury Department released final regulations relating to defined contribution plans and IRAs on April 17, 2002 (sometimes referred to as the "new rules"). These new rules will be the primary focus of this paper. Currently, the rules for distributions from defined benefit plans and annuity contracts are in the form of temporary and proposed regulations. *See Temp. Reg. § 1.401(a)(9)-6T.*

B. Minimum Distribution Rules. The amount and timing of distributions from retirement plans are prescribed by the "minimum distribution rules." These rules are generally contained in Section 401(a)(9) of the Internal Revenue Code (hereinafter sometimes referred to as "IRC" or the "Code"). These rules were initially set out in proposed regulations published on July 27, 1987, which were subsequently modified in December 1997 and again in January 2001. The recently released final regulations further modified the minimum required distribution (sometimes referred to as the "MRD") rules, providing much needed simplification and clarification of some issues, but also leaving many questions still unanswered.

1. Purpose Of Minimum Distribution Rules. There are at least two purposes of the minimum distribution rules:

a. To Provide Retirement Benefits Primarily To The Employee (And His Spouse).

b. To Prevent Indefinite Postponement Of Income Taxes.

2. When Are Minimum Distributions Required To Commence?

a. Required Beginning Date. As a result of amendments made by the Small Business Job Protection Act of 1996, P.L. 104-188, for taxable years after 1996, the required beginning date ("RBD") for an employee who does not own 5% or more of the employer sponsoring the qualified plan is April 1 of the year following the later of (i) the year in which the employee reaches age 70 ½ or (ii) the year in which the employee retires. *IRC § 401 (a)(9)(A) and (C).* Five percent (5%) or more owners of companies sponsoring the retirement plan and IRA owners continue to have an RBD of April 1 following the calendar year in which they attain age 70 ½. *IRC § 401 (a)(9)(C)(ii).* NOTE: To simplify understanding of the concepts discussed in this outline, it will be assumed that the person participating in a qualified plan or listed as the owner of an IRA, including an IRA rollover (hereinafter referred to collectively as the "participant"), is male and gender references will be made accordingly.

(1) Significance Of RBD Under "Old" Rules. Under the "old" minimum distribution rules (i.e., the proposed treasury regulations originally released in 1987 and modified in 1997), the period of time over which the participant had to take minimum required distributions from his qualified plans and IRAs was basically determined as of the participant's RBD. A key factor in determining the distribution period was whether, as of RBD, the participant had named a "designated beneficiary" (sometimes referred to as "DB") of his qualified plan or IRA. If so, the participant was entitled to use some form of joint life distribution upon reaching RBD. Special options were available to the participant if he named his spouse as his DB. Some of these options, such as the life expectancy recalculation election, had both advantages and disadvantages. In all, at least six different distribution periods were possible under the old rules for a participant who reached his RBD.

(2) Old Rules Required Prescience At RBD. Unfortunately, once the participant reached his RBD and began taking MRDs from his retirement plan, no change in beneficiary after that date could lengthen his distribution period (although a change in beneficiary could shorten it). Thus, beneficiary designations and elections made at RBD were basically irrevocable. In many

cases, the distribution method locked in at RBD later proved to be disadvantageous for the participant or his beneficiaries. For a complete discussion of the "old" minimum distribution rules, *see* Gerstner, *Designating Trusts as Beneficiaries of Qualified Plans and IRAs*, State Bar of Texas 10th Annual Advanced Drafting: Estate Planning and Probate Course, November 1999, and *Naming a Trust as the Beneficiary of Qualified Plan Benefits and IRAs,* December 2000, http://www.drjg.com – Learn More.

(3) Intervening Rules: The January 2001 Proposed Regulations. The Treasury Department released new proposed regulations under Code Sections 401(a)(9) and 408 on January 17, 2001. The January 2001 proposed regulations worked a major overhaul of the prior proposed regulations and served as a precursor to the final regulations released in April 2002. Treasury solicited comments from practitioners regarding the new proposed regulations. For the most part, the somewhat drastic changes proposed by Treasury were well received. The new proposed rules greatly simplified the calculation of MRDs and fixed some serious problems under the old rules. For an article that discusses the January 2001 proposed MRD regulations, *see* Gerstner, *Naming a Trust as the Beneficiary of Qualified Plan Benefits and IRAs Under the New Minimum Distribution Rules*, October 31, 2001, http://www.drjg.com – Learn More.

b. Lifetime Distributions To Participant Must Commence By Required Beginning Date. RBD has much less significance under the final regulations. Primarily, it is the date by which MRDs to the participant must commence. Whether the participant has a designated beneficiary as of RBD is irrelevant, except if the participant is trying to use the exception to the standard distribution period for a much younger spouse (*see* I.B.3.b, *infra*).

3. Distribution Periods During Participant's Life Under The New Rules. Upon reaching his RBD, the participant must begin taking minimum required distributions from his qualified plan or IRA based on one of only two possible distribution periods. In the vast majority of cases, the "Uniform Lifetime Table" will apply. Thus, it is much easier to determine MRDs during the participant's life under the new rules.

a. Participant's "Young Spouse" Is **Not** Sole Beneficiary. If the participant's beneficiary at RBD is anyone other than his more than 10 years younger spouse (referred to as the "young spouse" in this outline), then minimum required distributions from his retirement plan are calculated using the "Uniform Lifetime Table" found at Section 1.409(a)(1)-9, A-2 of the finalized Treasury Regulations. See Exhibit 1 attached. The divisor for the participant's age as of his birthday in each distribution year is obtained from the table and multiplied by the plan account balance on December 31 of the prior year (with certain adjustments). *See Treas. Reg. § 1.401(a)(9)-5, A-1(a) and A-3*. The uniform table assumes that the participant has named as his beneficiary a person who is 10 years younger than himself (whether he has, in fact, done so). It is basically the old minimum distribution incidental benefit ("MDIB") table utilized under the proposed regulations to artificially limit a joint life distribution period during the participant's life whenever the participant had in fact designated a non spouse beneficiary more than 10 years younger than himself at RBD. In addition, the life expectancy factors reflected in all of the applicable tables have now been updated to reflect current mortality assumptions. These changes made by the new rules lengthen the distribution period for most participants compared to the old rules. Thus, if the participant names his close-in-age spouse as his DB, the new uniform table provides a longer distribution period (and, therefore, lower minimum required distributions) than an actual joint life distribution would provide.

b. Participant's Young Spouse **Is** Sole Beneficiary. The only other table used for determining MRDs *during the participant's life* is the actual joint life table, the Joint and Last Survivor Table, found at Section 1.409(a)(1)-9, A-3 of the finalized Treasury Regulations. See Exhibit 2 attached. This table can only be used if the participant's young spouse (or a trust for his young spouse that is treated the same as the young spouse, discussed *infra* at IV.C.3.) is his sole designated beneficiary.

(1) Death Of Young Spouse After MRDs To Participant Commence. Under the proposed regulations released in January 2001, in order to

use the actual Joint and Last Survivor Table for determining his MRD in a particular year, the participant had to be married to the young spouse on the last day of the year. Practitioners commented to Treasury that if the young spouse died during the participant's life while still married to the participant, the participant should not be "penalized" by that fact by having to switch to the Uniform Table for calculating his MRD for the year of the young spouse's death. Treasury responded favorably to this comment by providing in the final regulations that if the participant and his sole DB young spouse are legally married on January 1, then the participant may use the Joint and Last Survivor Table for calculating his MRD for that year, even if the marriage terminates later that year due to divorce or the death of the young spouse. *Treas. Reg. § 1.401(a)(9)-5, A-4(b)(2)*. However, the change in the participant's beneficiary due to the death or divorce of the young spouse will affect the determination of his MRD in the following calendar year.

c. New Tables. Both new distribution tables provide participants with the benefit of recalculating life expectancies each year, thus minimizing required distributions during the participant's life (compared to using a "fixed" life expectancy method). Because of the new rules for distributions upon the participant's death, recalculation during the participant's life under the new rules does not have the disadvantage that it had under the old rules (namely, causing a drop to zero in the life expectancy of the person's life who was being recalculated upon the person's death and thereafter drastically shortening the distribution period).

4. Key To Distribution Periods After Participant's Death: Designated Beneficiary. Having a "designated beneficiary" provides the best income tax results (longer deferral) for the beneficiary/ies named to receive distributions from the participant's retirement plan upon the participant's death. With the exception of the young spouse situation, having a DB as of RBD no longer affects the distributions to the participant during his lifetime.

a. Who Is A Designated Beneficiary? The term "designated beneficiary" is a term of art under the rules. Not every named beneficiary of a participant's retirement plans will be treated as a designated beneficiary. Only individuals can be designated beneficiaries. *Treas. Reg. § 1.401(a)(9)-4, A-1 and A-3*. Thus, estates, charities and trusts are never designated beneficiaries. However, the final treasury regulations retain the special "look through" rules for trusts that are named as beneficiaries of retirement plans. *See Treas. Reg § 1.401(a)(9)-4, A-5*, discussed in detail in Section IV, *infra*. If a trust meets certain requirements, then the beneficiaries of the trust may be treated as designated beneficiaries for purposes of the minimum distribution rules.

b. New Applicable Date For Determining Designated Beneficiary. The designated beneficiary is no longer determined at the earlier of the participant's death or RBD. (The only exception is for a participant having a young spouse who wants to use the actual joint life table for calculating MRDs during his lifetime -- in that case, he must have named his young spouse as his sole DB as of his RBD.) Under the new rules, the participant's beneficiary is determined on September 30 of the year following the year of the participant's death. *Treas. Reg. § 1.401(a)(9)-4, A-4(a)*. For ease of reference, this date will be referred to as the "DB Determination Date" (not an officially defined term). The time period between the participant's death and the DB determination date is being referred to as the "shakeout period."

(1) Beneficiaries Remaining On DB Determination Date. The resultant designated beneficiary must have been "named" or "designated" by the participant or the plan and must effectively have been in place as a beneficiary as of the participant's death. *Treas. Reg. § 1.401(a)(9)-4, A-4(a)*. That is, new beneficiaries cannot be added "out of whole cloth" after the participant's death, but beneficiaries can be eliminated after the participant's death, and those who are left standing on the DB determination date will be treated as the actual beneficiaries.

(a) Death Of Beneficiary Before DB Determination Date. Note, however, that if an individual named as a beneficiary of the participant's plan survives the participant but then dies before the DB Determination date, unless that beneficiary executed a qualified disclaimer or

received full distribution of the amount to which he was entitled from the participant's plan prior to the DB Determination date, he will still be considered a beneficiary of the participant's plan for purposes of determining whether the participant had a designated beneficiary. *Treas. Reg. § 1.401(a)(9)-4, A-4(c).*

(b) Beneficiary Who Dies Before DB Determination Date Is Determined To Be Designated Beneficiary. If the deceased beneficiary discussed in (a) immediately preceding turns out to be the participant's designated beneficiary, distributions from the participant's plan after the participant's death will be made based on the non recalculated life expectancy of the (deceased) designated beneficiary. *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(2).* Amounts that would have been distributed to the designated beneficiary, had he been living, are to be paid to his/her successor beneficiary instead. (Note: This rule in the final regulations is different from the rule that was proposed in the 2001 proposed regulations).

(c) Post Death Designated Beneficiary Planning. Because there can be a period of up to one year and nine months between the participant's date of death and the DB determination date (e.g., participant dies on January 1, 2003, making the DB Determination date September 30, 2004), post-death planning opportunities exist to "change" the designated beneficiary. For the most part, changing the designated beneficiary will be accomplished by means of disclaimers and "cashouts" of less desirable beneficiaries.

(d) Post Death Planning For Successor Beneficiaries. As noted, if the individual who is determined to be the participant's designated beneficiary survives the participant and then dies, regardless of whether that DB's death occurs before or after the DB determination date, the DB's life expectancy will still be used for determining MRDs to the beneficiaries of the participant's plan. Thus, all DB planning must be done before the DB determination date. On the other hand, once the participant has died, the DB (and all other non-DB beneficiaries entitled to distributions from the participant's plan, for that matter) should name a "successor beneficiary" to take distributions in the event of the DB's death prior to complete distribution of all amounts in the participant's plan. These subsequent beneficiaries can be anyone (including entities, non-qualifying trusts, older persons, etc.) because their life expectancy (or lack thereof) will not change the DB determination. Further, the concern under the proposed regulations that the beneficiary's naming of a successor beneficiary will disqualify the plan has been eliminated. *Treas. Reg. § 1.401(a)(9)-5, A-7(c).*

c. Which Designated Beneficiary "Problems" Can Be Fixed After The Participant's Death? Under the new rules, the possibility exists for getting rid of "bad" beneficiaries and for directing plan/IRA benefits to more desirable beneficiaries (through disclaimers) before the DB determination date. Therefore, more attention needs to be paid to post-death planning during the shakeout period.

(1) Disclaimers. The new rules clearly take into account the effect of disclaimers done after the participant's death, whether the participant dies before or after RBD (there were some uncertainties regarding the effect of disclaimers under the prior rules). *Treas. Reg. § 1.401(a)(9)-4, A-4(a).* Disclaimers can be used to "skip over" certain beneficiaries so that more desirable beneficiaries will be in place by the DB determination date. No matter when the participant dies, there will always be sufficient time to do qualified disclaimers before the date on which the participant's designated beneficiary has to be determined. The disclaimer option, however, will have to be examined right away due to the absolute nine month deadline for making a qualified disclaimer.

(2) Other Post-Death DB Planning Techniques. If "bad" beneficiaries (e.g., charities) have been named by the participant as part of a group of multiple beneficiaries of a single plan or IRA and if they are fully "cashed out" (i.e., paid the entire amount to which they are entitled) before the DB determination date, then only the remaining beneficiaries as of the DB determination date will be taken into account in determining the designated beneficiary. *Treas. Reg. § 1.401(a)(9)-4, A-4(a).* Also, in situations where multiple beneficiaries are named jointly as beneficiaries of the participant's retirement plan, if separate accounts can be created for each of them by December 31 of the year following the year of

the participant's death, then each beneficiary will be treated as the sole beneficiary of his/her separate account (and, therefore, will be able to use his/her own life expectancy in calculating MRDs). *Treas. Reg. § 1.401(a)(9)-8, A-2*. (For a discussion of creating separate accounts after the participant's death, *see* I.B.6., *infra*.) Other possible post-death actions designed to clarify or improve the designated beneficiary determination could be tried and may work as long as completed prior to the DB determination date (e.g., modifying a defective trust). *But* see "Estate" as beneficiary, *infra* at I.B.5.a.(1)(a).

(3) **WARNING:** Avoid Hasty Spousal IRA Rollovers. Because of the increased availability of post-death DB planning techniques, the surviving spouse should *not* rush into a spousal IRA rollover of the participant's plans/IRAs prior to obtaining advice from qualified tax and estate planning professionals because that would foreclose many of the post-death planning options. A spouse designated beneficiary may roll over the participant's IRA into a spousal IRA rollover *at any time* (even years after the participant's death), so there is no need to rush.

5. Required Distributions On Or After Death Of Participant. A flow chart illustrating the minimum distribution rules after the participant's death is attached as Exhibit 30.

a. Participant's Death **Before** RBD. There are basically three rules that apply regarding distributions from retirement plans if the participant dies *before* reaching his RBD. Note that these "death before RBD" rules apply to distributions from Roth IRAs after the Roth IRA owner's death. The so called "5-year rule" is no longer the main rule, but still applies in cases where there is no "designated beneficiary" as of the DB determination date. Hopefully, most participants will be deemed to have a designated beneficiary by the DB determination date so that the 5-year rule will not apply. It should be noted, however, that some qualified plans mandate distribution pursuant to the 5 year rule where the participant dies before his RBD (whether or not the recipient of the plan benefits qualifies as a DB).

(1) No Designated Beneficiary: 5 Year Rule. If there is no DB as of the DB determination date, then the entire amount in the retirement plan must be distributed by December 31 of the year that contains the fifth anniversary of the participant's death. *Treas. Reg. § 1-401(a)(9)-3, A-4(a)(2)*. The retirement plan benefits may either be distributed entirely in the fifth year, ratably over the five (5) year period, or in any other manner just as long as no amount remains in the plan after December 31 of the fifth year. If a charity (not a DB) is the participant's beneficiary as of the DB determination date, there is no reason to delay distribution since a charity is not subject to income tax on the retirement plan benefits it receives.

(a) Query: If Participant's "Estate" Is Plan Beneficiary, Does Participant Have A Designated Beneficiary? Answer: No. The final regulations expressly state that an estate can never be a designated beneficiary (*see Treas Reg. § 1.401(a)(9)-4, A-3 and §1.401(a)(9)-8, A-11*). Thus, if a participant has named his "Estate" as the beneficiary of his retirement plan, even though his Will or state law will determine the ultimate beneficiaries of his "Estate" and those beneficiaries will receive his plan benefits, those recipients cannot qualify as DBs. Thus, if the participant dies before his RBD with his "Estate" named as the beneficiary of his retirement plan, the 5 year rule applies.

(b) Query: Can "Estate" Be Bypassed As The Beneficiary (i.e., Is This Beneficiary Designation "Fixable" After Participant's Death)? Answer: No. When the proposed regulations were released in January 2001, changing the date for determining the designated beneficiary, estate planning practitioners began discussing whether any post-death planning techniques could be utilized during the shakeout period to try to bypass the participant's estate altogether as the beneficiary of his retirement plan benefits and avoid the "No DB" rule. Practitioner's posited that if the executor/administrator of the participant's Estate were able to "distribute" the plan/IRA to the beneficiaries of the Estate before the DB determination date, then perhaps the 5 year rule could be avoided. Does this technique work? The answer appears to be "No." This was confirmed by Marjorie Hoffman, Attorney, Senior Technical Reviewer, Tax Exempt/Government Entities, of the Internal Revenue Service ("IRS") and one of

the principal authors of the final MRD regulations, in an ALI-ABA presentation on May 23, 2002. Thus, participants who have not yet reached RBD should be cautioned against listing their "Estate" as the beneficiary of their retirement plans.

(c) Reason For Estate Beneficiaries Failing DB Qualification: Only Beneficiaries Named By Participant (Or Plan) Can Be DBs. The reason why this approach fails is due to the rule that the designated beneficiary must be "named by" the participant (or the plan). *Treas. Reg. § 1.401(a)(9)-4, A-1.* The final regulations provide: "The fact that an employee's interest under the plan passes to a certain individual under a will or otherwise under applicable state law does not make that individual a designated beneficiary". Pursuant to a similar provision in the January 2001 proposed regulations, intestate heirs of an estate seemed to be clearly precluded from qualifying as DBs, but those proposed regulations left some doubt about the status of beneficiaries named in a Will. The final regulations clarify that neither intestate heirs nor Will beneficiaries can qualify as DBs where the participant (or the plan) has named the participant's "Estate" as the beneficiary of his retirement plan benefits.

(2) Participant's Spouse Is **Not** Sole Designated Beneficiary. If the participant has named one or more designated beneficiaries but the participant's spouse is not his sole designated beneficiary, MRDs from his retirement plan after his death must be taken by the beneficiary/ies over the (oldest) beneficiary's life expectancy. *Treas. Reg § 1.401(a)(9)-5, A-5(b) and (c)(1).* The divisor for the DB's age as of his/her birthday in the year following the year of the participant's death (i.e., in the first distribution year) is taken from the single life expectancy table (Single Life Table, Treas. Reg. § 1.401(a)(9)-9, A-1). See Exhibit 3 attached. This divisor is reduced by 1 in each subsequent year. Distributions based on the DB's life expectancy must begin by December 31 of the year following the year of the participant's death. *Treas. Reg. § 1.401(a)(9)-3, A-3(a) and § 1.401(a)(9)-5, A-5(b) and (c)(1).*

(a) "Inherited" IRA Rules. The DB's life expectancy may *not* be recalculated each year in this situation and the DB may *not* "roll over" the benefits to his/her own IRA. *IRC § 408(d)(3)(C).* The "inherited IRA" must reflect the deceased participant's name and/or otherwise indicate that it is an "inherited IRA" (it may state that it is held for the benefit of the beneficiary). A trustee to trustee (or custodian to custodian) transfer of an inherited IRA (to facilitate achievement of investment objectives, for example) is permitted, however. *See Rev. Rul. 78-406, 1978-2 C.B. 157; Rev. Proc. 89-52, 1989-2 C.B. 632; PLR 200228025 (July 12, 2992); and PLR 9250040 (December 11, 1992).*

(b) **IMPORTANT:** ***This Rule Is Applicable To Most Trusts***. Note that this non-recalculated life expectancy rule applies even if the spouse is treated as the participant's DB due to the fact that she is the oldest out of a group of multiple beneficiaries, unless separate accounts are created. (For a discussion of the creation of separate accounts, *see* I.B.6., *infra*.) Thus, most trusts that are named as the beneficiary of retirement plans (excluding "conduit" trusts and grantor trusts, discussed *infra* at IV.C.3.) will fall under this rule.

(3) Participant's Spouse **Is** Sole Designated Beneficiary. If the participant has designated his spouse (or a trust for his spouse that is treated the same as the spouse – *see* IV.C.3., *infra*) as the sole beneficiary of his retirement plan and he dies *before* his RBD, she has three options.

(a) Spouse's Option #1: Commencement Of Distributions When Participant Would Have Attained 70 ½. In this situation (participant's death *before* RBD), a surviving spouse sole DB need not begin taking minimum required distributions from the participant's retirement plan until December 31 of the calendar year in which the participant would have attained age 70 ½. *Treas. Reg. § 1.401(a)(9)-3, A-3(b)(2).* If this option is elected, the participant's retirement plans will remain in his name and the spouse will be taking distributions as a beneficiary. Thus, any distributions taken by the spouse prior to the required beginning date for minimum distributions will be discretionary and will *not* be subject to the early withdrawal penalty, regardless of the spouse's own age.

(i) Distribution Period For Sole DB Spouse. When the spouse begins taking minimum required distributions from the participant's retirement plan, she will take them over her life expectancy, recalculated each year. *Treas. Reg*

§ 1.401(a)(9)-5, A-5(b) and (c)(2). The divisor for distributions to the sole DB spouse is taken from the single life table *each year* the spouse is living. See Exhibit 3. Under the new rules, she can name a beneficiary ("successor beneficiary") to take the amount remaining in the participant's retirement plan upon her death (and there will <u>always</u> be amounts remaining in the plan in this situation due to recalculation of the spouse's life expectancy each year, assuming the spouse limits distributions to the minimum amount required), and this will not disqualify the plan or alter the initial DB determination. *Treas. Reg. § 1.401(a)(9)-5, A-7(c).*

(ii) <u>Spouse's Death Before MRDs Commence</u>. If the sole DB spouse dies *before* distributions from the participant's retirement plan have commenced, the successor beneficiary must commence taking MRDs by December 31 of the year following the year of the spouse's death. MRDs to the successor beneficiary are taken over the beneficiary's non-recalculated life expectancy. The successor beneficiary is treated as the spouse's DB if living on September 30 of the year following the year of the spouse's death. *Treas. Reg. § 1.401(a)(9)-4, A-4(b), § 1.401(a)(9)-3, A-5, and § 1.401(a)(9)-3, A-3(a).* If there is no successor DB, then the 5 year rule applies under these circumstances. *Treas. Reg. § 1.401(a)(9)-4, A-4(b).*

(iii) <u>Special Limitation Applicable To Beneficiary Spouse's New Spouse</u>. Even if the spouse's new spouse is her <u>sole</u> successor beneficiary, in this particular situation (participant dies before his RBD with spouse as sole DB and she dies before MRDs have commenced to her), in determining MRDs from the participant's plan, the participant's spouse's new spouse cannot recalculate his life expectancy each year. *Treas. Reg. § 1.401(a)(9)-3, A-5 [last sentence].*

(iv) <u>Spouse's Death After MRDs Commence</u>. If the participant's spouse dies *after* MRDs have commenced from the participant's retirement plan, the final MRD attributable to the participant's spouse for the year of her death must first be taken and then the successor beneficiary must commence MRDs by December 31 of the year following the spouse's year of death. In this situation, MRDs to the successor beneficiary (whether such beneficiary qualifies as a DB or not) are based on the spouse's remaining, non-recalculated life expectancy. *Treas. Reg. § 1.401(a)(9)-5, A-5(c)(2) [last sentence].*

(b) <u>Spouse's Option #2: Rollover Of Qualified Plan Benefits To IRA Rollover In Spouse's Name</u>. A surviving spouse who is entitled to a lump sum distribution from the participant's qualified plan may roll over all eligible amounts to an IRA rollover in her own name. *Treas. Reg. § 1.408-8, A-7.* She will then be treated <u>as the participant</u> of her IRA rollover and, as a result, required distributions need not commence until *her* RBD. *IRC §§ 408(d)(3), 402(a)(7), 402(c)(9), 401(a)(9)(A).* [NOTE: Prior to January 1, 2002, the spouse could not, however, roll over the deceased participant's qualified plan benefits to another qualified plan. *Treas. Reg. § 1.402(c)(2), A-12(a).* The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), P.L. 107-16, generally effective for tax years beginning after December 31, 2001, expanded the spousal IRA rollover provisions to allow surviving spouses to roll over the deceased spouse's interest in a qualified plan to certain qualified plans in which the spouse participates. *See* EGTRRA, Section 641(d) of Subtitle D - *Increasing Portability for Participants*, amending IRC Section 402(c)(9).] If the spouse takes a distribution before reaching age 59 ½ in this situation (where she has rolled over the deceased participant's qualified plan into a new plan or IRA in which she is now the participant), the distribution ***will*** result in a penalty for early withdrawal (unless some other exception under IRC Section 72(t) applies) because the spouse is now the participant of the new IRA rollover/plan in her name.

(i) <u>After Spousal IRA Rollover: Apply Rules With Spouse As Participant</u>. When the spouse begins taking MRDs from her IRA rollover at her RBD, she will use the Uniform Lifetime Table, unless her (new) young spouse is her *sole* beneficiary as of her RBD. In determining MRDs in this situation, the rules are applied with the spouse now being treated as the participant. *Treas. Reg. § 1.408-8, A-5(a).*

(c) <u>Spouse's Option #3: Spouse's Election To Treat Participant's IRA As Her Own</u>. A surviving spouse who is the designated beneficiary of the participant's IRA may elect to

roll it over into a new spousal IRA rollover in her own name or treat the participant's IRA as her own. *Treas. Reg. § 1.408-8, A-5(a) and A-8.* The effect of the latter is the same as a spousal IRA rollover. Distributions from the spousal IRA rollover need not commence until the surviving spouse's RBD. *IRC § 408(d)(3)(C)(ii); Treas. Reg. § 1.408-8, A-5(a).* If the surviving spouse fails to take distributions from the *participant's* IRA by the date that would have been the participant's RBD, it will be assumed that she has elected to treat the IRA as her own where she has not yet reached her own RBD. *Treas. Reg. § 1.408-8, A-5(b)(1); Treas. Reg. § 1.408-2(b)(7)(ii).* Again, if the spouse takes a distribution after the date that would have been the participant's RBD and before she reaches age 59 ½, the distribution ***will*** result in a penalty for early withdrawal (unless some other exception under IRC Section 72(t) applies) because the spouse is now the participant of the new IRA rollover in her name.

(d) Naming A Trust For Spouse's Benefit Versus Naming Spouse Directly As Beneficiary.

(i) Naming An Entity As Beneficiary Usually Precludes Spousal IRA Rollover Option. The spousal IRA rollover option will usually only be available to a surviving spouse in situations where she is the "outright" designated beneficiary of the participant. The spousal IRA rollover option will ordinarily be foreclosed in cases where the participant's estate or a trust created by the participant is named as the beneficiary (even if the spouse is the sole current beneficiary of the estate or trust). *See Treas. Reg. § 1.408-8, A-5(a).* Even if the retirement plan actually reaches the spouse due to action taken by the executor or trustee (such as a discretionary distribution), so that she obtains "possession" of the participant's retirement plan, the IRS takes the position in these cases that because the spouse is not receiving the plan benefits from the participant but from a third party, she cannot effect a spousal IRA rollover. There are some cases, however, based on certain important facts, where spousal IRA rollovers have been allowed even if an estate or trust was the participant's named beneficiary. The successful spousal IRA rollover cases involve situations where the spouse as fiduciary or beneficiary basically has an unlimited withdrawal right over the plan/IRA. *See* X., *infra*.

(ii) No "Spouse As *Sole* DB" Treatment For Most Trusts, Even If Spouse Is Sole Current Trust Beneficiary. Even if the spouse is the sole current beneficiary of a trust that has been named as the beneficiary of the participant's retirement plan (e.g., a QTIP Trust), she will not be treated as the sole DB of the participant under the rules unless the trust is either a "conduit" trust or a "grantor" trust. This is because the remainder beneficiaries of most trusts *could* ultimately receive distributions from the participant's retirement plan made to the trust during the spouse's life and, therefore, the remainder beneficiaries have to be considered beneficiaries along with the spouse. *See* IV., *infra*.

(iii) Special Commencement Date Option Should Still Apply To Conduit/Grantor Trust For Participant's Spouse. If a trust for the participant's spouse qualifies as a conduit or grantor trust (as to the spouse), although the IRA rollover option will usually be foreclosed (except in the case of a grantor trust over which the spouse possesses an unlimited withdrawal power over the participant's retirement plan and exercises it), the first spousal option discussed above (delay in commencing MRDs until the participant would have reached age 70 ½) should still be available. Other trusts for the spouse's benefit will not qualify for this option, however.

b. Participant's Death **After** RBD. If the participant dies *on or after* reaching his RBD, the commencement date for the participant's beneficiary/ies will be December 31 of the year following the year of the participant's death. *Treas. Reg. § 1.401(a)(9)-3, A-3.* The distribution period depends on whether the participant has a DB by the DB determination date and, if so, who it is. A "regular" minimum distribution attributable to the participant will be required to be made by December 31 of the year of the participant's death (to the extent not already paid to the participant before his death). *Treas. Reg. § 1.401(a)(9)-5, A-4(a)(1); Treas. Reg. § 1.408-8, A-4 and A-5(a).* The post-death MRD attributable to the participant is paid to his beneficiary/ies. *Treas. Reg. § 1.401(a)(9)-5, A-4(a) [last sentence]; Treas. Reg. § 1.408-8,A-5(a)*

[last sentence - involving the case where the participant's spouse is his DB].

(1) No Designated Beneficiary. If there is no DB as of the DB determination date, then distributions from the participant's plan are made over the participant's remaining, non-recalculated life expectancy. *Treas. Reg. § 1.401(a)(9)-5, A-5(a)(2).* The divisor for the participant's age as of his birthday in the year of his death is obtained from the Single Life Table and the number 1 is then subtracted in each subsequent year to calculate the MRD for the relevant year. *Treas. Reg. § 1.401(a)(9)-5, A-5(c)(3).* MRDs to the resulting beneficiary must commence by December 31 of the year following the year of the participant's death. *Treas. Reg. § 1.401(a)(9)-5, A-5(a)(2) and (c)(3) and § 1.401(a)(9)-3, A-3(a).*

(2) Participant's Spouse Is **Not** Sole Designated Beneficiary. If the participant has named one or more designated beneficiaries but the participant's spouse is not his sole DB, then distributions are made from the participant's plan over the (oldest) beneficiary's non-recalculated life expectancy or, if longer, over the participant's remaining life expectancy, not recalculated (this would be the case if the DB were older than the participant was). *Treas. Reg. § 1.401(a)(9)-5, A-5(a)(1) and A-5(c)(1).* Assuming the DB is younger than the participant was, in the first distribution year, the divisor for the DB's age as of his birthday in the year following the year of the participant's death (i.e., in the first distribution year) is obtained from the Single Life Table (see Exhibit 3 attached) and used to calculate the minimum required distribution. In subsequent years, the divisor is reduced by one. *Treas. Reg. § 1.401(a)(9)-5, A-5(c)(1).* If the participant's non-recalculated life expectancy is being used instead, the divisor for the participant's age as of his birthday in the year of his death is obtained from the Single Life Table and is then reduced by 1 in each subsequent year. *Treas. Reg. § 1.401(a)(9)-5, A-5(c)(3).* Distributions must commence by December 31 of the year following the year of the participant's death. *Treas. Reg § 1.401(a)(9)-3, A-3(a).* After the death of the DB (if the DB fails to live out his life expectancy), MRDs continue to his/her successor beneficiary following the same distribution schedule. *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(2).*

(3) Participant's Spouse **Is** Sole Designated Beneficiary. As in the case of the participant's death before his RBD, if the participant dies on or after RBD and the participant's spouse is his sole designated beneficiary, she will have certain additional options not available to other beneficiaries.

(a) Spousal IRA Rollover Option. One option usually available to a spouse who is the sole DB of the participant's qualified plan is the spousal IRA rollover, discussed *supra* at I.B.5.a.(3)(b). Another option available to the spouse who is the sole DB of the participant's IRA is the election to roll over the participant's IRA into her own IRA or to treat the participant's IRA as her own, also discussed *supra* at I.B.5.a.(3)(c). In either case, the spouse's RBD will then be used for commencing distributions since she will now be the participant of her new IRA rollover. REMINDER: The spousal IRA rollover option will usually not be available if the participant has named a trust for the spouse (versus the spouse directly) as the beneficiary of his retirement plan, unless the spouse has a complete withdrawal right over the plan benefits passing to the trust. *See* X., *infra*.

(b) Spouse As Participant's ***Sole*** Designated Beneficiary. If the spouse is named as the participant's sole designated beneficiary and she does not utilize one of the options described in (a) immediately preceding , in the situation where the participant dies *after* reaching his RBD, she must commence distributions from the participant's plan to herself on or before December 31 of the calendar year immediately following the calendar year of the participant's death, taking distributions from the participant's retirement plan over *her* life expectancy, recalculated each year. *Treas. Reg. § 1.401(a)(9)-5, A-5(c)(2) and § 1.401(a)(9)-3, A-3(b)(1).* During her life, the spouse utilizes the divisor from the Single Life Table in each distribution year to determine the minimum required distribution for that year. See Exhibit 3. The final regulations added another option for beneficiaries of participants who die after their RBD. If the deceased participant's remaining, non-recalculated life expectancy would be longer than the sole DB spouse's recalculated life expectancy (i.e., the surviving spouse is somewhat older than the deceased participant

was), then the sole DB spouse can opt to use the deceased participant's remaining, non-recalculated life expectancy to calculate MRDs, instead of using her own recalculated life expectancy. *See Treas. Reg. § 1.401(a)(9)-5, A-5(a)(1).*

(c) Distributions On Death Of Sole DB Spouse. After the spouse's death in this situation (where participant died on or after RBD and spouse took MRDs as participant's sole DB), the spouse's successor beneficiary will take MRDs over the spouse's remaining life expectancy, *not* recalculated (i.e., the divisor for the spouse's age as of her birthday in the year of her death is obtained from the Single Life Table and is then reduced by 1 in each subsequent year). *Treas. Reg. § 1.401(a)(9)-5, A-5(a)(1) and A-5(c)(2).* A final MRD attributable to the spouse must be taken in the year of her death (to the extent not taken by her before her death). *Treas. Reg. § 1.401(a)(9)-5, A-4(a)(1).* The spouse's successor beneficiary is determined on September 30 of the year following her date of death. *Treas. Reg. § 1.401(a)(9)-4, A-4(b).* The successor beneficiary must commence MRDs by December 31 of the year following the year of the spouse's death. *Treas. Reg. § 1.401(a)(9)-3, A-3(a).*

6. Creation Of Separate Accounts After Participant's Death. If a participant has named multiple beneficiaries of a single plan or account, assuming the participant's beneficiary designation is worded appropriately (or at least is not worded inappropriately), the individual beneficiaries of the participant's plan can separate their shares into separate accounts, even if the participant did not mandate separate accounts in his beneficiary designation. If the separation occurs by December 31 of the year following the year of the participant's death, and is done in accordance with the method required by the regulations (basically, pro rata and taking into account all distributions since date of death), then each beneficiary can use his/her own life expectancy for determining MRDs from his/her separate account. *Treas. Reg. § 1.401(a)(9)-8, A-2(2) [third sentence].* In fact, the participant's plan can be divided into separate accounts *at any time* after the participant's death (assuming the beneficiary designation is worded appropriately and the division is done in accordance with the regulations); however, if the separation occurs after the December 31 deadline noted above, it will not change the DB – in other words, each beneficiary of a separate account created after the applicable December 31 date must still calculate MRDs using the oldest DB's life expectancy. Even late created separate accounts may still be desirable for investment/management reasons, however.

a. Creation Of Separate Accounts: Issues Relating To Beneficiary Designation Wording. Due to the wording used in the final regulations, it appears that only "fractional" or "percentage" interests in a beneficiary designation can qualify for separate account treatment. *See Treas. Reg. § 1.401(a)(9)-8, A-3(a).* Thus, the type of wording in a beneficiary designation that will allow separate accounts to be created post-death will be something like "equally to my children" or "in equal shares to the following named beneficiaries" or a designation specifying factions or percentages of the plan to various beneficiaries. Another type of beneficiary designation that could lend itself to separate account treatment would be one that specifies a pecuniary amount to one or more beneficiaries, with the remaining balance to one or more other beneficiaries in equal or unequal shares. In this situation, however, the beneficiaries of the pecuniary amounts would have to be "cashed out" by the DB determination date (so that they can be ignored as beneficiaries), leaving only the beneficiaries who are entitled to the remaining portion or fractional shares of the plan to be considered with respect to the designated beneficiary determination.

(1) Problem: Division Of Retirement Plan Benefits Among Multiple Beneficiaries Is Not Provided For In Beneficiary Designation. Wording such as "to the Trustee named in my Will" or "to the Trustee of Participant's Living Trust" is now clearly problematic in terms of allowing multiple beneficiaries under the Will or Living Trust to create the type of separate accounts that would enable each beneficiary to use his/her own life expectancy for calculating minimum required distributions. *See, e.g., PLR 200349009 (December 5, 2003); PLRs 200317041, 200317043 and 200317044 (April 25, 2003); PLR 200234074 (August 23, 2002); and PLR 200208031 (February 22, 2002).* This is true even if the Will (or Living Trust) distributes the participant's estate equally to his children and even

if the children take their shares outright. This is because the IRS takes the position that the separation of benefits is not occurring in (or by reason of) the participant's beneficiary designation, but elsewhere and due to someone else's (i.e., the Trustee's) action. In PLR 200317041, the IRS stated it this way in the case of benefits passing to a Living Trust, and thereafter divided into subtrusts: "... the 'Final' Regulations do preclude 'seperate [sic] account' treatment for Code § 401(a)(9) purposes where amounts pass through a trust." The same would be true for amounts passing "through" an estate due to naming the "Trustee in the Will" as the beneficiary of the retirement plan (as noted earlier, if the "Estate" is listed as the beneficiary, DB treatment is not possible).

(2) Problem: Remainder Beneficiaries Of Accumulation Trusts Are Considered In Determining Designated Beneficiary. In cases where the Participant's retirement plan benefits will pass into trusts that could accumulate plan benefit distributions during the lifetime of the primary beneficiary ("accumulation trusts"), the final regulations, as interpreted by a number of private letter rulings, indicate that the remainder beneficiaries of the trust **must** be taken into account in determining whether there is and who will be treated as the designated beneficiary. *See, e.g., PLRs 200235038-200235041 (August 30, 2002); PLRs 200317041, 200317043 and 200317004 (April 25, 2003); and PLR 200228025 (July 12, 2002).* Thus, true separate account treatment may not be available in the accumulation trust context, even if the division of benefits among the trusts is spelled out in the beneficiary designation itself (versus in the Will or Living Trust Agreement).

(3) Does Failing To Obtain Separate Account Treatment Matter? Whether separate account treatment is necessary or desirable in a particular case depends on the participant's estate plan. For example, if the participant's retirement plan benefits pass to the Trustee in his Will, to be allocated between the Bypass Trust and the Marital Trust in such amounts as the Trustee determines, it should not matter whether separate account treatment is available if the participant's surviving spouse is the oldest beneficiary of both trusts (and is treated as the DB). For another example, if the Trustee in the Will (in general) is named as the beneficiary of the participant's IRA in the beneficiary designation form, and if the Trustee is directed by a Will provision to divide the IRA equally among the participant's three children, who are 37, 36 and 34 years old, even if the IRA is divided in a timely, correct manner after the participant's death, all three children will have to use the 37 year old child's life expectancy in calculating the MRDs from their separate inherited IRA, because the separation of benefits did not occur in the beneficiary designation itself. The difference in life expectancy between age 37 and age 34 is really not that significant, however (see Single Life Table at Exhibit 3). Even if all three children must use the oldest child's life expectancy to calculate MRDs, they may still find it desirable to create separate inherited IRAs for management/investment reasons. *See, e.g., PLRs 200235038-200235041 (August 30, 2002).* If separate account treatment is desired in this case, the *beneficiary designation* itself should specify the shares or percentages passing to each child. Examples of wording that could be used and that should allow for the creation of separate accounts after the participant's death is attached as Exhibits 9 and 13. Suppose, however, in the situation discussed above that the beneficiary designation itself provides for separate shares for each child but the share passing to the youngest child is subject to a contingent trust created in the Will. If the separate trust for that child allows for accumulation of distributions from the IRA during the term of the trust (which is usually the case), and if that child's 37 year old sibling is a "vested" remainder beneficiary of his/her trust, then, under the trust rules (discussed *infra* in Section IV), the 37 year old remainder beneficiary would be treated as the DB of the share held in that child's trust (and the 37 year old's life expectancy would be used to calculate MRDs payable to the youngest child's trust). *See PLR 200228025 (July 12, 2002)* and IV.D.2. Therefore, true separate account treatment would not be available in this case for the youngest child regardless of where and how the separation of benefits occurs.

b. Method For Division Into Separate Accounts After Participant's Death. The final regulations provide that separate accounts are separate portions of the participant's benefit

reflecting the separate interests of the participant's beneficiaries under the plan as of the date of the participant's death. *Treas. Reg. § 1.401(a)(9)-8, A-3.* All post-death investment gains and losses, contributions and forfeitures that occur between the participant's date of death and creation of the separate accounts must be allocated on a pro rata basis. Plus, any distribution(s) made during that time period must be allocated to the separate account of the beneficiary/ies receiving the distribution(s). *Treas. Reg. § 1.401(a)(9)-8, A-3.*

c. Ambiguities In Final Regulations Regarding Separate Accounts. The final regulations contain many ambiguities regarding separate accounts. Hopefully, some of these ambiguities will be clarified in the near future (some have already been clarified).

(1) Effective Date Of Separate Account Treatment. The effective date for calculating MRDs when separate accounts are established after death was not entirely clear in the final regulations. The wording used, that the minimum distribution rules are applied separately to each separate account "for years *subsequent to* the calendar year containing the date on which the separate accounts were established...", made it appear that MRDs will be calculated separately for each separate account beginning in the year *after* the account is established. *See Treas. Reg. § 1.409-8, A-2(a)*, original version (emphasis added). For example, if the participant dies in Year 1 having named multiple beneficiaries of his plan in his beneficiary designation form, and, after the designated beneficiary has been determined on September 30 in Year 2, separate accounts are established by December 31 of Year 2 (making each beneficiary of a new separate account the designated beneficiary of his/her own separate account), are MRDs for all of the beneficiaries for Year 2 determined based on the life expectancy of the DB determined on September 30 of Year 2, with separate account treatment only becoming available to each beneficiary in Year 3, or can each beneficiary of each new separate account use his/her own life expectancy for calculating MRDs in Year 2? The answer was clarified in Treasury Decision 9130, dated June 14, 2004, effective for calendar years beginning on or after January 1, 2003. T.D. 9130 removes Treasury Regulation Section 1.401(a)(9)-6T and modifies the first sentence of Paragraph (a)(2) of Treasury Regulation Section 1.401(a)(9)-8, A-2, to provide that if the participant's retirement plan/IRA is actually divided into separate accounts by the end of the calendar year following the year of the participant's death, then the beneficiaries may avail themselves of separate account treatment for determining MRDs beginning in the year following the year of the participant's death. *See Treas. Reg. § 1.401(a)(9)-8, A-2 (a)(2), as modified by T.D. 9130.* Thus, in the example above, each beneficiary can use his/her own life expectancy for calculating MRDs beginning in Year 2.

(2) How Are Separate Accounts "Established"? The final regulations introduce the concept, subtly, that establishing separate accounts means doing something more than recognizing that multiple beneficiaries of a participant's retirement account have separate interests in the account. This is because, prior to the final regulations, the definition of "separate account" in both the 1987 proposed regulations and the 2001 proposed regulations used the term "portion" to describe a separate account, indicating that the separate account concept was primarily an accounting rule. Further, the final regulations added the action verb "establish" to the separate account requirements. *See Treas. Reg. § 1.401(a)(9)-8, A-3.* So, how is a separate account actually established under the final regulations? While the final regulations are not entirely clear on this point, the safest approach would be for the IRA custodian/trustee to create new accounts for the beneficiaries (i.e., a separate "inherited IRA" account for each beneficiary) and then transfer from the deceased participant's original IRA the proportionate amount (taking into account the post-death adjustments delineated in the final regulations) belonging to each beneficiary to that beneficiary's new separate account by December 31 of the year following the year of the participant's death. All of the new separate accounts will be "inherited IRAs" and, as such, will retain the deceased participant's name, but wording such as "for the benefit of" [name of the individual beneficiary who has inherited that IRA] can be added after the deceased participant's name. Subsequent to establishment of the separate accounts, any beneficiary who wants to move his

separate account to another financial institution can accomplish that by a "trustee to trustee" transfer. See previous discussion at I.B.5.a.(2)(a).

7. Effective Dates. The final regulations state that for purposes of calculating MRDs from account balances or benefits in existence on or after January 1, 1985, the new rules are effective beginning on or after January 1, 2003. *Treas. Reg. § 1.401(a)(9)-1, A-2(a).* For determining MRDs for calendar year 2002, taxpayers may rely on the final regulations, the January 2001 proposed regulations or the 1987 proposed regulations. *Vol. 67, No. 74, Federal Register (April 17, 2002), Rules and Regulations, Required Distributions from Retirement Plans, Summary: Effective Date.*

a. Transitional Rules. Allegedly, the new rules apply for calendar years beginning on or after January 1, 2003, even if the participant died prior to January 1, 2003. The rules further state that, in such a case, the designated beneficiary and the applicable distribution period must be redetermined under the new rules. *Treas. Reg. § 1.401(a)(9)-1, A-2(b)(1).* There are many cases that have already arisen where additional guidance is needed to make this determination (due to uncertainty over how the new rules can be applied retroactively, especially in view of the change in the applicable date for when the designated beneficiary has to be determined). See Exhibit 4 for an example.

b. Relief From 5 Year Rule. A beneficiary stuck with the 5 year rule under the prior proposed regulations who can qualify for a life expectancy distribution under the new rules may switch to the life expectancy method as long as all amounts that should have been taken pursuant to the life expectancy method are actually distributed by the earlier of December 31, 2003, or the end of the originally applicable 5 year period. *Treas. Reg. § 1.401(a)(9)-1, A-2(b)(2).*

c. Relief For Failure To Provide Trust Documentation. If a trust failed the trust regulatory requirements solely due to not providing a copy of the trust document to the plan administrator by October 31 of the year following the year of the participant's death, that default can be cured by providing the required trust documentation to the plan administrator by October 31, 2003. *Treas. Reg. § 1.401(a)(9)-1, A-2(c).*

8. Reporting Requirements. The January 2001 proposed regulations attempted to impose on IRA trustees and custodians the same reporting responsibility applicable to administrators of qualified plans. That is, IRA trustees and custodians were directed to report the amount of an IRA owner's MRD from his IRA. A significant number of financial institutions sponsoring IRA accounts strenuously objected to this requirement. As a compromise, the final regulations left this matter somewhat incomplete. The Service has authority to determine the extent to which IRA trustees and custodians must report IRA information. In conjunction with this provision, Notice 2002-27, 2002-18 IRB 814 (April 16, 2002) has been issued, which specifies that, beginning in 2004, IRA trustees and custodians must identify to the IRS each IRA from which a MRD is required to be made. Although the IRA trustee/custodian does not need to report the amount of the MRD to the IRS, beginning in 2003, it must either provide such information to the IRA owner or offer to calculate the amount for the IRA owner upon request (and if requested to do so, must calculate the MRD). The Service still has concerns regarding compliance with the MRD rules by taxpayers and is likely going to continue to impose reporting requirements on trustees and custodians of IRAs similar to those imposed on administrators of qualified plans.

C. Taxation Overview.

1. Income Taxation. For the most part, distributions from retirement plans are taxed as ordinary income upon receipt. *See IRC § 72 and § 408(d).* Only items such as nondeductible participant contributions, amounts the participant included in income due to life insurance coverage, and loan repayments treated as taxable distributions, etc., are considered a return of basis (and, therefore, non-taxable). *IRC § 72.* The participant's basis in the plan must be reduced by any amounts distributed before his annuity starting date that were treated as a return of his investment. *IRC § 72(b)(4)(B).*

a. Special Income Tax Rules.

(1) Ten Year Averaging. Ten year averaging will not be discussed in this outline because such treatment is only available to those who qualify under the transitional rule. See *Tax Reform Act of 1986*, *P.L. 99-514, Section*

1122(a)(2)(A). The transitional rule is generally available only to participants (or beneficiaries of deceased participants) who had attained age 50 before January 1, 1986 (i.e., for participants born before 1936).

(2) Capital Gain Treatment. Capital gain treatment for certain plan distributions will not be discussed in this outline because such treatment is only available to those who qualify under the transitional rule. *See Tax Reform Act of 1986*, *P.L. 99-514, Section 1122(b)(2)(D)*. The transitional rule is generally available only to participants (or beneficiaries of deceased participants) who had attained age 50 before January 1, 1986 (i.e., for participants born before 1936).

(3) Five Year Averaging. Under 5-year averaging, a lump sum distribution from a qualified plan (not an IRA) is taxed separately from other income of the recipient. The amount of tax is determined by multiplying by 5 the amount of tax, using the single taxpayer rate, on 1/5 of the excess of the total taxable amount of the lump sum distribution over the minimum distribution allowance. The minimum distribution allowance is equal to the lesser of $10,000 or ½ of the total taxable amount of the lump sum distribution for the taxable year, reduced (but not below zero) by 20% of the amount (if any) by which such total taxable amount exceeds $20,000. See *IRC § 402(d)(1)*. Once the total taxable amount reaches $70,000, the minimum distribution allowance is eliminated. If there are multiple beneficiaries, each beneficiary may elect whether to take special averaging treatment or, with respect to a participant or spouse beneficiary only, roll the distribution into an IRA rollover. If 2 or more trusts or individuals are beneficiaries, a tentative tax is determined on the aggregate amount, regardless of whether each recipient elects special averaging, and is then apportioned according to the relative amount that each recipient receives. *IRC § 402(d)(2)(D)*. Five (5) year averaging was available through December 31, 1999, and is no longer available (beginning January 1, 2000) as a result of repeal by the Small Business Job Protection Act of 1996. *P.L. 104-188, Section 1401, amending Code Section 402(d).*

b. Rollovers.

(1) Rollover By Participant. The taxable portion of a qualified plan distribution received by a participant upon separation from service may be rolled over by the participant to another qualified plan or an IRA rollover, thereby continuing tax deferral until the participant's RBD (or as allowed under the minimum distribution rules). *IRC § 402(c).* [NOTE: As a result of EGTRRA, P.L. 107-16, beginning in 2002, participants in qualified plans will be able to roll over to certain other qualified plans or to an IRA rollover not just the taxable portion of their benefits, but the after-tax portion as well. See EGTRAA, Section 643 of Subtitle D -- *Increasing Portability for Participants*, amending IRC Section 402(c)(2).] The participant has sixty (60) days from receipt of the lump sum distribution to make the rollover. *IRC § 402(3)*. The entire distribution need not be rolled over (and non-taxable amounts, such as nondeductible employee contributions, may not be rolled over before 2002); however, any taxable amount not rolled over will be subject to ordinary income tax in the year of receipt. *IRC § 402(a).* Withholding in the amount of 20% will automatically occur unless the participant directs a trustee to trustee transfer (i.e., a "direct" rollover). See *IRC §§ 402, 403, and 3405(c)*. If 20% is withheld, the participant must replace it within the sixty (60) day time period or it will be treated as a taxable distribution, subject to income tax.

(2) Rollover By Spouse Designated Beneficiary. A surviving spouse is the ***only*** beneficiary of a deceased participant who may roll over the taxable amount of the participant's qualified plans to an IRA rollover or to another qualified plan (the latter option being available on or after January 1, 2002). *IRC § 402(c)(9).* [EGTRRA, P.L. 107-16, generally effective for tax years beginning after December 31, 2001, expanded the spousal IRA rollover provisions to allow surviving spouses to roll over the deceased spouse's interest in a qualified plan to certain qualified plans in which the spouse participates. *See* EGTRRA, Section 641(d) of Subtitle D - *Increasing Portability for Participants*, amending IRC Section 402(c)(9).] She may also elect to treat the participant's IRA as her own or roll over any of the participant's IRAs into a new IRA

rollover in her name. *See* I.B.5.a.(3) and I.B.5.b.(3), *supra*.

c. Inherited Retirement Plans.

(1) "Inherited" Qualified Plans. Unfortunately, many qualified plans require non-spouse beneficiaries of a deceased participant's interest in the plan to take distribution of the participant's entire interest in the plan within a relatively short period of time after the participant's death (this plan requirement is not based on federal law, but is included for the administrative convenience of the company sponsoring the plan). If such a full distribution occurred before the end of 1999, 5-year averaging would have been available to the beneficiary. Beginning in the year 2000, there would not appear to be any relief from income taxation on the entire taxable amount received by the beneficiary in the year of receipt. (Remember that, because qualified plans and IRAs are "income in respect of a decedent" or "IRD", they do not get a step up in basis at death. *IRC § 1014(c).)* A few plans may permit non-spouse beneficiaries to take distribution of the participant's interest in the plan pursuant to the minimum distribution rules. Many plans that don't require immediate distribution mandate distribution under the 5-year rule, even if another method would be permitted under the rules. The reason for these policies is that administrators of qualified plans do not want to maintain distribution responsibility for anyone other than the participant and his spouse.

(2) "Inherited" IRAs. IRAs passing to non-spouse beneficiaries upon the participant's death (including most trusts, even if the participant's spouse is the primary or sole current beneficiary of the trust) must remain in the deceased participant's name since non-spouse beneficiaries are not permitted to roll over the deceased participant's IRA to a new IRA in their name. *IRC § 408(d)(3)(C)*. (It is permissible to state that the deceased participant's IRA is "held for the benefit of" the named beneficiary.) If the beneficiary wants to move the inherited IRA to another institution (to achieve his/her investment objectives, for example), he/she can do so by effecting a "trustee to trustee" or "custodian to custodian" transfer, which is not a rollover (again, the inherited IRA remains in the deceased participant's name). *See Rev. Rul. 78-406, 1978-2 C.B. 157; Rev. Proc. 89-52, 1989-2 C.B. 632; PLR 200228025 (July 12, 2002); PLR 9250040*, *supra*. Distributions from inherited IRAs can often be made according to the minimum distribution rules in the Code, although, some IRA custodians and trustees limit distributions to the 5-year rule, even if a longer deferral would be permitted under the rules. Up until now, some IRA sponsors have disallowed continued distribution under the minimum distribution rules for inherited IRAs where the designated beneficiary dies prematurely (i.e., before receiving all amounts in the inherited IRA). Hopefully, because the new rules clearly allow the designated beneficiary to name a successor beneficiary to receive the amounts remaining in the inherited IRA upon the death of the DB before all plan benefits have been distributed, IRA custodians and trustees will now permit continued MRDs to the successor beneficiary.

d. $5,000 Death Benefit Exclusion. Prior to repeal by the Small Business Job Protection Act, a $5,000 death benefit exclusion from income tax was available to recipients of death benefits from a participant's *qualified plan* (but not IRAs) under Section 101(b) of the Code. Repeal of this exclusion became effective for decedents dying after August 20, 1996.

2. Estate Taxation.

a. General Rule. Under current law, a deceased participant's interest in retirement plans as of his date of death is included in his gross estate under either Code Section 2033 or Section 2039. Prior to 1983, however, the value of a participant's interest in a *qualified plan* was completely excludible from his gross estate if 10-year averaging was not elected and the plan benefits were *not* payable to his "Estate". The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced this unlimited exclusion for qualified plan benefits to $100,000 for decedents dying after December 31, 1982. *P.L. 97-248, Section 245(a)(b)*. After December 31, 1982 and through December 31, 1984, $100,000 of the value of the decedent's interest in qualified plans was excluded from his gross estate. As a result of the Deficit Reduction Act, the $100,000 exclusion was repealed for participants dying after December 31, 1984. *P.L. 98-369*. Thereafter, no

amount was excluded unless a transitional ruled applied.

b. Two Transitional Rules May Still Provide Exclusion From Participant's Estate For Qualified Plans Benefits.

(1) Unlimited Exclusion. If a participant separated from service before January 1, 1983, as long as the form of his benefit was not changed after that date or at any time prior to his death, his interest in that qualified plan would not have to be included in his estate upon his death.

(2) $100,000 Exclusion. If a participant separated from service after December 31, 1982 and before January 1, 1985, and did not (or does not) change the form of his benefit prior to his death, then $100,000 of his qualified plan may be excluded from his estate upon his death.

c. Estate Tax Transitional Rules Not Applicable To IRAs. The IRS has ruled that the estate tax transitional rules do not apply to IRAs. *Rev Rul. 92-22, 1922-1 C.B. 313; TAM 9144046*.

d. Caution Advised. If a participant could qualify for one of these estate tax transitional rules, he should exercise caution before making changes to the form of his benefits and/or before making an IRA rollover (which will cause loss of the exclusion).

D. Penalty Taxes. Be aware that the Code provides penalties for violating the minimum distribution rules.

1. Premature Distributions. If a participant takes distributions from his retirement plan/account before reaching age 59 ½ and one of the exceptions is not available, in addition to income taxes on the distribution, a 10% penalty will have to be paid. *See IRC § 72*.

2. Late Or Insufficient Distributions. If the participant or his beneficiary fails to take at least the minimum required distribution amount by the due date, a 50% penalty will apply (in addition to income taxes due on the required distribution in the year actually taken). *See IRC § 4974(a)*.

3. Elimination Of Penalty Taxes On Excess Accumulations And Distributions. The Small Business Job Protection Act of 1996 suspended the 15% penalty on excess retirement distributions for amounts received in 1997, 1998 and 1999. *P.L. 104-188*. The Taxpayer Relief Act of 1997 repealed both the excess distributions tax and the excess accumulations tax for distributions made and for estates of decedents dying after December 31, 1996. *P.L. 105-34, Section 1073(a)*.

E. Spousal Rights. Effective for plan years after 1984, a retirement plan will not be qualified under Section 401(a) of the Code unless it provides certain benefits to the participant's spouse. These benefits were generally added by the Retirement Equity Act of 1984 (REA), P.L. 98-397, and amended (retroactively) by the Tax Reform Act of 1986, P.L. 99-514.

1. Two Required Spousal Benefits For Certain Plans. All defined benefit plans and certain defined contribution plans (those that are subject to the minimum funding standards under Code Section 412, such as money purchase pension plans), must provide the following survivor annuity benefits:

a. QJSA. If a married participant is living on his annuity starting date, the plan must pay his accrued benefit in the form of a qualified joint and survivor annuity ("QJSA"). *IRC § 401(a)(11)(A)(i)*.

b. QPSA. If a married participant dies before his annuity starting date and is vested in any portion of his accrued benefit, the plan must provide his surviving spouse with a qualified preretirement survivor annuity ("QPSA"). *IRC § 401(a)(11)(A)(ii)*.

2. Spousal Benefit Requirements For Other Plans. Even those plans that are not subject to the QJSA and QPSA requirements, such as profit sharing plans and stock bonus plans, must satisfy certain rules to avoid the QJSA and QPSA requirements. The following conditions must be met:

a. Spouse Must Be Beneficiary. The plan must provide that if the participant is married at the time of his death, his vested accrued benefit will be paid in full to his surviving spouse unless she consents to the naming of another beneficiary. *IRC § 411(a)(11)(B)(iii)(I)*.

b. No Annuity Rule. The participant must not elect to receive benefits from the plan in the form of a life annuity. *IRC § 411(a)(11)(B)(iii)(II)*. If he does, the plan must provide that the QPSA and QJSA rules will then apply to all of his plan benefits (except in cases where separate elections are made for segregated benefits or shares in the plan and there is a

separate accounting for the account balance subject to the election). *Treas. Reg. § 1.401(a)-20, A-4*.

c. Not A Transferee Plan. To omit offering survivor annuities, the profit sharing or stock bonus plan must not be a transferee from a defined benefit plan (that would have been required to pay a survivor annuity). *IRC § 411(a)(11)(B)(iii)(III)*.

3. Additional Technical Rules. There are numerous additional technical rules relating to these spousal benefits, most of which are beyond the scope of this outline.

4. Waivers And Consents. For purposes of this outline, however, the rules regarding how the participant and his spouse can elect out of the required spousal benefits is relevant.

a. Participant's Waiver. A plan that must provide QPSA and QJSA benefits must also permit the participant to waive that form of benefit. The waiver must be in writing in order to be effective. *IRC § 417(a)(2)(A)(i)*. A plan must also give the participant the opportunity to revoke his waiver of the spousal annuity form of benefits within the relevant election period. *IRC §§ 417(a)(1) and 417(a)(2)*.

b. Spousal Consent To Waiver. The participant's waiver of the spousal annuity benefits provided by defined benefit plans, or the spouse's right to receive benefits from defined contribution plans, will only be effective if the participant's spouse consents to the waiver. The spouse's consent must be in writing and must be acknowledged before a representative of the plan administrator or a notary public. *IRC § 417(a)(2)(A)(i) and (iii)*.

(1) General Consent. A spouse may execute a general consent, consenting both to the waiver of the annuity form of benefits, if applicable, and to the designation by the participant of another beneficiary. If the spouse gives a full, general consent, no further consent will be required as to any subsequent change in beneficiary. *Treas. Reg. § 1.401(a)-20, A-31(a)*.

(2) Specific Consent. A spouse may specifically consent to waiver of just one particular form of benefit, or to waiver of all spousal benefits. Further, the spouse may consent to the naming of one particular beneficiary (only). In the case of a specific consent by the spouse, subsequent changes by the participant, other than the participant's subsequent waiver of his revocation of the spousal annuity form of benefits, will be ineffective without spousal consent. *Treas. Reg. § 1.401(a)-20, A-31(a)*.

(3) Optional Form Of Benefit Identified. Even in the case of a general consent by a spouse, for plan years beginning after 1986, the waiver and/or consent regarding the QJSA must specify the alternative form of benefit that is selected by the participant. *Treas. Reg. § 1.401(a)-20, A-31(b)*.

c. Sample Language. The IRS has published sample language that can be used to waive the spousal annuity form of benefits and to consent to receiving benefits in a form other than the QJSA and QPSA for plans required to pay them. Also included is sample language that can be used to waive the spouse's right to receive benefits from defined contribution plans. *See Notice 97-10, 1997-1, C.B. 370*.

d. Consideration To Spousal Rights. Because of the spousal rights in retirement plans, these rules must be taken into account whenever a participant desires to name someone other than his spouse (such as a trust) as the beneficiary of his retirement plans.

F. Community Property Laws. Although some Texas estate planning practitioners believe otherwise as a result of the U.S. Supreme Court's decision in Boggs v. Boggs, 177 S.Ct. 1759 (1997), the majority of practitioners still believe that the non-participant spouse ("NPS") has a community property interest in retirement plan benefits accruing during her marriage to the participant while living in a community property state. This conclusion has great support in the law, not the least of which is the Texas Constitution, and numerous Texas cases, including Allard v. Frech, 754 S.W.2d 111 (Tex. 1988), cert. denied, 109 S.C. 788 (January 8, 1989). In fact, federal law recognizes community property law in most cases. If a federal statute does not clearly override community property law, then federal courts must specifically find, under the facts in a particular case, that federal law conflicts with state community property law in a way that hinders the effectiveness of the federal law in order to preempt state law. In the case of qualified plans, the inclusion of statutory provisions relating to qualified domestic relations order is just one

example of federal law's recognition of spousal rights, including community property rights. Further, the additional provisions found throughout the Code relating to community property indicate Congress' recognition of the community property regime. Unfortunately, since the majority of states are not community property states, most lawmakers' understanding of community property law is not well developed and, therefore, erratic treatment often results.

1. Devisability Issue. Whether the NPS has the right to dispose of her community property interest in the participant's retirement plans upon her death if she is the first spouse to die is a separate issue from ownership. With respect to this issue, the answers seem relatively clear at the present time.

a. Qualified Plans - No Right Of Disposition. Although the Boggs case arose in Louisiana, the decision in that case applies to Texas participants and their spouses. In a somewhat awkwardly worded decision, a plurality of the U.S. Supreme Court held that the NPS does not have a right to dispose of her community property interest in the participant's *qualified plans* upon her death prior to the participant's death. The decision was based on ERISA preemption of state law, in this case, state community property law as it applies in the context of the death of the NPS. Since the primary purpose of ERISA qualified plans is to provide retirement income to employees (and their spouses), and not to provide inheritance-type benefits to (able bodied, employment age) children or other beneficiaries, the ERISA purpose would be defeated if the NPS's children in Boggs could take away retirement benefits from Mr. Boggs.

b. IRAs - *Boggs* Not Applicable. Although the Boggs case recites the fact that, subsequent to the NPS's death, the participant rolled over some of his qualified plan benefits to an IRA rollover, that fact is extraneous to the decision. In this author's opinion, the Boggs decision does not apply to IRAs for two (2) reasons. First, the decision is based on federal law (ERISA) preemption of state (community property) law. IRAs are not qualified plans under ERISA. They are merely tax favored accounts that are subject to most of the same minimum distribution rules applicable to qualified plans. Second, no IRA (IRA rollover) was in existence at the time of the death of the NPS in the Boggs case. Thus, the IRA issue was not ripe (and was not decided) in that case.

c. Status Of IRA Rollovers From Qualified Plans. If a participant rolls over his qualified plan benefits to an IRA rollover, is the Boggs result avoided? While no one knows the answer for certain at this time, most practitioners feel that this practice is worth recommending to clients. Assuming that the Boggs case stands only for the proposition that the NPS cannot devise her community property interest in the participant's qualified plans upon her death (because of ERISA preemption), plan benefits rolled out to the IRA rollover should continue to be community property. Another theory would be that an IRA rollover, which is not a qualified plan subject to ERISA, is a new asset, so that under the inception of title rule, a rollover that occurs during the marriage must create a community property asset. A recent private letter ruling is very helpful on this issue. In PLR 199937055 (Sept. 17, 1999), the Service ruled that IRC § 408(g), which provides that § 408 must be applied without regard to community property rules, relates primarily to the deduction rules under Code Sections 219 and 220 and does not abrogate substantive property rights under state law. Therefore, the classification of an IRA/IRA rollover as community property (or not) is a matter to be determined under applicable state law. Thus, until there is a federal case involving an IRA rollover in this fact situation that holds that some other federal law (besides ERISA) preempts state community property law with respect to devisability of the NPS's interest in the IRA rollover, the NPS who predeceases the participant should be able to dispose of her community property interest in the IRA rollover upon her death, even if the rollover was derived from the participant's qualified plan.

2. Drafting Issues. Even if the NPS has the right to devise her community property interest in the participant's IRA upon her death, how does she do it?

a. How Does The Interest Pass? It would appear, based on Texas case law, that the NPS's interest in the participant's IRAs passes by Will or intestacy upon her death. In a Living Trust plan, a pour over Will would probably be necessary

unless the NPS's community property interest in the IRA could somehow be conveyed to the Living Trust prior to her death. It is very doubtful that a qualified plan could be transferred or assigned to a Living Trust during the participant's life due to ERISA's anti-alienation rule. One recent private letter ruling states the "fact" that a Living Trust "owned" an IRA. *See PLR 199925033 (June 25, 1999).* It is not clear how ownership of an IRA can be conveyed to a Living Trust (if it can). This author has found no discussion regarding the documentation necessary to accomplish this. Therefore, it would appear safer to include the desired disposition in the NPS's Will (or, if the disposition is contained in the Living Trust document, then the pour over Will should be probated).

b. To Whom Should The Interest Pass?

(1) To Participant. Because federal law, for the most part, and IRA custodians and trustees (sponsors) consider the participant to be the owner of all IRAs in his name, it would be simpler in most cases for the NPS to make a specific bequest of her community property interest in the participant's IRAs, including IRA rollovers, directly to the participant spouse in her Will (this bequest is sometimes referred to as an "anti-*Allard*" clause). This gift should qualify for the federal estate tax marital deduction, regardless of the form of benefits (a specific statutory provision applies to survivor annuities under IRC § 2056(b)(7)(c)).

(2) To Participant, With Disclaimer Option. To accomplish additional estate tax and other objectives, the NPS may wish to pass her interest in IRAs to the participant spouse but provide, additionally, that if the participant disclaims all or any portion of that gift, the disclaimed amount will pass into trust. This author recommends using a specially drafted "Disclaimer Trust" in the Will or Living Trust Agreement as the recipient of disclaimed assets (versus the "regular" Bypass Trust or QTIP Trust created in the instrument). The Disclaimer Trust in the NPS's Will or Living Trust Agreement could either be a "stripped down" Bypass Trust (a Bypass Trust with no powers of appointment in it) or a multiple purpose trust set up to function as either a Bypass Trust or a QTIP Trust (providing mandatory income distributions to the spouse and disallowing distributions to others during the spouse's lifetime), therefore, maximizing the possibilities (including the possibility of obtaining the credit for tax on prior transfers if the spouses die within 9 months (disclaimer) or 15 months (partial QTIP election) of each other). Using a specially designed Disclaimer Trust as the recipient of disclaimed assets and, in particular, as the recipient of IRA benefits, is usually preferable to having disclaimed assets pass directly to a regular Bypass Trust or QTIP Trust, which often contain powers of appointment, thereby necessitating a disclaimer of those powers in order to effect a qualified disclaimer. To some extent, the technical issues that apply when a trust is named as the beneficiary of retirement plans may apply in this context (although, unlike the death of the participant, the death of the NPS does not trigger any required distributions under the federal income tax laws [i.e., minimum distribution rules]). Therefore, if designated beneficiary treatment, or other favorable income tax treatment, is desired, special drafting of the Disclaimer Trust is warranted.

c. Documentation Of Disclaimer By Participant. If the NPS devises her community interest in the participant's IRAs to the participant and the participant makes a qualified disclaimer of all or part of the gift so that the disclaimed portion is now "owned" by the Disclaimer Trust, what type of documentation is used?

(1) Qualified Disclaimer. Obviously, a written disclaimer meeting all of the requirements of Section 37A of the Texas Probate Code and Section 2518 of the Internal Revenue Code is the first document required. In the disclaimer, the participant should recite that a gift was made to him in the NPS's Will of the NPS's community property interest in the participant's IRA and that the participant is disclaiming all of that gift, or X% of that gift.

(2) IRA Documentation - Implementation Of Disclaimer. It would appear that at least three (3) possibilities exist for implementing the result of the disclaimer.

(a) Withdrawal By Participant. The participant could withdraw from his IRA the percentage passing to the Disclaimer Trust as a result of his disclaimer. That amount would then be transferred to the Disclaimer Trust (bank or

brokerage) account. Income taxes would be due on the withdrawn amount, which should be borne by the Disclaimer Trust (technically, the income taxes would probably be payable by the participant, who would then seek reimbursement from the Disclaimer Trust). If the participant is under age 59 ½ at the time of the withdrawal, a penalty tax would also apply. (The penalty tax exception for death under IRC Section 72 is not available in the case of the death of the NPS.) While the withdrawal approach is one possible method for implementing the disclaimer, it is not very popular due to the immediate tax consequences. It does have the advantage of simplicity, however, and may be worth doing in the case of very small amounts. (The Disclaimer Trust should be drafted so that if this method is chosen, the Trustee must reimburse the participant for any income taxes he has paid on the trust's behalf).

(b) Co-ownership Of IRA: Agreement Between Participant And Trustee. The participant's IRA could remain exactly as it was before the NPS's death. As a result of the participant's disclaimer of the testamentary gift of the NPS's interest in the IRA, however, the IRA would now be co-owned by the participant and (the trustee of) the Disclaimer Trust in percentages based on the amount disclaimed. The participant and the Trustee of the Disclaimer Trust (frequently the same person) could enter into an agreement memorializing the ownership of the IRA from that point forward. The Trustee of the Disclaimer Trust and the participant would also agree that the participant should designate the Disclaimer Trust (or its remainder beneficiaries) as the beneficiary of its percentage of the IRA. Distributions from the IRA would then be taken by the participant based on the applicable minimum distribution rules, utilizing the new lifetime distribution table. If the participant will be naming different beneficiaries for his percentage interest in the IRA, he should consider using separate accounts or segregated shares (because of problems that can arise under the multiple beneficiary rules). As the participant takes distributions from the IRA, the portion of the distribution allocable to the Disclaimer Trust would be paid to it by the participant and, depending on the terms of the Disclaimer Trust, could then distributed from the Trust (in whole or in part) to the participant as the income beneficiary of the Trust. The Agreement between the participant and the Trustee of the Disclaimer Trust should address the income tax liability issues. Because the IRA is not necessarily divided under this approach, the distributions taken from the IRA by the participant are being taken proportionately from the participant's portion and the Disclaimer Trust's portion of the IRA.

(c) Separate IRA Approach. A third approach for implementing the disclaimer by the participant is to separate the IRA into two (2) separate accounts, on a fractional or percentage basis, corresponding to the respective fractional/percentage interests owned by the participant and the Disclaimer Trust. Both IRAs would remain in the Participant's name. For ease of identification, the severed IRA now belonging to the Disclaimer Trust could have "for the benefit of the Disclaimer Trust" (or similar wording) included in the title following the participant's name, for example: "John T. Jones IRA for the benefit of the Mary Jones Disclaimer Trust." In any event, the Disclaimer Trust, or its remainder beneficiaries, would be designated as the beneficiary of that IRA. The advantages of this approach are (i) it allows for separate account treatment under the multiple beneficiary rules, and (ii) it should allow the participant to take minimum required distributions in a non-pro rata manner, as specifically authorized in IRS Notice 88-38, I.R.B. 1988-15. COMMENT: Some practitioners have expressed the opinion that, even in this situation, required distributions should still be taken proportionately from the two IRAs. Apparently, the reason for this position (author's speculation) is to avoid the appearance of taking full advantage of the tax laws as written in a situation where the result is too good (i.e., the Disclaimer Trust -- which is functioning as a Bypass Trust in this case -- will have all of the deferral opportunity because its IRA will be tapped last). But how is this any different, for example, from the participant dividing one (1) IRA into two (2) IRAs and designating a charity as the beneficiary of one of the two IRAs and taking all of the required distributions from just one of the IRAs until exhausted (a common practice)?

3. Planning Ideas To Assist NPS In Her Estate Planning. With the increasing estate tax exclusion amounts passed into law by EGTRRA, fully utilizing the NPS's estate tax exclusion amount if she dies first may be less of a concern than it was before. Nevertheless, here are some ideas to be considered.

a. Roll over qualified plan benefits to IRAs.

b. Increase NPS's assets through partition (even non-pro rata partition).

c. Increase NPS's assets through gifts.

d. Decrease amounts held in qualified plans and IRAs by taking discretionary distributions (after age 59 ½) before age 70 ½ and by taking additional distributions in excess of the minimum required amounts after age 70 ½. With additional amount taken, do one or more of the following:

(1) Spend it.

(2) Make tax free or charitable gifts with it.

(3) Invest it in (after tax) assets that will be suitable for funding a Bypass Trust.

e. Buy life insurance for liquidity to pay taxes and/or fund trusts.

f. Plan for disclaimer by participant spouse.

g. Participant and NPS get divorced and do a QDRO! They can remarry, if they desire, after a sufficient time period has elapsed to avoid "fraudulent divorce" argument.

II. OPTIMAL BENEFICIARY DESIGNATIONS

A. Married Participant: Designate Spouse As Primary Beneficiary. Designating the spouse as the primary beneficiary of retirement benefits has numerous advantages. NOTE: In this section, it will be assumed that the designated spouse is a U.S. citizen.

1. Qualifies for Estate Tax Marital Deduction. The participant's interest in retirement plans passing directly to his spouse will qualify for the federal estate tax marital deduction. *See IRC § 2056*. This is true even if the distribution is required to be made in annuity form.

a. Automatic QTIP Treatment For Survivor Annuities. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA), P.L. 100-647, amended the QTIP rules to require automatic QTIP treatment for a survivor annuity unless the decedent's executor elects otherwise. *IRC § 2056(b)(7)(C)*. Interestingly, while annuities are generally "terminable" interests, the qualified joint and survivor annuity (QJSA) and the qualified preretirement survivor annuity (QPSA) mandated by the Retirement Equity Act of 1984 (REA) are generally not *non*deductible terminable interests, since no amount will pass to anyone upon the spouse's death (actually, no amount should remain to be included and taxed in the surviving spouse's estate). Thus, strictly speaking, the TAMRA amendment to the QTIP rules should not have been necessary to make those types of annuities qualify for the marital deduction (although the amendments also apply to the community property interest in such annuities owned by the non-participant spouse in the event of her death prior to the participant, a more troublesome situation due to the possibility of the participant's subsequent remarriage). Does this mean that the amendment was meant to apply to other "annuity" types of distribution (such as a "life expectancy" payout)?

b. Periodic Payment Issues. On the other hand, if the deceased participant's spouse is his sole DB and will be taking MRDs over her life expectancy, recalculated each year, an amount *will* remain in the plan upon the surviving spouse's death for distribution to others. Does automatic QTIP treatment in the participant's estate per the TAMRA amendment apply in this case? One private letter ruling involving periodic payments over the joint and last survivor life expectancies of the participant and his spouse under the old rules indicated that it does. *See, e.g., PLR 9204017 (January 24, 1992).* Of course, the new rules have different distribution periods and the sole DB spouse would usually have the right to withdraw the entire balance in the deceased participant's plan at any time, which should make the gift to her qualify for the marital deduction as an *outright* gift.

2. No Gift Tax Issue. No transfer of the non-participant spouse's interest in the retirement plans is being made by her upon the participant's death because she is keeping her half (as well as receiving the participant's half).

3. Spouse Qualifies As Sole Designated Beneficiary. For purposes of determining lifetime distributions to the participant, it no longer matters (except in one case) who his designated beneficiary is as of his RBD. Distributions

beginning at RBD will be based on the Uniform Lifetime Table unless the participant's young spouse is his <u>sole</u> DB. *See* I.B.3., *supra*. However, by naming his spouse as the primary beneficiary of his retirement plans, the participant will have set up several favorable income tax options for his spouse upon his death and not jeopardized the federal estate tax marital deduction for his estate.

4. <u>Spouse's Options Upon Death Of Participant</u>.

a. <u>Spouse's IRA Rollover Option</u>. Assuming the participant's plan allows a lump sum distribution for a spouse designated beneficiary, if the participant designates his spouse as the <u>sole</u> beneficiary of his qualified plan, the spouse can roll over all or any portion of the participant's benefits (excluding the required minimum distribution for that year, if any, and, before January 1, 2002, ineligible rollover amounts, such as after-tax employee contributions) to a spousal IRA rollover (and after December 31, 2001, to certain qualified plans in which the spouse participates – *see* I.B.5.a.(3)(b), *supra*). If the participant's retirement benefits are held in an IRA/IRA rollover in his name and his spouse is the designated beneficiary, she can roll over his IRA/IRA rollover into a new IRA rollover in her name. A spouse is the ***only beneficiary*** who has a rollover option. The spousal rollover option will not usually be available if someone else, including a trust for the benefit of the spouse, is the designated beneficiary (unless the trust happens to have certain provisions that result in the spouse having complete access to the IRA, such as an unlimited withdrawal right over it -- *See* X., *infra*). A spouse may make an IRA rollover regardless of whether the participant dies before or after his RBD and regardless of the age of the spouse at the time of the participant's death. The spouse will then be treated as the participant of her spousal IRA rollover. As such, she is entitled to designate new beneficiaries of her rollover IRA. Because the spouse becomes the participant of her spousal IRA rollover, minimum required distributions must commence by *her* RBD (or, if she is already past her RBD, then by December 31 of the year following the year of the participant's death).

b. <u>Spouse's Assumption Of Participant's IRA</u>. As an alternative to a spousal IRA rollover, when the deceased participant's benefits are already in an IRA, a spouse who is the designated beneficiary may simply elect to treat the participant's IRA as her own instead of rolling it over into a new IRA. The effect is basically the same as a spousal rollover.

c. <u>Disadvantages Of Spousal IRA Rollover</u>.

(1) <u>Penalty On Distributions If Spouse Is Under Age 59 ½</u>. One disadvantage of exercising the spousal IRA rollover option is that a spouse designated beneficiary who is under age 59 ½ may *not* take distributions from her IRA rollover before reaching that age without triggering the early distribution penalty (unless one of the exceptions in IRC Section 72(t) applies). The penalty for withdrawal by a person under age 59 ½ does *not* apply if the spouse remains in the position of being the beneficiary of the deceased participant's IRA.

(2) <u>Rollover Could Accelerate Distributions To Spouse In Some Cases</u>. Another disadvantage of the spousal IRA Rollover is that it *could* accelerate distributions during the surviving spouse's lifetime if the surviving spouse is substantially older (i.e., more than 10 years older) than the participant was. This is because, after the spousal IRA rollover, MRDs to the surviving spouse will be based on his/her life expectancy, recalculated, plus ten years under the Uniform Lifetime Table, while distributions to the surviving spouse from an inherited IRA (an IRA still in the deceased participant's name) may be taken based on the deceased spouse's remaining life expectancy, not recalculated (thus providing lower required distributions if the deceased spouse was significantly younger). One factor to consider is the calculation vs. recalculation effect of the two methods. Another factor to consider is the effect of this choice on the beneficiaries who will receive what remains on the death of the surviving spouse (no "stretch IRA" will be available to those beneficiaries if the second option is taken).

d. <u>Taking Distributions As Participant's Beneficiary</u>. As an alternative to the rollover option discussed above, the spouse may decide not to do a spousal IRA rollover and not to treat the decedent's IRA as her own but to take distributions as the deceased participant's designated beneficiary. This might be the best choice, for example, where the designated beneficiary spouse

is much older than the participant spouse was and the participant has died before reaching his RBD. Tax deferral can be achieved because distributions will not have to begin until the later of (a) December 31 of the calendar year immediately following the calendar year in which the participant died and (b) December 31 of the calendar year in which the *participant* would have attained age 70 ½. *Treas. Reg. § 1.401(a)(9)-3, A-3*. This might also be the best choice (for at least part of the retirement plan) in cases where the surviving spouse is substantially under age 59 ½ and where she anticipates needing to take distributions before reaching that age. The death of the participant provides an exception to the penalty for early distribution in this situation.

e. Disclaimer Option. Naming the spouse as the primary beneficiary and then naming as the contingent beneficiary either the Trustee of a particular trust, such as the Bypass Trust or a Disclaimer Trust drafted specifically to hold disclaimed assets, or the Trustee, in general, under the Participant's Will or Living Trust Agreement, is, perhaps, the best strategy in the vast majority of cases. This beneficiary designation provides maximum flexibility because it allows for optimal estate and income tax planning by preserving options and delaying decisions until more factors are known. This beneficiary designation sets up the disclaimer option for the surviving spouse, so that she can disclaim the amount of retirement benefits necessary or desirable to fully fund or at least minimally fund the Bypass Trust created by the participant in his Will or Living Trust Agreement. Further, by naming the spouse first, the spousal IRA rollover option is preserved. At the time of the participant's death, calculations can be done comparing the income tax benefits of exercising the spousal IRA rollover option to the estate tax benefits of disclaiming to fund the Bypass Trust. The actual value of the retirement benefits, as well as the value of the other assets in the deceased participant's estate and the value of the assets owned by the surviving spouse, will be known at that time, thus eliminating part of the speculation that may skew pre-death planning calculations. The age and health of the surviving spouse at the time of the participant's death can also be taken into account, along with the estate and income tax rates in effect at that time, leading to a more informed decision.

B. Single Participant With Children: Designate Adult Children As Outright Beneficiaries. If the participant's children are adults and capable of managing money, in many cases the participant should just designate his children as the outright beneficiaries of his retirement plan benefits. While estate planning attorneys frequently recommend the use of trusts for assets passing to clients' children at death to protect them from creditors' claims, the assets held within both qualified plans and IRAs enjoy creditor protection due to ERISA's anti-alienation provisions and Texas Property Code Section 42.0021, respectively (note that in many other states, however, IRAs do not enjoy creditor protection).

1. Multiple Beneficiary Rule. If a participant with more than one child did not create separate accounts or segregated shares in his beneficiary designation prior to his death, it appears that, under the new rules, separate accounts for each child can be created after his death, unless precluded due to the type of wording used in the beneficiary designation. *See* I.B.6., *supra*. As long as separate accounts are established by December 31 of the year following the year of the participant's death, then each child may use his/her own nonrecalculated life expectancy for determining MRDs from his/her inherited IRA. If for some reason separate accounts are not created in time, then the oldest child's life expectancy will be used in determining the MRDs to all of the children (even if the IRA is later divided into separate accounts for investment or other reasons).

a. Separate Accounts/Segregated Shares. It is wise to use separate accounts or segregated shares whenever there are multiple beneficiaries (unless their ages are virtually the same). However, because under the new rules (i) the actual designated beneficiary is not determined until September 30 of the year following the participant's year of death, (ii) the identity of the beneficiaries at RBD no longer affects the lifetime distributions to the participant (except in the case of the young spouse sole DB), and (iii) several post-death techniques are available to eliminate "bad" beneficiaries and to create separate accounts, it is not as crucial for the participant himself to create separate accounts (or separate

IRAs) before his death. However, the participant should be careful not to word his beneficiary designation in a manner that might *preclude* the creation of separate accounts after his death. *See* I.B.6., supra.

2. Caveat: Restrictive Qualified Plan Provisions. It should be noted that many qualified plans and some IRA agreements have more restrictive rules than otherwise allowed by federal law and require immediate distribution of the entire balance in the participant's retirement account to children and other non-spouse beneficiaries. This is an issue that should be researched by the participant during the planning phase. If the participant's qualified plan requires a full distribution to children on the participant's death and the participant has the option of rolling over his qualified plan benefits to an IRA that is not so restrictive, the participant should consider doing so.

C. Single Participant, No Children, Charitable Intent: Designate Charity As Direct Beneficiary. If the participant has a charitable intent, he should designate one or more charities as the beneficiary of his retirement plans. The most efficient and tax effective way to do this is to designate the charity directly in the beneficiary designation (and not to make a pecuniary gift in the Will or Living Trust Agreement to charity that might be satisfied with other assets or with retirement plan proceeds that are paid to the estate or trust first).

1. Charity Is Not A Designated Beneficiary But No Longer Adversely Affects Participant. A charity is not a designated beneficiary for purposes of the minimum distribution rules. However, this does not make a difference in the lifetime distributions to the participant under the new rules, so it is no longer disadvantageous for the participant to name a charity as the beneficiary of his retirement plan.

2. Charity As One Of Multiple Beneficiaries: Use Separate Accounts. If the participant also wants to designate individuals as beneficiaries of any of his retirement benefits, he should consider utilizing separate accounts (i.e., separate IRAs) or segregated shares so as not to penalize his individual beneficiaries after his death. However, if he fails to create separate accounts before death, it appears that, under the new rules, they can be created after death, or the charity can be "cashed out" before the DB determination date, so that the individual beneficiaries can use the oldest designated beneficiary's non-recalculated life expectancy for determining minimum required distributions (or each DB's life expectancy with respect to his/her separate account if separate accounts for the individual beneficiaries are able to be established in time).

3. Estate Tax Result: Charitable Deduction. The value of the participant's retirement plan benefits passing to charity upon his death should qualify for the estate tax charitable deduction, thus eliminating estate tax on that transfer.

4. Income Tax Result For Charity. A charity is exempt from income tax (except for unrelated business income). Although retirement benefits are IRD, the charity does not pay any income tax on receipt of the IRD. Thus, the charity receives 100% of the retirement plan benefits, whereas other beneficiaries would net less due to the income taxes payable. Thus, naming a charity as the beneficiary of IRD items is a tax efficient way for a participant with a charitable intent to accomplish his goals.

III. REASONS FOR DESIGNATING A TRUST AS THE BENEFICIARY OF RETIREMENT PLANS

A. Non-Tax Reasons.

1. Control ultimate disposition of retirement plan benefits.

2. Provide capable management of retirement plan benefits.

3. In some states, achieve creditor protection for retirement plan benefits themselves (especially IRAs) and, in Texas, for distributions from retirement plans.

4. Preserve separate property character of inherited retirement plan benefits.

5. Provide for multiple beneficiaries' interests in retirement plan benefits.

B. Tax Reasons.

1. Fund a Bypass Trust (to save ultimate estate taxes).

2. Fund a QDOT Trust (to avoid immediate estate taxes where spouse is not a U.S. citizen).

3. Generation-skipping tax planning (achieve potential long term estate tax savings and income tax deferral).

4. Make gift to charity and obtain estate tax charitable deduction, but provide benefits to others as well (i.e., use a split interest trust).

IV. OBTAINING DESIGNATED BENEFICIARY TREATMENT IF A TRUST IS NAMED AS BENEFICIARY OF RETIREMENT PLANS

A. History Of The Trust Regulatory Requirements. The regulations as originally proposed in 1987 contained four (4) specific requirements that a trust had to meet in order for the participant who named the trust as the beneficiary of his retirement plans (or for the beneficiaries of the trust after the participant's death) to obtain designated beneficiary treatment. If the trust met the four (4) regulatory requirements as of the relevant date, then the beneficiaries of the trust could qualify as designated beneficiaries under the rules. The original proposed regulations for trusts were amended in 1997 and again (somewhat) by the proposed regulations released in January 2001. The final regulations provide some additional changes; however, there are still many unanswered issues with respect to trusts as beneficiaries of retirement plans and prior rulings may still be instructive. For a history and discussion of the trust regulatory requirements beginning with the 1987 original proposed regulations through the proposed regulations released in January 2001, *see* Gerstner, *Naming a Trust as the Beneficiary of Qualified Plan Benefits and IRAs Under the New Minimum Distribution Rules*, October 31, 2001, http://www.drjg.com – Learn More.

B. Trust Itself Is Not A Designated Beneficiary. A trust can never be a designated beneficiary because only individuals can be designated beneficiaries. *Treas. Reg. § 1.401(a)(9)-4, A-3.* Unlike an estate or a charity, however (which are also not designated beneficiaries), if a trust that is named as the beneficiary of a participant's retirement plans meets all of the regulatory requirements, then the beneficiaries of the trust can qualify as designated beneficiaries. *See Treas. Reg. § 1.401(a)(9)-4, A-5(a).* If there is more than one individual beneficiary of the trust, the individual with the shortest life expectancy (i.e., the oldest) will be treated as the designated beneficiary for purposes of the minimum distribution rules. *Treas. Reg. § 1.401(a)(9)-5, A-7(a)(1).* If the trust has *any* beneficiary that has an interest in the participant's plan benefits (excluding a "successor beneficiary") that is not an individual or qualified trust (e.g., a charity), then the trust cannot obtain designated beneficiary treatment. *Treas. Reg. § 1.401(a)(9)-5, A-7(b). See also PLR 9820021 (February 21, 1998).*

C. Trust Regulatory Requirements Under The Final Regulations. If the regulatory requirements are met by a trust named as the beneficiary of the participant's plan, then the beneficiaries of the trust (and not the trust itself) will be treated as the beneficiaries of the participant. *Treas. Reg. § 1.401(a)(9)-4, A-5(a).* The requirements are

(1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.

(2) The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.

(3) The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable within the meaning of A-1 of this section from the trust instrument.

(4) The documentation described in A-6 of this section has been provided to the plan administrator.

1. Overview Of The Four Trust Requirements.

a. First Requirement. The first requirement is basically the same as it has been since the original 1987 proposed regulations. This requirement is easy to satisfy – it basically just requires that a valid, written trust be created (even if currently unfunded) to receive the plan benefits.

b. Second Requirement. The second requirement is basically worded the same as it has been since the 1997 amendments to the original proposed regulations; however, it has been clarified and modified so that it is now clear that the trust that is named as the participant's beneficiary need not be irrevocable at the time when it is named as beneficiary or even at the participant's RBD, as long as it will become irrevocable as of the participant's death. Further, there is no longer any issue regarding whether revocable management trusts (i.e., "Living Trusts") or testamentary trusts created in a participant's Will will meet this requirement.

c. Third Requirement. The third requirement is also worded basically the same as it has been from the beginning. However, identification of the beneficiaries of the trust who have an interest in the participant's plan benefits is the most difficult part of determining whether the trust qualifies for designated beneficiary treatment. This issue is discussed separately at IV.C.4, *infra.*

d. Fourth Requirement. The fourth requirement, that certain trust documentation be provided to the plan administrator, has been modified by the final regulations and will be discussed separately at IV.C.2, immediately following.

2. Trust Documentation No Longer Required At RBD. Since it no longer matters (except in the case of a young spouse sole DB) who a living participant has named as his beneficiary for purposes of determining MRDs to him beginning at his RBD, the relevant trust documentation no longer has to be provided to the plan administrator at RBD (unless the young spouse exception is sought for a trust created for the young spouse). The general rule is that if the participant has named a trust as the beneficiary of his retirement plan, the plan administrator must be provided with the relevant trust documentation by October 31 of the year following the year of the participant's death. *Treas. Reg. § 1.401(a)(9)-4, A-6(b).*

a. Exception: Trust For Young Spouse. If the participant has named a trust created for his young spouse as the beneficiary of his retirement plan, and if the trust qualifies as the type of trust that is essentially ignored as an entity, so that the participant's young spouse is deemed to be the *sole* beneficiary of his plan at RBD (therefore allowing the participant to use the Joint and Last Survivor Table to calculate his MRDs during his lifetime – instead of the Uniform Lifetime Table), then the required trust documentation must be provided to the plan administrator by the participant's RBD. *Treas. Reg. § 1.401(a)(9)-4, A-6.*

(1) Who Is The Plan Administrator? The plan administrator is the administrator of the qualified plan in which the participant participates or the custodian or trustee of the participant's IRA. *Treas. Reg. § 1.408-8, A-1(b).*

(2) What Type Of Documentation Must Be Provided? The participant must provide either (a) a copy of the trust instrument itself, and agree to provide copies of any amendments to the trust instrument as they are made, or (b) a list of *all* beneficiaries of the trust (including contingent and remainder beneficiaries, with a description of the conditions of their entitlement sufficient to establish that the spouse is the sole beneficiary), certify that the list is correct and complete, agree to provide copies of any amendments to the trust instrument as they are made, and agree to provide a copy of the trust instrument to the plan administrator upon demand. *Treas. Reg. § 1.401(a)(9)-4, A-6(a)(1) and (2).*

b. Post-Death Trust Documentation. After the participant's death, if a trust is named as the beneficiary of all or a portion of the participant's retirement plan benefits, the required trust documentation must be provided to the plan administrator by October 31 of the year following the year of the participant's death. *Treas. Reg. § 1.401(a)(9)-4, A-6(b).* The plan administrator must evaluate whether the trust meets all four of the regulatory requirements, so that it can be ascertained whether designated beneficiary treatment is available for post-death MRDs. Once all trust beneficiaries who have an interest in the deceased participant's plan benefits are identified, then the beneficiary with the shortest life expectancy (i.e., the oldest) can be determined and the appropriate initial divisor obtained from the Single Life Table to calculate MRDs to the trust. COMMENT: It is interesting to note that the final regulations do not specifically require that the birthdates of all trust beneficiaries be provided to the plan administrator, but, obviously, that is one of the most crucial pieces of information needed and most trust instruments would not reveal this information.

3. What Types Of Trusts Created For The Spouse Will Qualify For Sole DB Treatment? If the participant wants to use the Joint and Last Survivor Table for calculating his MRDs, his young spouse must be considered the *sole* beneficiary of his plan. *Treas Reg. § 1.401(a)(9)-5, A-4(b)(1).* While the participant can name as his beneficiary a trust that has been created for his young spouse instead of naming his young spouse directly, most traditional trusts used by estate planners will not qualify for "spouse as sole DB" treatment. The only two types of trusts that will

work for this purpose are the "conduit" trust and the "grantor" trust.

a. Conduit Trust. The conduit trust is a trust whose terms expressly require that all amounts distributed from the participant's plan to the trust must be paid out to the "current" beneficiary of the trust by the trustee upon receipt. Thus, plan distributions merely flow through the trust directly to the trust beneficiary. *See Treas. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2*.

b. Grantor Trust. For purposes of the minimum distribution rules, references to a "grantor trust" are to that type of trust over which the current beneficiary possesses an unlimited withdrawal right. Therefore, if this type of trust is named as the beneficiary of the participant's plan and if the plan itself does not preclude complete withdrawal by the beneficiary of the participant's entire interest in the plan, then the sole, current beneficiary of the trust, who possesses an unlimited withdrawal right over the trust assets, should be treated as the sole beneficiary of the participant's plan benefits. This trust is not specifically referred to in the final regulations, but has been recognized in several private letter rulings and is recognized by implication in the regulations. *See*, e.g., PLR 199903050 (January 22, 1999) and discussion therein of the "survivor's trust", over which the surviving spouse had a complete withdrawal right. Thus, if the participant has named a grantor trust for the benefit of his young spouse as his beneficiary as of his RBD and the appropriate trust documentation is provided to the plan administrator, he should be able to use the Joint and Last Survivor Table for calculating his MRDs during his lifetime.

4. Identification Of All Trust Beneficiaries Having An Interest In Participant's Plan. The third trust requirement appears relatively straightforward on its face, but it is extremely complicated. The final regulations clarify some trust situations, but fail to address many more.

a. Contingent Beneficiaries. All trust beneficiaries, except for those who can qualify as merely potential "successor beneficiaries" (discussed below), ***must*** be taken into account in determining whether a person other than an individual is designated as a beneficiary (thereby disqualifying the trust for DB treatment) and in determining which DB has the shortest life expectancy. *Treas. Reg. § 1.401(a)(9)-5, A-7(b)*. A person who has any right (including a contingent right) to any part of the participant's plan benefits, beyond being a mere potential successor to the interest of another beneficiary upon that person's death, ***must*** be considered a beneficiary. *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(1)*.

(1) Explanation. The final regulations state: "[I]f the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries." *Treas. Reg § 1.401(a)(9)-5, A-7(c)(1) [last sentence]* (emphasis added).

(2) The Death Contingency Rule Under The Former Proposed Regulations. Recall the controversy and ambiguity relating to the so-called "death contingency" rule in the prior, proposed regulations. Under the former rules, contingent beneficiaries had to be taken into account in determining the designated beneficiary; however, if the death contingency "exception" applied, then beneficiaries receiving benefits due to the death of a prior beneficiary could be ignored. The only way this author could reconcile the death contingency rule with the "normal" contingent beneficiary rule under the proposed regulations was to read the word "solely" into the rule. The 2001 proposed regulations actually added the word "only" to clarify that if a contingent beneficiary's entitlement to any of the participant's plan benefits was due only (solely) to the death of the prior beneficiary (without more), then he/she could be ignored. If any other factor was involved (such as the trustee's determination to accumulate distributed plan benefits in the trust), then that contingent beneficiary could not be ignored. *See* Gerstner, *Naming a Trust as the Beneficiary of Qualified Plan Benefits and IRAs Under the New Minimum Distribution Rules*, October 31, 2001, http://www.drjg.com – Learn More.

b. Successor Beneficiary. A person will ***not*** be considered a beneficiary for purposes of determining whether only individuals have been named and, if so, which individual has the shortest life expectancy, if "the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death." *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(1).* If the individual beneficiary who is treated as the participant's DB dies after the DB determination date, distributions to the subsequent beneficiary will continue to be calculated based on the original DB's remaining (non-recalculated) life expectancy. *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(2).*

c. Specific Examples In The Regulations.

(1) Non-conduit QTIP Trust. Participant (referred to as "A") names a traditional QTIP Trust (referred to as "Trust P") as the beneficiary of his plan. Of course, A's spouse (referred to as "B") is the sole, current beneficiary of the QTIP Trust (remember, that *does not* make her the sole beneficiary of the participant's plan). A's children (who are all younger than A's spouse, B) are the remainder beneficiaries (apparently outright) of the QTIP Trust.

(a) Terms Of QTIP Trust. Pursuant to the terms of the trust, all income of the QTIP Trust is payable at least annually to A's spouse, B, and no one has the power to appoint the principal of the trust to anyone other than B during her lifetime. B has the power to compel the Trustee to withdraw from the plan the greater of (i) the MRD (calculated pursuant to the life expectancy rule for situations where the spouse is *not* the sole DB, but assuming the trust qualifies for DB treatment and the spouse is treated as the DB because she is the oldest of all of the DBs), or (ii) the amount of income earned on A's interest in the plan (or in A's account) that year. Only the "income portion" of the amount withdrawn from the plan by the Trustee of the QTIP Trust must be paid out to B pursuant to the specific terms of the QTIP Trust and applicable federal estate tax marital deduction rules. The "principal portion" of the distribution from the plan may be retained in the QTIP Trust and accumulated for possible later distribution to B (if authorized by the instrument and warranted under the circumstances) or for final distribution to the remainder beneficiaries upon termination of the trust.

(b) DB Analysis. The regulations provide: "Because some amounts distributed from A's account in Plan X to Trust P may be accumulated in Trust P during B's lifetime for the benefit of A's children, as remaindermen beneficiaries of Trust P, even though access to those amounts are (sic) delayed until after B's death, A's children are beneficiaries of A's account in Plan X in addition to B and B is not the sole designated beneficiary of A's account. Thus the designated beneficiary used to determine the distribution period from A's account in Plan X is the beneficiary with the shortest life expectancy. B's life expectancy is the shortest of all the potential beneficiaries of the testamentary trust's interest in A's account in Plan X (including remainder beneficiaries). Thus, the distribution period for purposes of section 401(a)(9)(B)(iii) is B's life expectancy." *Treas. Reg § 1.401(a)(9)-5, A-7(c)(3), Example 1(iii).* The example also notes that because A's spouse cannot be treated as A's *sole* DB, the options available to a spouse named as sole DB (such as the delay in commencement of MRDs until A would have reached age 70 ½, where A dies before RBD) are not available.

(2) Conduit Trust. The second example in the final regulations explaining the difference between contingent trust beneficiaries (who must be taken into account) and mere potential successor beneficiaries (who can be ignored) involves a conduit trust. Since all amounts distributed from the participant's plan to the trust *must* be distributed out of the trust by the Trustee to the beneficiary (i.e., this is mandated by the instrument and the Trustee has no discretion), then the remainder beneficiaries of the trust are mere potential successor beneficiaries who can be ignored, and the current trust beneficiary, who must receive each distribution from the plan as it is made (even though it goes through the trust) is deemed to be the *sole* DB under the rules. *See Treas. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2.*

D. Unanswered Questions Regarding Trusts Named As Beneficiaries. The final regulations do not specifically address potential beneficiaries who can receive trust benefits due to the exercise of a power of appointment by another trust beneficiary. In addition, the regulations do not contain any examples where the remainder beneficiaries' shares pass into further trust

(whether an age-contingent trust or some sort of lifetime trust).

1. Beneficiaries Of Powers Of Appointment. It would seem that beneficiaries who could receive a portion of the trust assets due to the exercise of a power of appointment would be contingent beneficiaries (who *must* be taken into account) and not successor beneficiaries (who can be ignored under the new rules).

a. General Powers And Broad Special Powers. Therefore, if any beneficiary of a trust that is named as the beneficiary of a participant's plan possesses a *general* power of appointment over the trust, that trust would **not** qualify for designated beneficiary treatment (because it is impossible to identify all of the possible beneficiaries of a general power of appointment, therefore failing the third regulatory requirement). [NOTE: For purposes of the MRD rules, possessing a general power of appointment over a trust is far different from possessing an unlimited withdrawal power over a trust]. With respect to non-general powers of appointment, a trust over which a beneficiary is given the broadest possible special power of appointment (i.e., one that merely excludes the power holder, the power holder's estate, creditors of the power holder and creditors of the power holder's estate) will also not pass the test.

b. Limited Powers. Certain other limited powers of appointment might be all right. If it is desired that the particular trust named as beneficiary of the participant's plan qualify for DB treatment, then the beneficiaries of the non general power of appointment must be defined in such a way so that it is clear that (i) all potential beneficiaries are individuals (human beings) or qualifying trusts for individuals, and (ii) none of those beneficiaries are older than the beneficiary of the trust who is the intended DB. Obviously, then, if a power of appointment contained in a trust that is named as the beneficiary of a retirement plan includes "charities" as permissible beneficiaries, that trust cannot qualify for DB treatment (because charities are entities, not human beings). If it is desired to allow the exercise of a power of appointment among members of a class, the class should be defined in a way to preserve designated beneficiary treatment. For example, if a special or limited power of appointment can be exercised in favor of "spouses of descendants", then wording to the effect that any spouse of a descendant who is older than the trust beneficiary who is the intended DB will be excluded from the class.

2. Remainder Beneficiaries. Example 1 in the final regulations is instructive with respect to all trusts that can accumulate any part of a distribution made from a retirement plan during the life of the intended DB of the trust. Per Example 1, the immediate remainder beneficiaries (at least) must be taken into account in determining the DB issue. If the assets remaining in the trust (including already distributed, accumulated plan benefits) pass outright to the remainder beneficiaries upon termination of the trust, it appears that any potential successor beneficiaries (such as the surviving descendants of a remainder beneficiary who predeceases termination of the trust) can be ignored. Example 1 in the final regulations does not discuss what level of remainder beneficiary must be considered if the assets in the original trust pass into further trust for the remainder beneficiaries.

a. Is The Life Expectancy Theory Still Viable? In a private letter ruling issued under the January 2001 proposed regulations, the Internal Revenue Service ruled that secondary, contingent remainder beneficiaries of an age 30 contingent trust had to be taken into account in determining the designated beneficiary issue. *See PLR 200228025 (July 12, 2002).*

(1) Facts. A participant named a contingent trust for his two minor grandsons as the beneficiary of his retirement plan. The trust provided that each grandson had the right to withdraw his entire share upon reaching age 30. If either grandson were to die prior to attaining age 30, the other grandson would then become the sole beneficiary and receive all distributions from the trust. In the event both grandsons failed to reach age 30, then certain other beneficiaries (the oldest of whom was age 67 at the time of the participant's death) would receive the remaining trust assets.

(2) Ruling. In ruling that the 67 year old (secondary) contingent remainder beneficiary had to be taken into account and, therefore, had to be considered the DB (requiring the 67 year old's life expectancy to be used to calculate MRDs to the

grandsons' trust), the Service stated: "In this case, the discretion the trustee of Trust X has with respect to the payment of trust amounts to the Grandchildren, who are the primary beneficiaries, is a contingency over and above the death of a prior beneficiary. The Trust X language does not require that the payments from the IRA Accounts be paid to the Grandchildren on an annual basis and therefore Trust X language does not preclude there being an accumulation of distributions from the IRA Accounts [in the trust]." Some commentators have stated that this ruling appears to conflict with several prior rulings (e.g., PLRs 9846034 and 199903050, *supra*) and seems to negate a life expectancy theory. However, in this author's opinion, it does seem consistent with the "flavor" of certain prior rulings [cited in this author's previous outlines] and this author has never embraced the life expectancy theory.

(3) Analysis. In comparing this ruling to Example 1 in the final regulations, the main difference in the facts appears to be that the initial remainder beneficiaries in Example 1 take outright, whereas the initial remainder beneficiary of a grandson trust beneficiary who dies prematurely is the other grandson, who is also a trust beneficiary. Does this difference in facts justify the different result? Obviously, it is just as possible for all of the children who are the outright remainder beneficiaries of the non conduit QTIP Trust in Example 1 to predecease the surviving spouse, and for some other beneficiaries named in Trust P to receive the trust benefits (including accumulated distributions from A's retirement plan) upon termination of the trust, as it is for both of the minor grandchildren in the private letter ruling to die before reaching age 30. Example 1 does not describe what the instrument provides in the event all of A's children predecease B (i.e., who these secondary remainder beneficiaries would be). If Example 1 assumes that the children will live to their respective life expectancies (and will outlive B), then perhaps it overrules PLR 200228025.

V. SPECIAL CONCERNS IN NAMING A QTIP TRUST AS BENEFICIARY

A. Complete Distribution To QTIP Trust. Most retirement plans allow the beneficiaries of a deceased participant to take a complete distribution of the participant's entire interest in the plan at one time. Many qualified plans *require* all non-spouse beneficiaries (including trusts of any type) to take such a full distribution shortly after the participant's death.

1. Estate Tax Marital Deduction. A direct payment of the participant's full interest in the plan to a QTIP trust will qualify for the federal estate tax marital deduction. *See, e.g., PLR 9729015 (July 18, 1997) and PLR 8351097 (September 22, 1983).* Of course, a full distribution directly to the participant's spouse will also qualify for the estate tax marital deduction. Thus, naming a QTIP Trust as the beneficiary of a retirement plan is done for non-tax reasons.

2. Income Tax Issues. If a QTIP Trust received a complete distribution of the participant's interest in the retirement plan on or before December 31, 1999, 5-year averaging would have been available to reduce the income tax impact of receiving such a large among in one taxable year. After that date, 5-year averaging is no longer available (due to its repeal). (In the case of certain participants in qualified plans born before 1936, special 10 year averaging and capital gains treatment may be available pursuant to the transitional rule). *See* I.C.1., *supra*.

3. IRD. The lump sum payment from the retirement plan to the QTIP Trust is IRD to the Trust and subject to ordinary income tax in the year received (non-taxable amounts, such as nondeductible participant contributions, are not subject to income tax).

a. No IRD Deduction. Because the lump sum amount is paid directly to a QTIP trust, assuming all QTIP qualification requirements are met and the QTIP election is made, no estate tax will be payable on it due to the marital deduction. Therefore, there will not be an IRD deduction under Section 691(c) (for estate taxes paid) for income tax purposes.

4. Allocation Between Principal And Income. Although the lump sum payment is taxable as ordinary income for income tax purposes, it should be possible to allocate the entire distribution to principal for fiduciary accounting purposes. There were some issues and potential problems with the allocation of receipts from retirement plans under prior Texas law. For a discussion of principal and income allocation

issues involving retirement plan benefits paid to a trust under pre-2004 Texas law, *see* Gerstner, *You Have Named a Trust as the Beneficiary of Qualified Plans/IRAs - Now What? (Fiduciary Accounting, Tax and Other Administrative Issues to Consider When Plan/IRA Benefits Pass to a Trust)*, State Bar of Texas 25th Annual Advanced Estate Planning and Probate Course, June 2001 (hereinafter cited as "*You have Named a Trust - Now What?*").

a. New Texas Uniform Principal And Income Act Allocation Rules. Texas law has recently been changed to provide a new rule for allocating receipts from retirement plans. *See Texas Trust Code § 116.172,* part of the newly adopted Uniform Principal and Income Act ("UPIA"). Of course, a different allocation rule can be provided for in a Will or Trust instrument. For those instruments subject to UPIA, receipts from retirement plans passing to trusts are allocated as follows:

(1) Income Characterization By Payer. To the extent that the payer characterizes a payment as interest or a dividend, the trustee must allocate the receipt to income. TTC § 116.172(b).

(2) The 4% Rule. If no part of a payment "required to be made" is characterized as interest or a dividend, then the trustee must allocate to income "the part of the payment that does not exceed an amount equal to: (1) four percent of the fair market value of the future payment asset as determined under Subsection (d); less (2) the total amount that the trustee has allocated to income for a previous payment received... during the accounting period." TTC § 116.172(c). Amounts received are allocated to income until they aggregate during the accounting period 4% of the value of the asset. The remaining amounts received are allocated to principal.

(3) Determination Date. The determination of the 4% valuation is made on the later of "(1)the date on which the future payment right first becomes subject to the trust; or (2) the first day of the trust's accounting period during which the future payment asset is received." TTC § 116.172(d).

(4) Receipt of Entire Amount = Principal. If no part of a payment is required to be made, or the payment received is the entire amount to which the trustee is entitled, the trustee must allocate the entire payment to principal. TTC § 116.172(e).

(5) Discretionary Withdrawal Rule. A payment is not "required to be made" to the extent that it is made only because the trustee exercises a right of withdrawal. TTC § 116.172(g).

(6) No Real Allocation Rule For Marital Trusts. If the marital deduction is at stake with respect to a trust to which payments are made, the trustee must allocate sufficient amounts to income to protect the marital deduction. TTC § 116.172(h).

b. Comparison to "National" UPIA. The new UPIA retirement plan distribution allocation rule is not based on the "national" version of UPIA, but is unique to Texas. It follows a "unitrust" approach, which is fairer than the "national" UPIA approach (wherein 90% *of each distribution* is principal and 10% is income). The new Texas UPIA allocation rule is also an improvement over prior Texas law. *See* Gerstner, *You Have Named a Trust - Now What?*, cited at V.A.4. Some of the wording in the Texas statute needs to be clarified, however.

5. Observation Regarding Reduction In Value Of Retirement Plan Due To IRD. It is interesting to note that the gross value of the full distribution to the QTIP Trust qualifies for the federal estate tax marital deduction; yet, because it is IRD, the net amount remaining in the QTIP Trust after payment of income taxes is substantially lower. While no one has put forth an argument (to this author's knowledge) that the *marital deduction* ought to be reduced to the net after tax amount of the distribution from a retirement plan, in some respects the issue is analogous to the concerns raised by the Hubert case (and now addressed in the regulations to Section 2056). NOTE: An argument to this effect (that the estate tax value of the retirement plan should be reduced due to the income tax liability) involving valuation of retirement plan benefits passing to beneficiaries in a taxable estate situation failed. *See Estate of Smith v. U.S., 93 AFTR 2d 2004-556 (300 F. Supp.2d 474, D.C. Tex. 2004) and TAM 200247001 (November 22, 2002).*

B. Periodic Payments To QTIP Trust. Most participants would prefer not to have a full distribution of their entire plan benefits made all at once to the QTIP Trust, but to have the QTIP

Trust receive periodic payments pursuant to the minimum distribution rules. During the planning phase, the participant should ascertain whether his qualified plan or IRA permits this (many qualified plans do not, requiring that a distribution of the full amount be made to a trust named as beneficiary). Further, participants not only desire to obtain a federal estate tax marital deduction for the retirement plan benefits passing to the QTIP Trust, they also desire to obtain "designated beneficiary" treatment because it provides a better income tax result. The following considerations relate to these desires.

1. Estate Tax Marital Deduction Issues. A primary area that deserves significant drafting attention involves the requirements for obtaining the federal estate tax marital deduction when qualified plan or IRA benefits are passing to a marital trust.

a. Satisfying The "Qualifying Income Interest For Life" Requirement. In order to obtain the federal estate tax marital deduction for "terminable interests" passing to the decedent's spouse, the spouse must have a qualifying income interest for life. *IRC* § *2056(b)(7)(B)(i)(II)*. The spouse will have a qualifying income interest for life if (a) she is entitled to all of the income from the property, payable at least annually, and (b) no person has a power to appoint any part of the property to anyone other than the spouse. *IRC § 2056(b)(7)(B)(ii)*.

(1) Form Of Benefit. Lump sum distributions to the participant's spouse will qualify for the marital deduction. If the spouse has the option to take a lump sum distribution, the marital deduction is available even if she elects a different option. If the plan mandates the form of benefit or the participant elects a form of benefit that does not automatically qualify for the marital deduction, such as an annuity or other periodic payment that would be considered a terminable interest and that does not come within Section 2056(b)(7)(C) of the Code, then QTIP treatment may be necessary to obtain the marital deduction.

(2) Periodic Distributions From Retirement Plans. Periodic distributions from retirement plans are "terminable interests". In order for those distributions to qualify for the marital deduction, all of the QTIP requirements must be satisfied. As a result of amendments made by TAMRA, certain survivor annuities are deemed to satisfy the qualifying income interest for life requirement under the QTIP rules and a QTIP election is automatic for such annuities. *IRC § 2056(b)(7)(C)*. In such cases, the Executor must elect out of the automatic QTIP treatment, otherwise the annuities are deemed to be QTIPped.

b. Two Alternatives For Meeting The Qualifying Income Interest Requirement.

(1) The Conduit Approach. If the plan distributions themselves qualify as QTIP under the special survivor annuity rule (and the Executor does not elect *out* of QTIP treatment), and the plan distributions flow through the QTIP Trust to the spouse, so that the trust is a mere "conduit," then the qualifying income interest requirement will be met. Another variation of the conduit approach where a survivor annuity is not involved is to have 100% of the periodic distribution from the plan (i.e., both the required "all income" distribution amount and the additional "principal" amount, if any, that must be distributed from the plan pursuant to the minimum distribution rules) flow out of the plan to the trust and out of the trust to the spouse (i.e., the full distribution amount flows from the plan, through the trust, to the spouse.) If this method is desired, the trust should be affirmatively drafted as a "Conduit Trust" -- at least with respect to qualified plan and IRA benefits passing to it. Under the conduit approach, there would be no accumulations of plan benefit distributions in the trust. Therefore, the plan benefits are, in essence, passing directly to the spouse with the trust being a mere "flow through" entity. Thus, all of the remainder beneficiaries and potential beneficiaries under a testamentary special power of appointment can be ignored in making the DB determination.

(a) Comment On Conduit Approach. While not a type of trust structure used very often in the past, some clients may find the conduit approach acceptable. While it is true that, over time, the amount remaining in the plan will be virtually depleted due to minimum required distributions being forced out, and since distributions from the plan to the QTIP Trust flow right out of the trust to the spouse (so that no distributed amounts will remain in the trust either), perhaps the QTIP Trust is desired more for

management reasons or perhaps the client does not mind using the plan benefits to support his spouse during her lifetime and merely wants to protect other assets (e.g., those assets held in the Bypass Trust) or to preserve what is left in the plan itself (if anything) at the spouse's death for the participant's ultimate beneficiaries.

(2) Flow Through Of "Income" Portion Of MRD (Only). If the conduit approach is not used, then the surviving spouse must at least have the right to compel the trustee of the QTIP Trust to withdraw from the plan each year the greater of (a) the minimum distribution amount under Section 401(a), or (b) all income produced by the trust's interest in the plan that year. *See Rev. Rul. 2000-2, I.R.B. 2000-3, January 18, 2000, rendering obsolete Rev. Rul. 89-89, 1989-2, C.B. 231 and also Treas. Reg. § 1.409(a)(9)-5, A-7(c)(3), Example 1.* The trust instrument should provide that the Trustee has the power to demand, and the spouse has the power to compel the Trustee to demand, distribution of such additional amount above the minimum required distribution, if any, so that all income earned by the trust's interest in the plan will be distributed to the trust each year. In the latter case, all of the income produced by the trust's interest in the plan for the current year that is actually withdrawn from or distributed by the plan (plus all income earned by the QTIP Trust itself on all of its other assets) will then be distributed out of the trust to the spouse.

c. Conflict Between Minimum Distribution Rules And "All Income" Requirement Under The Estate Tax Marital Deduction Rules.

(1) Problem: Delay In Commencement Of Distributions. If the participant dies before his RBD, depending on whether there is a "designated beneficiary" and, if so, who it is, distributions may not have to commence (or be made) until (a) December 31 of the year that contains the fifth anniversary of the participant's death (5 year rule), (b) December 31 of the year following the year in which the participant died (rule where spouse is not sole DB -- the rule that applies to most trusts), or (c) the year in which the participant would have reached age 70 ½ (exception for sole designated beneficiary spouse, available with the conduit trust approach). This delay in commencement of distributions under the minimum distribution rules is not compatible with the estate tax marital deduction "all income" requirement for a QTIP Trust.

(a) One (Rejected) Theory: Plan Or IRA Is An Asset Of QTIP Trust. Theoretically, it could be argued (and was argued by certain taxpayers early on) that the qualified plan or IRA is merely an asset of the QTIP Trust that happens to be unproductive of income during this time period, and since the surviving spouse is given the right in the instrument to compel the Trustee to make unproductive QTIP assets productive of income, no problem should arise. This is not the IRS's view, however. In PLR 9220007 (May 15, 1992), the IRS stated, "Initially, we question whether the IRA is properly characterized as an asset. The nature of the IRA account (a significant amount of liquid assets held by a fiduciary) is such that the account is itself a trust that may qualify for QTIP treatment based on its own terms, as in Rev. Rul. 89-89. The QTIP rules should not be avoidable by classifying what is inherently a separate trust corpus as an 'asset' of a QTIP Trust, thus vitiating the requirement that the spouse receive all the income from the separate trust property."

(2) Problem: Minimum Distribution Is Less Than Income Produced. In other cases, even when a minimum distribution is currently required under the rules, the amount required to be distributed to the QTIP Trust as the beneficiary can be less than the income actually produced by the trust's interest in the plan assets.

d. Solution: Two Choices Now For Meeting "All Income" Requirement. Formerly, the QTIP Trust had to be drafted to provide that all income earned by the trust's interest in the plan *had* to be demanded or withdrawn by the Trustee of the QTIP Trust each year (including during the time period predating the commencement of required distributions) in order to obtain QTIP treatment. See *Rev. Rul. 89-89, 1989-2, C.B. 231.* Rev. Rul. 2000-2 provides an important new method to use in this situation. Rev. Rul. 2000-2 allows distributions to be delayed until otherwise required under the minimum distribution rules, even if a QTIP Trust is the named beneficiary, and allows the trust to qualify for the marital deduction as long as the spouse has the ***right*** to compel the Trustee to withdraw the income earned on the trust's interest in the plan each year.

(1) Preferred Method: Rev. Rul. 2000-2. As a result of Rev. Rul. 2000-2, most practitioners will now probably draft the QTIP Trust to provide the spouse with the power to compel the trustee to withdraw the income earned by the trust's interest in the retirement plan or IRA, rather than mandating that the Trustee actually withdraw such income from the plan or IRA each year. If the spouse does not need the income, it can remain in the plan, accumulating tax deferred, until minimum distributions are required to commence under the applicable rules. Thus, Rev. Rul. 2000-2 provides a way to meet the "all income" requirement and still observe (and, for the most part, obtain the benefit of) the minimum distribution rules. There are some other potential problems caused by the Rev. Rul. 2000-2 approach, however. *See* Gerstner, *You Have Named a Trust - Now What?*, cited earlier at V.A.4.

e. Principal And Income Allocation Issues. Pursuant to the instrument or state law (or the Trustee's proposed allocation, see PLR 9232036 (May 13, 1992), or the participant's allocation in the beneficiary designation, *see* PLR 9830004 (July 24, 1998)), either (i) the entire distribution from the plan is treated as trust accounting income (follows the conduit theory) or (ii) the portion of the distribution from the plan representing income earned in the plan that year on the trust's interest in the plan is allocated to income for trust accounting purposes (and, therefore, is distributable to the spouse from the QTIP Trust once received, at least annually), and the balance of the distribution, if any, is allocated to principal. WARNING: The latter approach can result in accumulation of plan benefit distributions in the trust, therefore making remainder beneficiaries of the trust "countable" beneficiaries in determining whether the trust qualifies for designated beneficiary treatment. Because the remainder beneficiaries of the QTIP Trust are also "counted" as beneficiaries in this situation, the spouse cannot use the special spousal commencement date for required distributions and designated beneficiary treatment will be precluded if a charity or other entity is a remainder beneficiary. See IV.C.4., *supra*.

(1) Why Is Principal And Income Allocation Of Plan Benefit Receipts Necessary? In cases in which the participant has named a trust as his beneficiary and is deemed to have a designated beneficiary (because the trust regulatory requirements have all been met), payment of the required distribution amount to the trust after the participant's death satisfies the minimum distribution rules. Thus, the trust is not required to redistribute the payment it has received from the plan to the trust beneficiary merely to satisfy the minimum distribution rules. As noted above, however, distribution of trust accounting income to the spouse from a QTIP Trust is required for estate tax marital deduction qualification purposes.

(2) State And Uniform Principal And Income Allocation Rules Applicable To Retirement Plans. Following the allocation rules provided in some states' principal and income allocation statutes may or may not produce an acceptable result. Under some state statutes and under various uniform acts, only a small percentage (e.g., 5% or 10%) of the periodic distribution received by the trust from the retirement plan is treated as "income" for fiduciary accounting purposes. *See* Gerstner, *You Have Named a Trust - Now What?*, cited earlier at V.A.4. The new Texas Uniform Principal and Income Act (effective on and after January 1, 2004) basically "punts" on this issue. *See Texas Trust Code § 116.172(h).* Therefore, specific drafting of principal and income allocation rules in the relevant instrument is recommended. A provision requiring that just that portion of the distribution equal to the income earned by the trust's interest in the plan for that year must be allocated to income has been deemed acceptable under the IRS rulings to date. This allocation would allow retention of the "principal" portion of the plan distribution in the QTIP Trust, if desired. It may not be desirable to do this, however, since the "principal" portion of the distribution is still taxable as ordinary income for income tax purposes. Thus, retention of such taxable amounts in the trust will cause income taxation at the high income tax rates applicable to trusts. Of course, this accumulation of the principal portion of the plan benefits distributed to the trust also causes problems under the multiple beneficiary rules, as previously discussed. Most QTIP Trusts allow distributions of principal to the spouse also, so that

all of the distribution from the plan *can* be passed through the trust to the spouse (and taxable to her), if desired. Merely because the Trustee exercises his discretion to do so, however, does not make the QTIP Trust a conduit trust for purposes of the minimum distribution rules.

f. Post-death Administrative Requirement: Two QTIP Elections. The executor or trustee must make two (2) QTIP elections in this situation, one for the QTIP Trust itself and one for the qualified plan or IRA. *Rev. Rul. 2000-2, I.R.B. 2000-3, January 18, 2000.* In the case of a qualified survivor annuity, the Executor or Trustee must make the QTIP election for the QTIP Trust and must not elect out of the automatic QTIP treatment for such annuity.

g. Plan Distribution Options Must Be Satisfactory. The qualified plan or IRA must allow distribution options that will qualify for QTIP treatment. See *PLR 9220007 (January 30, 1991)*. (As explained by the IRS in the cited ruling, this problem cannot be cured by post-death redrafting of options by the Trustee.)

2. Designated Beneficiary Issues.

a. The Trust Regulatory Requirements. The QTIP Trust must meet the four (4) trust requirements under the proposed regulations as of the applicable date in order to "look through" the trust to determine the designated beneficiary. See IV.C., *supra*.

(1) The Multiple Beneficiary Rule: Trusts That Accumulate Distributions. If any remainder beneficiary of the QTIP Trust is not an individual (e.g., a charity), there should be no accumulations in the trust of any amount of plan benefits distributed to the trust from the plan during the spouse's life (regardless of whether such distributions are treated as income or principal and regardless of the fact that QTIP treatment can be obtained merely by distributing all income).

(a) Designated Beneficiary Treatment Unavailable for Accumulation Trusts If Charity Is Remainder Beneficiary. In PLR 9820021 (May 15, 1998), involving accumulations of plan benefits in a QTIP Trust, the surviving spouse could not be treated as the designated beneficiary because the remainder beneficiaries, whose interests were deemed not to be *solely* contingent on her death, were charities. Thus, the trust could not obtain designated beneficiary treatment.

(b) Special Spousal Commencement Date Option Unavailable. In PLR 199908060 (March 1, 1999), because of the accumulation of plan benefit distributions in the trust, the remainder beneficiaries were also counted as beneficiaries under the multiple beneficiary rules, and since the spouse was not the sole beneficiary of the plan benefits under these rules, the special distribution commencement date option allowed where the spouse is the sole DB was not available. The same decision was reached by the IRS in PLR 9847022 (November 20, 1998), although the death contingency issue was not explicitly addressed in that ruling. This "spouse as sole beneficiary" requirement for utilizing the special option of beginning minimum required distributions when the participant would have reached age 70 ½ was reconfirmed in Rev. Rul. 2000-2 and has now been codified in the final regulations. *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 1 (iii) [last sentence].*

(c) Drafting For Trust Accumulation Of Plan Distributions: Obtaining DB Treatment. If a complete flow through of the entire distribution made from the plan to the QTIP Trust each year (i.e., the "conduit" approach) is not desired (so that the "principal" portion of the distribution is retained in the QTIP Trust), the accumulated distributions could be specially earmarked for distribution only to the surviving spouse, preferably during her lifetime, if the trust has any potentially problematic beneficiaries. Accumulated distributions could also be required to be distributed outright only to "qualified" remainder beneficiaries (e.g., children) on the spouse's death. Another idea would be to specify in the trust instrument that all accumulated plan benefit distributions must be kept in a separate account from other trust assets and must be utilized first to make discretionary principal distributions to the spouse. A further idea would be to give the spouse a withdrawal power (but not a general power of appointment, which precludes designated beneficiary treatment) over accumulated plan distributions held in the QTIP Trust. A "savings clause" to the effect that accumulated plan distributions can never be distributed to "bad" beneficiaries could also be included.

(2) Example. For example, in cases in which a participant dies before reaching his RBD having named the QTIP Trust as his beneficiary, with proper planning (e.g., the participant's children, who are all younger than the participant's spouse, are outright remainder beneficiaries of the trust and the plan or IRA allows all of the distribution options under the minimum distribution rules), the QTIP Trust Trustee should be able to take distributions over the surviving spouse's life expectancy (as the DB), even if plan distributions are accumulated. Whether the surviving spouse's life expectancy is recalculated each year depends upon whether the conduit approach (yes) or regular trust approach (no) is used. See Examples 1 and 2 in the final regulations, discussed earlier in this outline at IV.C.4.c.

(3) Form Of Marital Trust Used Affects DB Qualification. A life estate with general power of appointment ("LEPA") marital trust under IRC § 2056(b)(5), which is named as the beneficiary of qualified plan or IRA benefits will not qualify for designated beneficiary treatment because of the spouse's possession of a general power of appointment. See IV.D.1., *supra*.

3. IRD Issues. Because retirement plan benefits are IRD, they should not be used in a discretionary manner to satisfy a pecuniary bequest, including a pecuniary marital deduction formula bequest. This could happen where the plan benefits are made payable to the Trustee under the participant's Will or Living Trust Agreement, and then are distributed by the Trustee, in the exercise of its complete discretion, to satisfy a pecuniary marital bequest to the QTIP Trust. This will accelerate the IRD. *IRC § 691(a)(2).*

a. Specific Bequest Approach. If the relevant instrument makes a specific bequest of the retirement plan benefits to the QTIP Trust, IRD is not accelerated. For example, the beneficiary designation could direct that the participant's interest in the retirement plan is to pass directly to the QTIP Trust. As an alternative, if the participant's interest in the plan passes to the Trustee under his Will and the Trustee is specifically directed by a provision in the Will to allocate all of that IRD to the QTIP Trust, no acceleration of IRD should occur.

b. Fractional Share Approach. Another way to avoid triggering current income taxes on the entire present value of the retirement plan benefits when it is desired that such IRD pass into trust, especially to more than one trust, is to use a fractional share formula. Admittedly, this is not the simplest method for dealing with this problem.

c. Residuary Trust. If the IRD items pass to a residuary trust under the Will, then IRD should not be accelerated.

4. Tax Payment Issues.

a. Estate Taxes. If estate taxes are due on the participant's death, it would be better if assets other than the decedent's interest in retirement plans were used to pay them (because withdrawal from the plan to pay estate taxes will trigger income taxes). Further, if plan benefits are being paid to a QTIP Trust and no QTIP election is made or only a partial QTIP election is made, resulting in estate tax becoming due, a standard tax apportionment clause is not advisable (again, it would be better if other assets were used to pay the estate taxes in this situation). Another reason to be cautious in this regard is due to the IRS's theory that if the instrument requires or even authorizes the use of plan benefits to pay estate taxes, the participant's "Estate" is deemed to be one of the beneficiaries (and an estate is not a designated beneficiary).

b. Income Taxes And Expenses. Some of the favorable rulings allowing DB treatment to a QTIP Trust named as a plan beneficiary recited the fact that no trust expenses or income taxes payable on the plan distribution received by the QTIP Trust were charged to the income of the trust. While it is not clear whether this fact was important, some consideration should be given to having the income portion of the plan distribution flow through the QTIP Trust to the spouse without diminution by such charges.

5. Instructive Rulings. A review of various private letter rulings in which the marital deduction was allowed for retirement plans (usually IRAs) passing to a QTIP Trust should be helpful in determining what provisions, among others, ought to be included in the relevant instrument. The most important recent ruling in this area is more than just instructive on some of these issues. *See Rev. Rul. 2000-2, supra.* Many important document provisions have already been

discussed in this section of the outline. It is important to note, however, that in many of the rulings, the designated beneficiary issue was not addressed. The following are some favorable rulings issued before release of the final regulations on April 17, 2002, that the practitioner may want to study, in addition to Rev. Rul. 2000-2: PLR 8351097; PLR 8843033 (actually involving a LEPA and not a QTIP Trust); Rev. Rul 89-89, *supra*; PLR 9204017; PLR 9229017; PLR 9232036; PLR 9245033; PLR 9320015; PLR 9416016; PLR 9442032; PLR 9537005; PLR 9551015 and PLR 9830004.

6. Will Contests And Other Litigation. What if the Will which creates the QTIP Trust is contested and prolonged litigation is likely? If it is not clear who the beneficiary of the participant's retirement plan is by the DB determination date, then designated beneficiary treatment will be jeopardized. Could the QTIP Trust provisions and related designated beneficiary provisions in the Will be incorporated by reference into the beneficiary designation so that minimum distribution amounts can be determined and timely distributed (even if a Will contest is still unresolved by the DB determination date)? What if the decedent's waiver or the spouse's consent to waiver of REA rights is being challenged? Does state law or ERISA control the decision? How do community property laws impact this issue (if they do)? Some interesting complex litigation issues can arise involving trusts that are named as the beneficiary of retirement plan benefits and the impact of the litigation on both the estate tax marital deduction (if applicable) and the designated beneficiary issue should be determined.

VI. SPECIAL CONCERNS IN NAMING A QDOT TRUST AS BENEFICIARY

A. Spouse **Not** U.S. Citizen. If the participant's spouse is not a U.S. citizen, amounts passing directly to her will not qualify for the federal estate tax marital deduction. IRC § 2056(d). A qualified domestic trust ("QDOT") must be used to obtain the marital deduction in this situation. *IRC § 2056A.*

B. Creation of QDOT. Either the participant or the surviving spouse may create the QDOT. The considerations discussed above relating to the QTIP Trust will usually apply, especially if the participant is the one creating the QDOT. In addition, all of the usual QDOT requirements must be included in the governing instrument.

C. Rollover to QDOT by Non-Citizen Spouse.

1. Three Illustrative Rulings.

a. PLR 9623063.

(1) Facts. The participant of three (3) IRAs died, having designated his spouse, S, who was not a U.S. citizen, as his beneficiary. S timely created a QDOT that met all of the QDOT requirements. S proposed to roll over to one or more IRAs in her name the participant's community property interest in his IRAs. The IRA rollovers would then be allocated to corpus of the QDOT. S, who was age 68 when the participant died, had a complete withdrawal right over the IRAs. S proposed to treat the portion of the distributions from the IRA rollovers to the QDOT representing the trust's income available for distribution (i.e., income earned by the trust during the calendar year) as income, and to treat the income earned in the IRA rollovers but not distributed during the calendar year as principal.

(2) QDOT Qualification For Marital Deduction. The IRS ruled that because the IRAs passed directly (outright) to S, the QDOT to which the IRA rollovers were transferred did not have to meet the QTIP requirements of Code Section 2056(b)(7), or the LEPA requirements of Code Section 2056(b)(5), or constitute an estate trust under Treasury Regulation Sections 20.2056(c)-2(b)(1)(i) through (iii). The IRS concluded that S's IRA rollovers were eligible for the marital deduction under Section 2056(d)(2)(B) of the Code.

(3) Income Issue. The IRS did not quite use the same terminology S used in S's ruling request, but ruled that amounts distributed from her IRA rollovers during any calendar year will be deemed income, to the extent of the IRA rollover's current income for the calendar year, within the meaning of Section 2056(c)(2) of the Code.

b. PLR 9109021. In this ruling, the non-citizen spouse rolled over 403(b) and IRA benefits to a QDOT that she created after the participant's death. Although the ruling contains very little discussion of the income issue, the IRS held that the QDOT created with the plan benefits qualified for the marital deduction. *PLR 9109021 (November 30, 1990).*

c. PLR 9321032. For a ruling that contains an excellent discussion of both the marital deduction issue in the case of a non-citizen spouse and the minimum distribution issues, see PLR 9321032 (May 28, 1993). *See also PLR 9322005 (June 4, 1993).*

D. Annuity As QDOT. Congress allowed Treasury to issue regulations stating that annuities, including those emanating from qualified plans and IRAs, may be treated as QDOTs. *IRC § 2056A(e).* The problem with this approach is that the annuity distributions under the minimum distribution rules eventually carry out "principal" and the non-citizen surviving spouse must pay estate tax on principal distributions from a QDOT.

E. Final QDOT Regulations. Under the final QDOT regulations, a non-citizen spouse can obtain QDOT treatment for annuities if she either agrees to pay the deferred estate tax on the principal portion of each annuity distribution or rolls the principal portion of the annuity distribution into a QDOT. *Treas. Reg. § 20.205A-4(c); see also PLR 9729040 (July 18, 1997).*

VII. SPECIAL CONCERNS IN NAMING A BYPASS TRUST AS BENEFICIARY

A. Complete Distribution To Bypass Trust. In cases involving qualified plans, where the Bypass Trust has been named as the participant's beneficiary, many plans will require a complete distribution of the participant's interest in the plan to the trust. Obviously, the Bypass Trust will be underfunded because the date of death value of the participant's interest in the plan (the "gross" amount) is included in his estate under either Section 2033 or Section 2039 and, yet, when the Bypass Trust receives the distribution, it is fully taxable as IRD in the year of receipt. Thus, the Bypass Trust immediately shrinks by the amount of the income taxes on the distribution. In some cases, there may be no other option, but all other options should be pursued first (including having the participant roll out of the plan to an IRA rollover that would not require a full distribution of all amounts in the IRA to the trust upon the participant's death). Another option that may be superior in many cases, especially where long term income tax deferral is actually likely (i.e., the participant's children won't just pull it all out immediately after his death), would be for the participant to convert a regular IRA to a Roth IRA. Discussion of the Roth IRA is beyond the scope of this outline. However, for some excellent comparisons of various options a participant might consider and the final "after tax" result of selecting the various options, see Trytten, "Economics of Retirement Plan Distributions [Parts III-XI]," *Estate Planning for Distributions from Qualified Plans and IRAs*, ALI-ABA Satellite Course, May 20, 1999.

1. IRD Deduction. If estate taxes are paid by the participant's estate as a result of the IRD passing to the Bypass Trust, then the Bypass Trust should be entitled to the IRC § 691(c) deduction for income tax purposes (for estate tax attributable to the IRD item).

2. Principal And Income Allocation Issues. Obviously, if a complete distribution of the participant's interest in the plan is received by the Bypass Trust, it would be beneficial to allocate such receipt to principal. The new Texas UPIA rules would require this. *See Texas Trust Code § 116.172(e).* The income taxes due on the lump sum distribution should be borne by the lump sum distribution, even if labeled principal under fiduciary accounting rules. Note, there were some problems with principal and income allocations under prior Texas law. *See* Gerstner, *You Have Named a Trust - Now What?*, cited earlier at V.A.4. Now that Texas has adopted UPIA, the allocation rules have been clarified somewhat. *See Texas Trust Code § 116.172.* If the Bypass Trust is structured in such a way so that minimum required distributions are all that must be paid to it each year from the retirement plan, if the plan administrator or IRA custodian/trustee does not characterize the distribution as interest or dividend income, then the "4% rule" applies. *See Texas Trust Code § 116.172(c).*

B. Minimum Distribution Payments To Bypass Trust. If the Bypass Trust is going to be a beneficiary of retirement plan benefits, it would obviously be preferable for the Bypass Trust to qualify for designated beneficiary treatment so that payments to the trust could be made over the life expectancy of the oldest trust beneficiary pursuant to the minimum distribution rules. Fortunately, in some situations under the final regulations, failure of the trust to qualify for DB treatment has less disastrous results than under the

old rules. In any event, periodic distributions from the plan to the Bypass Trust will allow for further tax deferred growth in the plan assets (versus a complete distribution up front).

1. IRD Reduces Estate Tax Effectiveness. It is still better to have non-IRD assets (i.e., "after tax" assets) pass into a Bypass Trust for federal estate tax purposes because IRD assets are not true "growth" assets (due to the inherent income tax liability). While some possibility for growth exists as long as the opportunity for deferral is preserved, IRD assets do not "grow" in the same way as after-tax assets. Thus, allocating IRD assets to the Bypass Trust is not often the best use of the participant's federal estate tax exclusion amount. Planning efforts should be directed toward allocating all other assets that could be used to fund the Bypass Trust, including real estate and life insurance, to the Bypass Trust first.

2. Strategies For The Participant. If the participant is concerned with fully funding or, at least, optimally funding the Bypass Trust, he should consider the following strategies:

a. Not Waiting Until Age 70 ½ To Take Distributions From His Retirement Plans. Many retired people under age 70 ½ spend all of their after tax assets, while continuing to let their retirement plans grow larger (thus, worsening the problem). If a participant's estate is taxable and consists primarily of retirement plans, he should consider taking distributions earlier (as long as he is at least age 59 ½). He will pay income taxes on the distributions, but then he can either invest the net after tax amount in other assets that will be more suitable for funding a Bypass Trust, spend it, or make gifts with it -- all effective estate tax reduction strategies.

b. Not Taking Merely The Minimum Required Distributions Upon Reaching RBD. While many people complain about having to pay income taxes on retirement plan distributions, these monies have not paid any income taxes previously and they have benefitted tremendously by this tax deferral. On the other hand, when the surviving spouse dies and estate taxes are payable, the children may have to withdraw amounts from the retirement plans (or they may be forced to receive all remaining plan amounts in a complete distribution at that time), incurring income taxes and, perhaps also, estate taxes on these assets all at once (resulting in a combined 70% or 80% tax rate on these assets in many cases). The participant and his spouse will never have to pay taxes at that high a rate on distributions from these plans. Thus, taking extra distributions during lifetime to save taxes later is not a bad idea. Some people take just enough extra from their plans to stay within the income tax bracket they would have been in anyway as a result of their required distribution and other taxable income. Also, every time income taxes are paid on these assets, the participant's estate is being reduced by that tax payment.

c. Rolling Over Qualified Plan Benefits To An IRA. For two (2) reasons the participant should consider taking a lump sum distribution from his qualified plan and rolling it over to an IRA rollover. One reason is that this action arguably avoids the result from the Boggs case of the non-participant spouse not having a devisable interest in the plan (IRAs are not qualified plans under ERISA and the Boggs decision should not be applicable to them). The other reason for doing an IRA rollover is to avoid a complete distribution of the participant's interest in the qualified plan upon his death, as mandated by the terms of many plans whenever a participant has named a trust (or anyone other than his spouse) as his beneficiary. The participant should also make sure that his IRA agreement does not require a complete distribution to a trust named as beneficiary.

3. Complicating Factors.

a. Multiple Beneficiaries. A Bypass Trust often has current multiple beneficiaries, but even if it is drafted so that the surviving spouse is the sole current beneficiary, unless it is drafted in the form of a conduit trust, its remainder beneficiaries *must* be taken into account in determining its qualification for DB treatment. *See* IV.C.4., *supra*. If the Bypass Trust has only individual beneficiaries, then the individual with the shortest life expectancy (usually the spouse) will be treated as the designated beneficiary whose life expectancy will be used as the measuring life for calculating MRDs.

(1) Power Of Appointment To Charity. If the spouse has a power of appointment over the Bypass Trust in favor of charity, then designated beneficiary treatment is jeopardized. The surviving spouse should timely disclaim the

offending power to appoint to charities if DB treatment is desired.

(2) Charity Is Potential Remainder Beneficiary Of The Trust. If charity is a "countable" remainder beneficiary, designated beneficiary treatment is not available. *See, e.g., PLR 9820021, supra.* If there are intervening beneficiaries before an ultimate charitable beneficiary is reached, it may be possible to draft the trust so that charity is deemed a mere potential successor beneficiary of the trust and can be ignored. For example, if the Bypass Trust passes *outright* to the deceased participant's children upon termination at the spouse's death, and if charity only takes if all of the children predecease the surviving spouse, charity should be treated as a mere potential successor beneficiary in that case (and, therefore should be ignored in evaluating the DB issue). Example 1 in the final regulations would appear to support this result (although it does not go that far). *See* IV.D.2, *supra*.

(3) Trust Accumulations: Special Commencement Date Option Not Available. Even if all of the beneficiaries of the Bypass Trust are individuals, thereby qualifying the trust for designated beneficiary treatment (assuming all four trust regulatory requirements are satisfied), if the full amount distributed from the plan to the trust is not then distributed from the trust to the spouse pursuant to specific provisions in the instrument, the IRS takes the position that the trust cannot avail itself of the special commencement date for distributions available to a sole designated beneficiary spouse under Section 401(a)(9)(B)(iv)(I) of the Code. This interpretation was originally found in PLRs 9847022 and 199903050, *supra*, recently confirmed by implication in Rev. Rul. 2000-2, *supra*, and now expressly stated in the final regulations. *Treas. Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 1 (iii) [last sentence]*. Thus, distributions to the trust must commence by December 31 of the year following the year of the participant's death. Note that this is even sooner than under the 5 year rule (applicable where the participant dies before RBD and there is no DB by the DB determination date), where distributions do not have to be made until December 31 of the fifth year following the year of the participant's death. Even though commencement of distributions is sooner in this case, greater tax deferral may still be achieved compared to the 5 year rule because of the ability to utilize the spouse's non-recalculated life expectancy (assuming she is the oldest beneficiary of the trust) in calculating MRDs.

4. Drafting Strategies.

a. Beneficiary Designations. In many estate planning situations, the beneficiary designation should be designed so that the surviving spouse will have the option, at least, of using the retirement plan benefits to fund the Bypass Trust. There is no universal rule regarding the wording of the beneficiary designation. Various sample wording for beneficiary designations is attached to this outline as Exhibits 5-13. Here are some possibilities:

(1) Simplest Method. Spouse is primary beneficiary, Trustee in participant's Will (or Living Trust Agreement) is contingent beneficiary. *See*, e.g., Exhibit 5. Benefit: Spouse will clearly qualify as a designated beneficiary if spouse is living on the DB determination date. Spouse has the option to do the spousal IRA rollover (or treat the participant's IRA/IRA rollover as her own) and also has the option to disclaim all or a portion of the participant's interest in the retirement plan benefits passing to her in order to fund the Bypass Trust (assumes Will or Living Trust has a provision allocating disclaimed plan benefits to the Bypass Trust). If the spouse is not living on the DB determination date, the contingent beneficiary designation will usually result in plan benefits following the participant's estate plan in his Will or Living Trust Agreement (i.e., allocation provisions in the instrument will funnel plan benefits to the correct contingent beneficiaries). Thus, the beneficiary designation form need not be "cluttered up" with various contingencies that are more effectively addressed in the Will or Trust Agreement.

(2) Method Affirmatively Discussing Disclaimer. Spouse is primary beneficiary; however, if disclaimer is executed by spouse, disclaimed amount passes to Trustee of Bypass Trust (or Disclaimer Bypass Trust) created in Will (or Living Trust Agreement). *See*, e.g., Exhibit 7. Descendants, per stirpes, could be listed as contingent beneficiaries (perhaps subject to Contingent Trust or TUTMA provisions). *See*, e.g., Exhibit 6.

(3) Possibly Risky Method. Trustee in participant's Will (or Living Trust Agreement) is primary beneficiary (there may be no contingent beneficiary named or spouse, if any, may be contingent beneficiary).

(a) Issues. What is happening to non-participant spouse's interest? Is spouse being forced to an "election"? If Will or Trust Agreement doesn't clearly allocate spouse's interest directly to her, she could have serious rollover problems (even though she "owns" half of the plan already under community property law). See X., *infra*. If the Will or Living Trust has multiple beneficiaries, separate account /segregated share treatment may not be available with this designation. *See* I.B.6., *supra*. Possible acceleration of IRD, depending upon terms of Will or Trust Agreement.

(4) Another Option. Primary Beneficiary Designation: Spouse is the beneficiary of ½ of the benefits and the Trustee of the Bypass Trust is the beneficiary of the other ½ of the benefits; the contingent beneficiary is the Trustee in the Will (or descendants, per stirpes). *See*, e.g., Exhibit 8 for similar wording, splitting plan benefits between spouse and QTIP Trust. Assuming all of the benefits are community property, the surviving spouse is receiving her community share outright and can clearly do a spousal IRA rollover as to that half. The participant's half will pass directly to the Trustee of the Bypass Trust, so no acceleration of IRD should occur. The amount may be too large, however, and needs to be monitored. The Bypass Trust must meet all of the trust regulatory requirements to obtain designated beneficiary treatment.

b. Bypass Trust Provisions. All of the usual Bypass Trust drafting considerations apply (e.g., if spouse will be the Trustee, limit distributions to the ascertainable standard; don't give spouse a general power of appointment over Bypass Trust, etc.). Consider, in addition, the following:

(1) No Power Of Appointment Or Specially Designed Limited Power Of Appointment. If the plan benefits will reach the Bypass Trust via a disclaimer by the participant's spouse, then the participant's spouse should not be given a power of appointment over the trust (because of the rules for qualified disclaimers). Further, it would be safer in all cases involving distribution of plan benefits to the trust to forego giving the spouse any type of power of appointment because all potential donees of the power have an interest in plan benefits accumulated in the trust. If the plan benefits will pass to the Bypass Trust directly, either because the Trustee of the Bypass Trust is specifically named as the beneficiary in the beneficiary designation or because the Trustee in the Will (or Living Trust Agreement) must allocate or chooses to allocate plan benefits as to which the Trustee is named the beneficiary to the Bypass Trust, then, theoretically, the spouse can have a limited power of appointment, but it must be designed so as not to cause problems under the trust regulatory requirements (including the multiple beneficiary rules). *See*, IV.D.1., *supra*. All donees of the power of appointment must be clearly identifiable (pursuant to the trust regulatory requirements). The power of appointment should not be exercisable in favor of a charity (not a designated beneficiary). If it is desired that the participant's spouse be treated as the designated beneficiary for purposes of calculating MRDs, then no possible appointees older than the spouse should be included. This could theoretically happen if permissible appointees include spouses of descendants (who might happen to be older than the participant's spouse).

(2) Address Trust Accumulation Of Plan Benefits. If it is desired that the spouse be treated as the sole beneficiary for purposes of the minimum distribution rules, and especially the more favorable commencement date option, then no one else (e.g., descendants) can be a current beneficiary of the trust and no plan distribution amounts can be accumulated in the trust for the benefit of the remainder beneficiaries. Either the "conduit" approach must be used (not necessarily bad from an income tax standpoint) or the spouse must be given some sort of withdrawal power over the plan distribution amounts not distributed to her by the Trustee of the Bypass Trust (making her a grantor of the trust to that extent). *See* IV.C.3., *supra*. The spouse will not be treated as the "sole" beneficiary merely because the Trustee, in fact, chooses to distribute to the spouse 100% of the plan distributions received by the trust. Special drafting in the instrument will be required to achieve this result.

(a) Commencement Date For Distributions. If the spouse is treated as the sole beneficiary for purposes of the minimum distribution rules and if the participant dies before reaching his RBD, distributions to the Bypass Trust will not need to commence until December 31 of the year in which the participant would have reached age 70 ½. This continued deferral is very valuable. Of course, the usual form of Bypass Trust used by estate planners would not ordinarily be able to meet the requirements for obtaining this special MRD commencement date. It may be simpler to use a more "normal" Bypass Trust and begin taking distributions by December 31 of the year following the participant's death (assuming the trust meets the regulatory requirements and has no beneficiaries who do not qualify as designated beneficiaries). NOTE: It is the IRS' continuing position that if the Trustee named in the Will, in general (versus the Trustee of the Bypass Trust), is named as the beneficiary in the participant's beneficiary designation form and the Trustee makes the allocation of plan benefits to the Bypass Trust as a result of exercise of the Trustee's discretion, all potential beneficiaries who *could* have received plan benefits as a result of the Trustee's discretionary allocation (including all other beneficiaries and all other trusts created in the instrument and their beneficiaries) have to be taken into account to determine whether the participant has a designated beneficiary and, if so, whose measuring life is used for purposes of the minimum distribution calculations. *See PLR 199903050, supra, PLR 9305025 (November 12, 1992), and PLR 9641031 (October 11, 1996).* This same theory is being used by the IRS to preclude post-death separation of benefits into separate accounts. *See* I.B.6., *supra*. Therefore, if the Trustee in the Will, in general, is designated as the beneficiary, at the very least the Will should mandate or direct the allocation of the plan benefits, so that it is not a matter left to the Trustee's discretion. Note that in many cases, it may not matter whether separate account treatment is available, however, because the distribution period may be the same regardless. *See* I.B.6.(a)(2), *supra*.

VIII. SPECIAL CONCERNS IN NAMING A CHARITABLE REMAINDER TRUST AS BENEFICIARY OF RETIREMENT PLANS

A. Distinguish From Naming A Charity As The Beneficiary. While the focus of this paper is primarily on naming a trust as the beneficiary of retirement plans, the discussion in this section regarding naming a charitable trust as beneficiary also applies, for the most part, to naming a charity directly as the beneficiary of retirement plans. One difference would be the amount of the charitable deduction available to the deceased participant's estate at death. With a "split interest" charitable trust, such as a charitable remainder trust, the participant's estate is only entitled to a charitable deduction for the actuarially determined value of the charity's remainder interest in the trust (versus an estate tax charitable deduction for the full value of transfers made directly to qualified charities at death).

B. Distinguish Naming a Charitable Remainder Trust And Naming a QTIP Trust With Remainder To Charity As The Beneficiary. There are some differences in naming a QTIP Trust with remainder to charity and in naming a charitable remainder trust as the beneficiary of retirement plans.

1. Marital Deduction Issue. If a QTIP Trust is named as the beneficiary, all of the special concerns discussed above regarding qualifying for the federal estate tax marital deduction apply, making drafting significantly more complex. On the other hand, with a charitable remainder trust ("CRT"), since the trust is not a taxable entity, the full amount of the decedent's interest in the plan can be distributed to the trust without adverse income tax consequences, making the marital deduction issue much simpler. If the spouse is the only non-charitable beneficiary of the CRT, then the marital deduction is allowable for the value of the spouse's interest in the CRT. *IRC § 2056(b)(8)(a).*

2. Income Tax Issues. Another difference between naming a QTIP Trust with remainder to charity and a CRT as the beneficiary of retirement plans is the income taxability of distributions from the plan. A charitable remainder trust is a tax exempt entity, so that no income tax is due when the full amount of the participant's plan benefits is paid to the trust on the participant's death. Of

course, that portion of the unitrust or annuity distribution paid out to the non-charitable beneficiary of the trust each year that represents taxable income (versus corpus) will be subject to income tax. On the other hand, distribution of retirement plans to QTIP Trusts that have charitable organizations as the initial remainder beneficiaries will result in the inability to make distributions over the spouse's life expectancy if the trust accumulates plan benefit distributions made during the spouse's life. *See PLR 9820021, supra.* If the trust does not qualify for DB treatment, then the 5 year rule would apply if the participant dies before his RBD. If the participant dies after reaching his RBD with a non-qualifying trust as his beneficiary, MRDs can still be made over the deceased participant's non-recalculated, remaining life expectancy, which is not necessarily a "bad" distribution period.

3. Benefits To Spouse. Of course, there are differences in the type and amount of benefits a spouse may receive from a QTIP Trust versus a CRT. For example, the spouse can receive unlimited amounts of principal (in addition to all the income) from the QTIP Trust during her lifetime, as opposed to merely the specified annuity or unitrust amount from a CRT.

4. Benefits To Charity. There are also differences in the benefits provided to charity with the two different trusts. Because of the possibility of substantial distributions being made to the surviving spouse during her lifetime from the QTIP Trust, there may, in fact, be nothing left in the Trust to pass to charity upon her death. On the other hand, under the recently revised rules applicable to charitable remainder trusts, a certain minimum amount, at least, is likely to pass to charity from these trusts. The Taxpayer Relief Act of 1997 requires that the minimum value of the charity's remainder interest be at least 10% of the value of the initial assets transferred to the trust in order to qualify as a valid CRT.

C. Disadvantage Of Naming A Charitable Trust As Beneficiary.

1. No Designated Beneficiary-But No Longer Hurts Participant. It is clear that a participant who names a charitable trust as his beneficiary will not have a designated beneficiary but, under the final regulations, this no longer matters in calculating MRDs to the participant during his lifetime. It only makes a difference in the distribution period applicable upon the participant's death. If the participant dies before reaching his RBD, then the 5 year rule applies. If he dies on or after reaching his RBD, then MRDs to the trust can be made over his remaining life expectancy, not recalculated. In the case of a charitable trust named as the participant's beneficiary, however, which may not be subject to income tax (if it is a CRT, for example), there is really no reason to stretch out distributions from the retirement plan anyway. Presumably, the trustee will withdraw the entire amount remaining in the participant's plan upon his death and put it into the charitable trust account. This is another difference between using a QTIP Trust with remainder to charity and using a CRT with the spouse as the life "income" unitrust/annuity recipient.

2. Other Beneficiaries May Suffer Because Of The Multiple Beneficiary Rule. If the participant names a charitable trust as the beneficiary of only part of his retirement plan and names individuals as beneficiaries of the remaining part, the multiple beneficiary rule will hurt the individual beneficiaries unless separate accounts or segregated shares are created. Under the new proposed regulations, separate accounts can now be created after the participant's death in many cases. In addition, the charitable beneficiary can be "cashed out," leaving only the individual beneficiaries on the DB determination date.

a. Percentage Or Fractional Share Designation. Utilizing a percentage or fractional share in the beneficiary designation should satisfy the separate account/segregated share rule. Specifying a pecuniary amount for charity with the balance to individuals should also allow separate account treatment. A more conservative approach would be for the participant to physically divide his IRAs, so that one entire IRA will pass to charity or to a charitable trust and the other IRA(s) will pass to individual(s). Of course, the participant need not take the required distributions pro rata from all of his IRAs as long as he takes the correct amount in total. *IRS Notice 88-38, I.R.B. 1988-15.* (NOTE: This notice only applies to IRAs and not to qualified plans) So, if it is desired that only a particular dollar amount pass to the charitable trust, the participant should be able to accomplish that result by taking the

distributions from the various IRAs so as to maintain the appropriate balance, more or less, in the IRA that will pass solely to the charitable trust.

b. Post-death Creation Of Separate Accounts/Cashing Out Charity. Although the participant may want to utilize separate accounts/segregated shares to make things easier for multiple beneficiaries where one or more charities are named along with individuals, it is clear under the final regulations that several post-death planning techniques (e.g., creation of separate accounts, cashing out charity) are available to prevent harm to the individual beneficiary/ies, as discussed earlier. *See* I.B.4.c., *supra*.

3. Loss Of IRD Deduction. If IRD assets, such as retirement plans and IRAs, pass to a CRT, the income tax deduction available under IRC Section 691(c) for the estate tax attributable to the IRD item will usually be wasted. Even though the non-charitable beneficiary of the CRT receives either an annuity or a unitrust payment from the CRT during its term, the IRD deduction does not flow out of the CRT to the individual beneficiary. This is because distributions to the individual come first out of taxable income and last out of principal. Since the IRD item reduces the taxable income of the trust, it effectively becomes principal. Only very rarely, and late in the term, if at all, would any principal of the CRT be distributed to the non-charitable beneficiary and, therefore, carry out the IRC Section 691(c) deduction. *See PLR 199901023 (October 8, 1998).*

4. Avoid Naming A Charitable Beneficiary Of Roth IRA. There is no income tax advantage in naming a charity or a charitable remainder trust as the beneficiary of a Roth IRA.

D. Proposed Law: Direct Rollover Of IRA To Charity. During 1999, two bills (H.R. 1311 and S. 1086) were introduced that would have allowed a participant to make a "direct rollover" of IRA benefits to charity during his lifetime versus taking a distribution from his IRA and then making a charitable contribution with it (or versus naming the charity as the beneficiary of his IRA to receive benefits only upon his death). The direct rollover would have the advantage of excluding the distribution amount from the participant's income in the first place (versus including the amount in income and then taking a charitable deduction). The direct rollover proposal did not pass in 1999 and was proposed again in 2000. Apparently, however, a lot of controversy developed over the proposal. As a result of a compromise between the House and the Senate, the modified version appeared to allow direct rollovers of IRAs to *public* charities, but not to charitable trusts or to other deferred giving arrangements. The charitable IRA proposal was part of the initially proposed Taxpayer Relief Act of 2000, which was passed by the House on October 26, 2000. It did not become law in 2000, nor did the proposal become law as part of the Economic Growth and Tax Relief Reconciliation Act of 2001. This provision was also part of the CARE Act of 2002; however, it did not get enacted. While it still has many backers in Congress, this proposal has apparently been "tabled" for the time being. If the direct rollover proposal ever becomes law, it will provide a very simple way to make inter vivos gifts directly to public charities using IRAs.

IX. SPECIAL CONCERNS IN NAMING A GST TRUST AS BENEFICIARY

A. No GST Exemption Allocation Until Participant's Death. Unless a participant makes an irrevocable beneficiary designation of his retirement plan benefits before his death to a GST Trust and those benefits are not included in his gross estate for federal estate tax purpose (i.e., one of the transitional rules applies), none of his GST exemption can be applied at that time because of the QTIP rules. Further, it may be that even if one of the estate tax transitional rules applies to exclude the benefits from the participant's estate under Section 2039 or 2033, the benefits may still be includible in his estate under Section 2036 or 2038 because the participant has made an irrevocable transfer but has retained an interest in the property (the plan) for his life. Thus, again, no GST exemption allocation for the plan benefits may be made while the participant is alive. At any rate, allocating GST exemption to plan benefits in this situation might not be a good use of the exemption because the assets could shrink appreciably in value between the date of designation and the date of death, due to required distributions made from the plan to the participant

before the participant dies (or due to poor investment returns).

B. GST Exemption Allocation At Death. If the participant names a GST Trust as the beneficiary of his retirement plans upon his death, his GST exemption may be allocated to that transfer on the estate tax return filed for his estate. Because of the limit on the amount of generation-skipping transfers that each transferor may make, care must be taken to insure that the value of the plan benefits being transferred to the GST Trust will not result in the transferor exceeding his GST exemption (formula language should be used).

1. IRD Issue. The usual problem of accelerating IRD by utilizing plan benefits to satisfy a pecuniary gift must be addressed. It would seem that, in this case, designating the Trustee of the GST Trust directly as the beneficiary of the plan benefits will be the safest choice.

2. Various Problems. If the Plan value exceeds the participant's available GST exemption amount, only that portion which may safely pass to the GST Trust should be designated to pass to the Trustee of the GST Trust. If other beneficiaries will be named for the remaining amount, separate accounts or segregated shares should be used. Allocating GST exemption to "pre-tax" assets is not usually the best use of the exemption; although, if the participant dies prematurely, a very long deferral could be achieved with these trusts because of the young age of the GST Trust beneficiary. All of the usual trust regulatory requirements must be met, however, including having identifiable beneficiaries. Thus, it is doubtful that this would work for a class of descendants, no member of which is in being as of the applicable date.

3. Advantages. If the GST Trust can obtain designated beneficiary treatment, then once the participant has died, distributions from the retirement plan to the Trust can be made over the oldest beneficiary's actual life expectancy. If the GST Trust is for grandchildren only, this could result in a very long deferral indeed.

4. Potential Problems. Not infrequently, a charity will be a remainder beneficiary in a long-term GST Trust. Depending on how the trust is drafted to deal with the accumulation of plan benefits issue, the charity may have to be "counted" as a beneficiary, thus precluding designated beneficiary treatment. Further, if no grandchildren are living on the DB determination date, all of the beneficiaries of the trust may not be "identifiable" under the trust regulatory requirements (designating a class of beneficiaries is acceptable, even if the class can expand, as long as there is at least one member of the class on the relevant date). Further, it is not uncommon in GST Trusts to give the current beneficiary a special power of appointment over the trust. All of the potential problems with powers of appointment previously discussed in this outline must be evaluated and addressed in drafting the instrument. Again, various drafting ideas can be considered for plan distributions that have been made to the GST Trust during the beneficiary's lifetime and accumulated in the trust. For example, accumulations could be (i) held in a separate account for ease of identification and subject to special distribution provisions, (ii) directed to be used first to make discretionary distributions to the current trust beneficiary, (iii) subject to a special withdrawal power by the trust beneficiary who is treated as the designated beneficiary, or (iv) payable upon the beneficiary's death to identifiable remainder beneficiaries who qualify as designated beneficiaries, free of trust, or subject to typical contingent trust or TUTMA provisions.

X. TRUST (OR ESTATE) WAS NAMED AS BENEFICIARY BUT SPOUSE DESIRES IRA ROLLOVER

A. Not A Planning Technique: Trying To Salvage Spousal IRA Rollover. This section is not included for purposes of planning with respect to retirement plan beneficiary designations. These rulings involve "mistakes" in beneficiary designations that were sometimes able to be corrected. These rulings are included in the event a spousal IRA rollover is desired but the participant's spouse was not named directly as the beneficiary of his retirement plan. The regulations state that, in order to make a spousal IRA rollover, the spouse must be the sole beneficiary of the plan/IRA, and that this requirement will not be met if a trust is named as the beneficiary of the plan/IRA "even if the spouse is the sole

beneficiary of the trust." *Treas. Reg. § 1.408-8, A-5(a)*.

B. Illustrative Rulings.

1. Some Favorable Rulings: Spousal IRA Rollover Permitted. In the following rulings the spouse was allowed to do an IRA rollover even though she was not named directly as the beneficiary of the participant's retirement plan: PLR 200317040 (April 25, 2003); PLR 200314029 (April 4, 2003); PLR 200305030 (January 31, 2003); PLR 200304037 (January 24, 2003); PLR 200242044 (October 18, 2002); PLR 200236052 (September 6, 2002); PLR 200212036 (March 22, 2002); PLR 200211054 (March 15, 2002); PLR 200210066 (March 8, 2002); PLR 200208031 (February 22, 2002); PLR 200151054 (September 25, 2001); PLR 200136031 (September 10, 2001); PLR 200130056 (July 30, 2001); PLR 200032044 (August 15, 2000); PLR 20027061 (July 10, 2000) (intestacy situation); PLR 199951051 (December 27, 1999); PLR 199913048 (April 5, 1999); PLR 9623056 (June 7, 1996); PLR 9611057 (March 15, 1996); PLR 9537030 (June 21, 1995); PLR 9515042 (January 18, 1995); PLR 9502042 (January 13, 1995); PLR 9451059 (December 23, 1994); PLR 9511039 (December 20, 1994) (partial); PLR 9450041 (December 16, 1994) (interesting situation involving a non-qualified disclaimer); PLR 9450042 (December 16, 1994); PLR 9426049 (April 12, 1994); PLR 9416039 (January 26, 1994); PLR 9402023 (October 18, 1993); PLR 9401039 (October 18, 1993); PLR 9350040 (September 23, 1993); PLR 8911006 (December 12, 1988).

a. Factors Leading To Favorable Ruling. Even though the participant's estate or a trust was named as the beneficiary of the participant's retirement plan benefits (instead of the spouse), if the surviving spouse was the fiduciary (usually the sole fiduciary) and if she had the right to allocate the plan benefits directly to herself or to a trust over which she had a complete right of withdrawal, then a rollover was permitted. Another technique that can result in obtaining the IRA rollover option for the spouse is to use disclaimers to cause the benefits to end up with the spouse.

2. Unfavorable Rulings: No Spousal IRA Rollover Permitted. In the following rulings, the spousal IRA rollover was not allowed: PLR 9145041 (August 16, 1991); PLR 9303031 (October 29, 1992); PLR 9322005 (February 24, 1993); PLR 9851050 (December 18, 1998) (partially permitted and partially not permitted); PLR 9321032 (February 24, 1993).

a. Reasons For Unfavorable Ruling. The IRS generally takes the position that if the participant's plan benefits first pass to a trust, trustee or estate, even if they are then distributed to the participant's spouse, they are not passing to the spouse directly but only to her through a third party. Thus, the spouse is not acquiring the benefits from the participant in a way that clearly entitles her to do a spousal IRA rollover under the rules.

XI. CONCLUSION

A. Rules Are Complex. Despite the release of final regulations relating to distributions from defined contribution plans and IRAs, the rules relating to obtaining designated beneficiary treatment when a trust is named as the beneficiary of retirement plans are still very complex (and subject to constant change). The possibility for an unfavorable income tax result must be weighed against the value of the other objectives sought in naming a trust as the beneficiary. This is especially true now that changes in the law made by EGTRRA, if allowed to remain as passed, will reduce the number of estates subject to estate tax over the next 7 or 8 years.

B. Obtain Private Letter Ruling. In many cases, it would be advisable to obtain a timely private letter ruling on the various tax aspects of a particular situation involving a trust as the beneficiary of retirement plans (assuming it is not a hypothetical situation). A review of analogous private letter rulings is also worthwhile (even if they are not precedent, they usually indicate the IRS's likely position). Of course, many of the previously issued rulings may no longer be applicable due to the release of the final regulations. Presumably, many new rulings will be coming out, interpreting the new rules.

C. Consider Other Alternatives. Before naming a trust as the primary beneficiary of the participant's retirement plans, all other possible

alternatives that could achieve the client's goals should be considered.

UNIFORM LIFETIME TABLE

(Old MDIB Table)

Treas. Reg. § 1.409(a)(1)-9, A-2

Table For Determining Applicable Divisor For MRDs to Participant During His/Her Lifetime*

Age of the participant	*Applicable divisor*	*Age of the participant*	*Applicable divisor*
70	27.4	95	8.6
71	26.5	96	8.1
72	25.6	97	7.6
73	24.7	98	7.1
74	23.8	99	6.7
75	22.9	100	6.3
76	22.0	101	5.9
77	21.2	102	5.5
78	20.3	103	5.2
79	19.5	104	4.9
80	18.7	105	4.5
81	17.9	106	4.2
82	17.1	107	3.9
83	16.3	108	3.7
84	15.5	109	3.4
85	14.8	110	3.1
86	14.1	111	2.9
87	13.4	112	2.6
88	12.7	113	2.4
89	12.0	114	2.1
90	11.4	115 and older	1.9
91	10.8		
92	10.2		
93	9.6		
94	9.1		

*Use Exhibit 2 instead (i) if the sole beneficiary is participant's spouse; (ii) if spouse is more than ten years younger than participant; and (iii) if the distribution is from an IRA, or from a retirement plan so permitting.

JOINT AND LAST SURVIVOR TABLE
Treas. Reg. § 1.409(a)(1)-9, A-3

Only for Use by Living Participant Whose Sole Beneficiary Spouse is More than Ten Years Younger

Age of Spouse	Age of Participant												
	70	71	72	73	74	75	76	77	78	79	80	81	82
35	48.7	48.7	48.7	48.6	48.6	48.6	48.6	48.6	48.6	48.6	48.5	48.5	48.5
36	47.8	47.7	47.7	47.7	47.7	47.7	47.6	47.6	47.6	47.6	47.6	47.6	47.6
37	46.8	46.8	46.8	46.7	46.7	46.7	46.7	46.7	46.6	46.6	46.6	46.6	46.6
38	45.9	45.9	45.8	45.8	45.8	45.7	45.7	45.7	45.7	45.7	45.7	45.7	45.6
39	44.9	44.9	44.9	44.8	44.8	44.8	44.8	44.8	44.7	44.7	44.7	44.7	44.7
40	44.0	44.0	43.9	43.9	43.9	43.8	43.8	43.8	43.8	43.8	43.7	43.7	43.7
41	43.1	43.0	43.0	43.0	42.9	42.9	42.9	42.9	42.8	42.8	42.8	42.8	42.8
42	42.2	42.1	42.1	42.0	42.0	42.0	41.9	41.9	41.9	41.9	41.8	41.8	41.8
43	41.3	41.2	41.1	41.1	41.1	41.0	41.0	41.0	40.9	40.9	40.9	40.9	40.9
44	40.3	40.3	40.2	40.2	40.1	40.1	40.1	40.0	40.0	40.0	40.0	39.9	39.9
45	39.4	39.4	39.3	39.3	39.2	39.2	39.1	39.1	39.1	39.1	39.0	39.0	39.0
46	38.6	38.5	38.4	38.4	38.3	38.3	38.2	38.2	38.2	38.1	38.1	38.1	38.1
47	37.7	37.6	37.5	37.5	37.4	37.4	37.3	37.3	37.2	37.2	37.2	37.2	37.1
48	36.8	36.7	36.6	36.6	36.5	36.5	36.4	36.4	36.3	36.3	36.3	36.2	36.2
49	35.9	35.9	35.8	35.7	35.6	35.6	35.5	35.5	35.4	35.4	35.4	35.3	35.3
50	35.1	35.0	34.9	34.8	34.8	34.7	34.6	34.6	34.5	34.5	34.5	34.4	34.4
51	34.3	34.2	34.1	34.0	33.9	33.8	33.8	33.7	33.6	33.6	33.6	33.5	33.5
52	33.4	33.3	33.2	33.1	33.0	33.0	32.9	32.8	32.8	32.7	32.7	32.6	32.6
53	32.6	32.5	32.4	32.3	32.2	32.1	32.0	32.0	31.9	31.8	31.8	31.8	31.7
54	31.8	31.7	31.6	31.5	31.4	31.3	31.2	31.1	31.0	31.0	30.9	30.9	30.8
55	31.1	30.9	30.8	30.6	30.5	30.4	30.3	30.3	30.2	30.1	30.1	30.0	30.0
56	30.3	30.1	30.0	29.8	29.7	29.6	29.5	29.4	29.3	29.3	29.2	29.2	29.1
57	29.5	29.4	29.2	29.1	28.9	28.8	28.7	28.6	28.5	28.4	28.4	28.3	28.3
58	28.8	28.6	28.4	28.3	28.1	28.0	27.9	27.8	27.7	27.6	27.5	27.5	27.4
59	28.1	27.9	27.7	27.5	27.4	27.2	27.1	27.0	26.9	26.8	26.7	26.6	26.6
60		27.2	27.0	26.8	26.6	26.5	26.3	26.2	26.1	26.0	25.9	25.8	25.8
61			26.3	26.1	25.9	25.7	25.6	25.4	25.3	25.2	25.1	25.0	24.9
62				25.4	25.2	25.0	24.8	24.7	24.6	24.4	24.3	24.2	24.1
63					24.5	24.3	24.1	23.9	23.8	23.7	23.6	23.4	23.4
64						23.6	23.4	23.2	23.1	22.9	22.8	22.7	22.6
65							22.7	22.5	22.4	22.2	22.1	21.9	21.8
66								21.8	21.7	21.5	21.3	21.2	21.1
67									21.0	20.8	20.6	20.5	20.4
68										20.1	20.0	19.8	19.7
69											19.3	19.1	19.0
70												18.5	18.3
71													17.7

JOINT AND LAST SURVIVOR TABLE (continued)

Age of Spouse	Age of Participant												
	83	84	85	86	87	88	89	90	91	92	93	94	95
35	48.5	48.5	48.5	48.5	48.5	48.5	48.5	48.5	48.5	48.5	48.5	48.5	48.5
36	47.6	47.6	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5	47.5
37	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.6	46.5
38	45.6	45.6	45.6	45.6	45.6	45.6	45.6	45.6	45.6	45.6	45.6	45.6	45.6
39	44.7	44.7	44.7	44.6	44.6	44.6	44.6	44.6	44.6	44.6	44.6	44.6	44.6
40	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.7	43.6
41	42.8	42.7	42.7	42.7	42.7	42.7	42.7	42.7	42.7	42.7	42.7	42.7	42.7
42	41.8	41.8	41.8	41.8	41.8	41.8	41.7	41.7	41.7	41.7	41.7	41.7	41.7
43	40.9	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8
44	39.9	39.9	39.9	39.9	39.9	39.9	39.8	39.8	39.8	39.8	39.8	39.8	39.8
45	39.0	39.0	38.9	38.9	38.9	38.9	38.9	38.9	38.9	38.9	38.9	38.9	38.9
46	38.0	38.0	38.0	38.0	38.0	38.0	38.0	38.0	37.9	37.9	37.9	37.9	37.9
47	37.1	37.1	37.1	37.1	37.0	37.0	37.0	37.0	37.0	37.0	37.0	37.0	37.0
48	36.2	36.2	36.2	36.1	36.1	36.1	36.1	36.1	36.1	36.1	36.1	36.1	36.1
49	35.3	35.3	35.2	35.2	35.2	35.2	35.2	35.2	35.2	35.1	35.1	35.1	35.1
50	34.4	34.3	34.3	34.3	34.3	34.3	34.3	34.2	34.2	34.2	34.2	34.2	34.2
51	33.5	33.4	33.4	33.4	33.4	33.4	33.3	33.3	33.3	33.3	33.3	33.3	33.3
52	32.6	32.5	32.5	32.5	32.5	32.5	32.4	32.4	32.4	32.4	32.4	32.4	32.4
53	31.7	31.7	31.6	31.6	31.6	31.6	31.5	31.5	31.5	31.5	31.5	31.5	31.5
54	30.8	30.8	30.7	30.7	30.7	30.7	30.7	30.6	30.6	30.6	30.6	30.6	30.6
55	29.9	29.9	29.9	29.8	29.8	29.8	29.8	29.8	29.7	29.7	29.7	29.7	29.7
56	29.1	29.0	29.0	29.0	28.9	28.9	28.9	28.9	28.9	28.8	28.8	28.8	28.8
57	28.2	28.2	28.1	28.1	28.1	28.0	28.0	28.0	28.0	28.0	28.0	27.9	27.9
58	27.4	27.3	27.3	27.2	27.2	27.2	27.2	27.1	27.1	27.1	27.1	27.1	27.1
59	26.5	26.5	26.4	26.4	26.4	26.3	26.3	26.3	26.3	26.2	26.2	26.2	26.2
60	25.7	25.6	25.6	25.5	25.5	25.5	25.4	25.4	25.4	25.4	25.4	25.3	25.3
61	24.9	24.8	24.8	24.7	24.7	24.6	24.6	24.6	24.5	24.5	24.5	24.5	24.5
62	24.1	24.0	23.9	23.9	23.8	23.8	23.8	23.7	23.7	23.7	23.7	23.6	23.6
63	23.3	23.2	23.1	23.1	23.0	23.0	22.9	22.9	22.9	22.9	22.8	22.8	22.8
64	22.5	22.4	22.3	22.3	22.2	22.2	22.1	22.1	22.1	22.0	22.0	22.0	22.0
65	21.7	21.6	21.6	21.5	21.4	21.4	21.3	21.3	21.3	21.2	21.2	21.2	21.1
66	21.0	20.9	20.8	20.7	20.7	20.6	20.5	20.5	20.5	20.4	20.4	20.4	20.3
67	20.2	20.1	20.1	20.0	19.9	19.8	19.8	19.7	19.7	19.6	19.6	19.6	19.6
68	19.5	19.4	19.3	19.2	19.2	19.1	19.0	19.0	18.9	18.9	18.8	18.8	18.8
69	18.8	18.7	18.6	18.5	18.4	18.3	18.3	18.2	18.2	18.1	18.1	18.0	18.0
70	18.2	18.0	17.9	17.8	17.7	17.6	17.6	17.5	17.4	17.4	17.3	17.3	17.3
71	17.5	17.4	17.3	17.1	17.0	16.9	16.9	16.8	16.7	16.7	16.6	16.6	16.5
72	16.9	16.7	16.6	16.5	16.4	16.3	16.2	16.1	16.0	16.0	15.9	15.9	15.8
73		16.1	16.0	15.8	15.7	15.6	15.5	15.4	15.4	15.3	15.2	15.2	15.1
74			15.4	15.2	15.1	15.0	14.9	14.8	14.7	14.6	14.6	14.5	14.5
75				14.6	14.5	14.4	14.3	14.2	14.1	14.0	13.9	13.9	13.8
76					13.9	13.8	13.7	13.6	13.5	13.4	13.3	13.2	13.2
77						13.2	13.1	13.0	12.9	12.8	12.7	12.6	12.6
78							12.6	12.4	12.3	12.2	12.1	12.0	12.0
79								11.9	11.8	11.7	11.6	11.5	11.4
80									11.3	11.2	11.1	11.0	10.9
81										10.7	10.6	10.5	10.4
82											10.1	10.0	9.9
83												9.5	9.4
84													9.0

SINGLE LIFE TABLE
Treas. Reg. § 1.401(a)(9)-9, A-1

Table For Determining Applicable Divisor For Designated Beneficiary*

Age	Divisor	Age	Divisor	Age	Divisor
5	77.7	42	41.7	79	10.8
6	76.7	43	40.7	80	10.2
7	75.8	44	39.8	81	9.7
8	74.8	45	38.8	82	9.1
9	73.8	46	37.9	83	8.6
10	72.8	47	37.0	84	8.1
11	71.8	48	36.0	85	7.6
12	70.8	49	35.1	86	7.1
13	69.9	50	34.2	87	6.7
14	68.9	51	33.3	88	6.3
15	67.9	52	32.3	89	5.9
16	66.9	53	31.4	90	5.5
17	66.0	54	30.5	91	5.2
18	65.0	55	29.6	92	4.9
19	64.0	56	28.7	93	4.6
20	63.0	57	27.9	94	4.3
21	62.1	58	27.0	95	4.1
22	61.1	59	26.1	96	3.8
23	60.1	60	25.2	97	3.6
24	59.1	61	24.4	98	3.4
25	58.2	62	23.5	99	3.1
26	57.2	63	22.7	100	2.9
27	56.2	64	21.8	101	2.7
28	55.3	65	21.0	102	2.5
29	54.3	66	20.2	103	2.3
30	53.3	67	19.4	104	2.1
31	52.4	68	18.6	105	1.9
32	51.4	69	17.8	106	1.7
33	50.4	70	17.0	107	1.5
34	49.4	71	16.3	108	1.4
35	48.5	72	15.5	109	1.2
36	47.5	73	14.8	110	1.1
37	46.5	74	14.1	111+	1.0
38	45.6	75	13.4		
39	44.6	76	12.7		
40	43.6	77	12.1		
41	42.7	78	11.4		

*If participant's spouse is sole beneficiary, use table to obtain divisor for spouse's age each year. Otherwise, use table to obtain divisor for age of (oldest) beneficiary as of birthday in year following participant's death, reduced by one each year thereafter.

TRANSITIONAL CASE EXAMPLE: "IRMA JEAN'S DILEMMA"

Facts:

1. Brother-in-law, "C", was the Participant of an IRA rollover.
2. At C's required beginning date ("RBD") in 1990, the beneficiary designation for C's IRA was worded as follows: C's spouse as primary beneficiary; C's Estate as contingent beneficiary.
3. C's spouse was living on C's RBD; therefore, C had a designated beneficiary ("DB") as of his RBD.
4. At RBD, C irrevocably elected to take minimum required distributions ("MRDs") based on the joint life expectancy of C and C's spouse, not recalculating either life expectancy (this was one of the options available under the prior MRD Rules). Under that option, the Participant obtained the divisor from the Joint Life Table then in effect for the joint life expectancy of the Participant and the Participant's spouse in the first distribution year, and then reduced the divisor by one in each subsequent year to calculate the MRD for the year in question. C was 70 and C's spouse was 67 in 1990.
5. C's spouse died in 1996. This had no effect on the calculation of MRDs to C because C had elected joint life, <u>not</u> recalculating. Thus, under the "at least as rapidly" rule, C continued to take MRDs based on the *joint* life expectancy of C and C's spouse, not recalculated.
6. C died in 1998.
7. Because C's spouse predeceased him, the remaining amount in C's IRA passed to the contingent beneficiary named in the beneficiary designation, "C's Estate".
8. Irma Jean turned out to be the sole beneficiary of C's Estate under his Will (Irma Jean, who was C's spouse's sister, was the sole named contingent beneficiary of C's Estate in his Will).
9. Under the old rules, Irma Jean could continue taking MRDs from C's IRA using the same distribution period begun by C at RBD (i.e., joint life expectancy of C and C's spouse, not recalculating) per the at least as rapidly rule.
10. Irma Jean took MRDs from C's IRA (the inherited IRA) in 1999 and 2000 based on the remaining joint life expectancy of C and C's spouse, not recalculated.
11. In January 2001, new proposed regulations regarding distributions from qualified plans and IRAs were released. Those regulations allowed IRA "owners" to calculate 2001 MRDs using either the original proposed regulations or the new proposed regulations.
12. Irma Jean took MRDs in 2001 based on the old proposed regulations (i.e., she continued taking MRDs over the remaining joint life expectancy of C and C's spouse, not recalculated).
13. Final regulations were released in April 2002. Those regulations allowed IRA "owners" to use the original proposed regulations, the 2001 proposed regulations or the final regulations to calculate MRDs for year 2002.
14. Irma Jean took her 2002 MRD from C's IRA based on the remaining joint life expectancy of C and C's spouse, not recalculated, per the original regulations' at least as rapidly rule.
15. The final regulations provide various transitional rules. The rule that appears to apply to Irma Jean's case is as follows:

    > The distribution rules of this section and §§ 1.401(a)(9)-2 through 1.401(a)(9)-9 apply to account balances and benefits held for the benefit of a beneficiary for calendar years beginning on or after January 1, 2003, even if the employee died prior to January 1, 2003. Thus, in the case of an employee who died prior to January 1, 2003, the designated beneficiary must be redetermined in accordance with the provisions of § 1.401(a)(9)-4 and the applicable distribution period (determined under § 1.401(a)(9)-5 or 1.401(a)(9)-6T, whichever is applicable) must be reconstructed for purposes of determining the amount required to be distributed for calendar years beginning on or after January 1, 2003.
    > *Treas. Reg. § 1.401(a)(9)-a, A-2(b).*

Issue: How should Irma Jean calculate the MRD from C's IRA for calendar year 2003?

Analysis:

1. Under the final regulations, the DB is no longer determined at the Participant's ("P") RBD but on September 30 of the year following the year of P's death.
2. Under the final regulations, an "Estate" can never qualify as a DB and there is no way to fix the naming of an estate as a beneficiary after P's death to avoid the "no designated beneficiary" rule (except in certain limited cases involving surviving spouses with special facts).
3. Under the final regulations, if there is no DB on the DB determination date, where P has died *after* reaching RBD, MRDs to the resulting (actual) beneficiary are paid over P's remaining single life expectancy, not recalculated. Thus, if this rule applies to Irma Jean in 2003, she must go to the Single Life Table, look up the divisor for C's age as of his birthday in the year of his death, subtract the number one for each year that has passed since the year of C's death until she gets to the distribution year in question, and use that factor for calculating her MRD. Although the divisors reflected in the Single Life and Joint Life Tables have been updated to reflect current mortality assumptions (longer life expectancies have resulted in larger divisors, which produce lower MRDs), this method still results in the worst case for Irma Jean.
4. On the other hand, C was deemed to have had a DB based on the DB requirements under the old regulations at the relevant time (C's RBD). Irma Jean would like to take the position that she is C's DB now because, under the old rules, C's spouse was treated as his DB as of his RBD and, therefore, Irma Jean should be able to be treated as C's DB (even though the final regulations do not allow the beneficiary of an "estate", where the estate is named as P's beneficiary, to qualify as a DB) and, therefore, claim DB treatment for calculating MRDs from C's IRA in 2003 (a bootstrap argument). Under the final regulations, if P has a DB who is someone other than his surviving spouse, that DB can use his/her own life expectancy, not recalculated, to calculate MRDs from the inherited IRA. Under this scenario, Irma Jean would go to the Single Life Table to obtain the divisor for her single life expectancy based on her age as of her birthday in the first distribution year (Irma Jean was 71 in 1999), and then subtract one for each subsequent year to determine the divisor for 2003. If Irma Jean decides to take this position, could she use the new Single Life Table instead of the old Single Life Table? Note that the first distribution year under this method is the year after C's death (1999). This position produces the best result for Irma Jean but would probably be considered fairly aggressive in view of the wording in the final regulations (although it is certainly not clear how to "reconstruct" the facts in transitional cases).
5. A third scenario would be for Irma Jean to continue taking MRDs under the old rules (although those rules no longer seem to be authorized), using the remaining joint life expectancy of C and C's spouse, not recalculated. If Irma Jean takes this position, can she obtain a new divisor for the joint life expectancy of C and C's spouse using the new updated Joint Life Table in order to calculate her MRD for 2003 (i.e., go back and obtain the divisor for the joint life expectancy of C and C's spouse in the first distribution year and subtract one for each subsequent year)? Probably not since this distribution method does not even exist under the new rules.

Here is a chart showing the three different factors Irma Jean could conceivably use to calculate her 2003 MRD from the IRA that she inherited from C.

Factors to Use to Calculate Irma Jean's 2003 MRD from Inherited IRA

FACTOR/PERCENTAGE USING OLD TABLES			**FACTOR/PERCENTAGE USING NEW TABLES**		
C's remaining single life expectancy, not recalculated	Irma Jean's single life expectancy, not recalculated	Joint Life Expectancy of C and C's spouse, not recalculated	C's remaining single life expectancy, not recalculated	Irma Jean's single life expectancy, not recalculated	Joint Life Expectancy of C and C's spouse, not recalculated
N/A	N/A	9.0 11.111%	5.6 17.857%	11.3 8.850%	N/A

Which one is correct?

BENEFICIARY DESIGNATION
FOR RETIREMENT PLANS
AND IRAs OF BILLY SIMPLE

[Typical Beneficiary Designation for Married Participant]

(a) Primary Beneficiary: All to my wife, Nancy Simple.

(b) Contingent Beneficiary: If my wife does not survive me, to the Trustee(s) named in my Last Will [**or,** named in Last Will of Billy Simple].[1]

[1]If wife fails to survive, this wording will preclude separate account treatment for shares passing to beneficiaries named in Will – *see* I.B.6. in outline. If contingent beneficiaries are all competent adults, consider spelling out division among beneficiaries in beneficiary designation form, to allow for separate account treatment.

BENEFICIARY DESIGNATION FOR RETIREMENT PLANS AND IRAs OF JOSEPH WORTHY

[Common alternative to Typical Designation]

(a) Primary Beneficiary: All to my wife, Sarah Worthy.

(b) Contingent Beneficiary: If my wife does not survive me, in equal shares to my children,[1] ________[names]_______; however, if a child fails to survive me but leaves one or more descendants who survive me, that child's share shall be paid per stirpes to that child's descendants, subject to the contingent trust created in my Last Will for any descendant under age _____.[2]

Alternative wording for (b):

(b) Contingent Beneficiary: If my wife does not survive me, in equal shares to my children who survive me; however, if any child who fails to survive me leaves one or more descendants who survive me, the share that child would have received (if he or she had survived) shall be distributed per stirpes to his or her descendants who survive me; provided that, any distribution to be made to an individual who has not yet attained the age of twenty-one years shall not be distributed to that individual outright, but instead shall be distributed to the personal representative of my estate ("my Executor"), as Custodian for that individual under the Texas Uniform Transfers to Minors Act (TUTMA).[3] If my Executor fails or ceases to serve as Custodian, one shall be appointed by my Executor.

[1]If wife fails to survive, this wording should allow separate account treatment for children if creation of separate accounts after death is done correctly and timely – *see* I.B.6. in outline.

[2]If wife fails to survive and a child also fails to survive, leaving children who will take his/her share, the typical contingent trust for a young person (i.e., usually an "accumulation" trust and not a "conduit" trust) will have participant's other children as potential remainder beneficiaries so that grandchild's life expectancy cannot be used to determine MRDs to his trust – *see* I.B.6. in outline.

[3]Since a TUTMA account is "indefeasibly vested in the minor" (Texas Property Code § 114.012 (b)), the minor child should qualify as a designated beneficiary.

**BENEFICIARY DESIGNATION
FOR RETIREMENT PLANS
AND IRAs OF JOHN HARDY**

[Disclaimer Option in Beneficiary Designation]

(a) Primary Beneficiary: All to my wife, Susan Hardy, if she survives me; provided that, if my wife disclaims all or any portion of my interest in the proceeds passing to her, the disclaimed proceeds shall be paid to the Trustee(s) of the Disclaimer [Bypass] Trust created in my Last Will.[1]

(b) Contingent Beneficiary: If my wife does not survive me, to the Trustee(s) named in my Last Will.[2]

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[1]If wife survives and disclaims, because disclaimed amount is directed to a specific trust per beneficiary designation, amount passing to wife and to trust can be treated as separate shares (note, however, that unless Bypass Trust is a conduit trust, wife's life expectancy, not recalculated, will be used for calculating MRDs to Bypass Trust (assuming trust qualifies for look-through treatment) because wife will (usually) be oldest beneficiary of trust. Undisclaimed retirement plan benefits can be placed in an "inherited IRA" for wife or can be rolled over by wife to spousal IRA rollover, making spouse the (new) participant as to the IRA rollover and allowing her to use the Uniform Lifetime Table (with MRDs based on her life expectancy, recalculated, plus 10 years).

[2]This wording will preclude separate account treatment for contingent beneficiaries – *see* I.B.6. in outline.

BENEFICIARY DESIGNATION
FOR RETIREMENT PLANS
AND IRAs OF DOCTOR PROCTER

[Split Between Spouse & QTIP Trust]

(a) Primary Beneficiary: Pay that amount representing my wife's community property interest in the plan/account [**or,** pay one-half (½) of the proceeds] to my wife, Caroline Procter, and pay that amount representing my community property interest in the plan/account [**or,** pay one-half (½) of the proceeds] to the Trustee of the QTIP Trust created in my Last Will.[1]

(b) Contingent Beneficiary: If my wife does not survive me, to the Trustee(s) named in my Last Will.

[1]This beneficiary designation assumes that the participant has waived and the spouse has consented to the waiver of REA benefits, if applicable, in a legally effective manner.

BENEFICIARY DESIGNATION FOR RETIREMENT PLANS AND IRAs OF I. M. SINGLE

All to my children who survive me, in equal shares. However, if any child who fails to survive me leaves one or more descendants who survive me, the share that child would have received (if he or she had survived) shall be distributed per stirpes to his or her descendants who survive me; provided that, any distribution to be made to an individual who has not yet attained the age of twenty-one years shall not be distributed to that individual outright, but instead shall be distributed to the personal representative of my estate ("my Executor"), as Custodian for that individual under the Texas Uniform Transfers to Minors Act (TUTMA). If my Executor fails or ceases to serve as Custodian, one shall be appointed by my Executor.[1]

[1] Separate account treatment should be fully available to all resulting beneficiaries.

BENEFICIARY DESIGNATION FOR RETIREMENT PLANS AND IRAs OF I. M. BLEST

(a) All of such proceeds shall be paid as follows:

(1) Twenty-five percent (25%) of the proceeds shall be paid to the trust created for the primary benefit of Aaron B. Blest under Participant's Will, if Aaron B. Blest survives Participant; provided that, if he predeceases Participant but leaves one or more descendants who survive Participant, the share of such proceeds that the trust for Aaron B. Blest would have received (if Aaron B. Blest had survived) shall be distributed per stirpes to the trusts created under Participant's Will for the descendants of Aaron B. Blest who survive Participant.

(2) Twenty-five percent (25%) of the proceeds shall be paid to the trust created for the primary benefit of Carl D. Blest under Participant's Will, if Carl D. Blest survives Participant; provided that, if he predeceases Participant but leaves one or more descendants who survive Participant, the share of such proceeds that the trust for Carl D. Blest would have received (if Carl D. Blest had survived) shall be distributed per stirpes to the trusts created under Participant's Will for the descendants of Carl D. Blest who survive Participant.

(3) Twenty-five percent (25%) of the proceeds shall be paid to the trust created for the primary benefit of Elliott F. Blest under Participant's Will, if Elliott F. Blest survives Participant; provided that, if he predeceases Participant but leaves one or more descendants who survive Participant, the share of such proceeds that the trust for Elliott F. Blest would have received (if Elliott F. Blest had survived) shall be distributed per stirpes to the trusts created under Participant's Will for the descendants of Elliott F. Blest who survive Participant.

(4) Twenty-five percent (25%) of the proceeds shall be paid to the trust created for the primary benefit of Gayle S. Blest Doubly under Participant's Will, if Gayle S. Blest Doubly survives Participant; provided that, if she predeceases Participant but leaves one or more descendants who survive Participant, the share of such proceeds that the trust for Gayle S. Blest Doubly would have received (if Gayle S. Blest Doubly had survived) shall be distributed per stirpes to the trusts created under Participant's Will for the descendants of Gayle S. Blest Doubly who survive Participant.

(b) If there is no trust that is entitled to an interest in the proceeds to be paid under one or more of the numbered subparagraphs in paragraph (a), then the proceeds which would otherwise have been paid under that subparagraph shall be paid to the other trusts that are entitled to receive a portion of the proceeds passing under the other subparagraphs in the foregoing paragraph (a), each such trust receiving such portion of such proceeds as the interest which such trust is entitled to receive under the foregoing paragraph (a) bears to the total of the interests of all such trusts that are entitled to receive proceeds under the foregoing paragraph (a) [**NOTE:** this redistribution wording, while somewhat awkward, should work even if the percentages are unequal].

NOTE: Separation of shares into separate trusts is occurring in the beneficiary designation (and not Participant's Will), making separate account treatment at least theoretically possible (but remember issue of remainder beneficiaries of accumulation trusts being taken into account for determining designated beneficiary – the wording in the Will regarding the type of trust [conduit vs. accumulation] and the potential beneficiaries of each trust will be determinative) – see I.B.6. in outline.

BENEFICIARY DESIGNATION FOR RETIREMENT PLANS AND IRAs OF N. SECOND MARRIAGE

If my wife, Happy Marriage ("my wife"), survives me, two-thirds (2/3) shall be distributed to the Trustee(s) named in my Will to be administered as provided in Article 4 (providing for a Marital Trust for my wife during her lifetime), and one-third shall be distributed to my children who survive me, in equal shares.

If my wife does not survive me, one hundred percent shall be distributed to my children who survive me, in equal shares.

However, whether or not my wife survives me, if any child of mine who fails to survive me leaves one or more descendants who survive me, the share that child would have received (if he or she had survived) shall be distributed per stirpes to his or her descendants who survive me; provided that, any distribution to be made to an individual who has not yet attained the age of twenty-one years shall not be distributed to that individual outright, but instead shall be distributed to the personal representative of my estate ("my Executor"), as Custodian for that individual under the Texas Uniform Transfers to Minors Act (TUTMA). If my Executor fails or ceases to serve as Custodian, one shall be appointed by my Executor.

BENEFICIARY DESIGNATION FOR
IRAs AND IRA ROLLOVERS ("IRAs") IN THE NAME OF
N.O.T. HAPPY ("PARTICIPANT")

The beneficiaries of all of such IRAs are as follows:

(1) If Participant's wife, Vera Happy ("Vera"), survives Participant, allocate all of such proceeds to the then acting Trustee(s) of the Marital Trust created in Participant's Will for the lifetime benefit of Vera.

(2) If Vera fails to survive Participant, allocate all of such proceeds as follows:

(A) Fifty percent (50%) of such IRAs shall be allocated to the then acting Trustee(s) of the Descendant's Trust created for the primary benefit of Jane Happy ("Jane") under Participant's Will, if Jane survives Participant; provided that, if Jane fails to survive Participant but leaves one or more descendants who survive Participant, the share of such proceeds that would have been allocated to the trust for Jane (if Jane had survived) shall instead be allocated in per stirpes shares to the then acting Trustee(s) of the Descendant's Trusts created in Participant's Will for the descendants of Jane who survive Participant; provided further that, if neither Jane nor any descendant of Jane survives Participant, such proceeds shall instead be allocated to the individuals or trusts designated in Section 9.16 of Participant's Will who are to receive Jane's (and her descendants', by right of representation) share in such event.

(B) Fifty percent (50%) of such IRAs shall be allocated to the then acting Trustee(s) of the Descendant's Trust created for the primary benefit of Dick Happy ("Dick") under Participant's Will, if Dick survives Participant; provided that, if Dick fails to survive Participant but leaves one or more descendants who survive Participant, the share of such proceeds that would have been allocated to the trust for Dick (if Dick had survived) shall instead be allocated in per stirpes shares to the then acting Trustee(s) of the Descendant's Trusts created in Participant's Will for the descendants of Dick who survive Participant; provided further that, if neither Dick nor any descendant of Dick survives Participant, such proceeds shall instead be allocated to the individuals or trusts designated in Section 9.16 of Participant's Will who are to receive Dick's (and his descendants', by right of representation) share in such event.

If there is more than one designated beneficiary of Participant's IRAs, then it is Participant's desire that, as of the date required by the final Treasury Regulations, a separate account shall be established and maintained for each beneficiary, bearing its own pro rata share of gains and losses and otherwise separately accounted for to comply with such Regulations.

SCHEDULE A

BENEFICIARY DESIGNATION FOR INDIVIDUAL RETIREMENT ACCOUNTS ("IRAs") IN THE NAME OF PATRICIA ANN BROOKS ("PARTICIPANT")

(A) Per Stirpes Distribution to Participant's Descendants. If any child or other descendant of Participant survives Participant, distribute all of such IRAs in equal shares to the children of Participant who survive Participant[1]; provided that, if any child of Participant fails to survive Participant but leaves one or more descendants who survive Participant, the share that would have been distributed to that deceased child (had he or she survived) shall instead be distributed per stirpes to his or her descendants who survive Participant; provided further that, the preceding distributions are subject to the provisions of Paragraph 2.5 of Participant's Will (providing for Contingent Trusts for Participant's grandchildren and more remote descendants who are under age twenty-five at the time of Participant's death). Participant's children, and their social security numbers, are:

1. Christopher Brooks; social security number ________________________.
2. Michelle Brooks; social security number ___________________________.
3. Leslie Brooks; social security number ______________________________.
4. Nicole Brooks; social security number ___________________________.
5. Patrick Brooks; social security number ____________________________.

(B) Contingent Distribution if No Descendant Survives Participant. If no descendant of Participant survives Participant, then distribute all of such IRAs to the Trustee(s) named in Participant's Will.

[1] Each child who survives Participant should be able to use his/her own life expectancy for calculating MRDs from his/her share if separate accounts are timely and correctly established after Participant's death.

BENEFICIARY DESIGNATION CONSIDERATIONS

1. The Participant's "Estate" (or "the Executor named in Participant's Will") should *almost never* be named as the beneficiary of the Participant's retirement plans/IRAs.

2. If the Participant is married and he is not going to name his spouse as the primary beneficiary of his defined contribution plan or IRA plans (or is going to waive the QJSA for his defined benefit plan), the spouse must consent to the naming of the non spousal beneficiary (or waiver of the QJSA). Remember that a waiver of the required spousal benefits for qualified plans made in a prenuptial agreement by a person prior to marriage is not sufficient – such a waiver must be ratified by the spouse after the wedding in order to be valid.

3. Be careful when naming multiple beneficiaries of a retirement plan/IRA if any charities (or other non human beings) are among the multiple beneficiaries: in order to establish separate accounts for the individual beneficiaries, the charities must be "cashed out" in a timely manner and the individuals must timely and correctly establish separate accounts.

4. Issues regarding naming trusts as beneficiaries of retirement plans/IRAs:

   Question 1: Are the retirement benefits significant enough in size to justify the complexity and the tradeoffs (such as the less favorable distribution method)?

   Question 2: Does the Participant already have sufficient other assets to fully fund a bypass trust? If not, would underfunding the bypass trust actually result in any (or much) estate tax exposure on the second spouse's death?

   Question 3: Would use of conduit trusts be compatible with the participant's estate planning goals (conduit trusts easily qualify for designated beneficiary treatment under the minimum distribution rules and may be an appropriate form of trust in certain circumstances).

5. Issues regarding separate accounts:

   Question 1: Is it possible to indicate the division of the benefits among multiple beneficiaries in the beneficiary designation form? (Such a division in the beneficiary designation preserves the ability to achieve separate account treatment after death; although, in some cases, even if trusts are provided with separate shares in the beneficiary designation form, separate account treatment may not in fact be possible because remainder beneficiaries of accumulation trusts must be taken into account in determining the DB [unless the trust is drafted to provide otherwise]).

   Question 2: How crucial is it that the participant's beneficiaries receive separate account treatment? If all of the beneficiaries are of a similar age, it may not be that important.

6. Beneficiary Designation Problems when naming a Trustee as the Beneficiary:

   a. Plan administrators and IRA custodians/trustees frequently want participants to name a "Trust" (and not a "Trustee") in the beneficiary designation form (others will not accept a beneficiary designation naming a "Trust"). This is not a problem if the Participant's estate plan is set out in a Living Trust Agreement – in fact that advantage may be one of the reasons for selecting the Living Trust format over a Will as the participant's estate planning vehicle. Even though new trusts will be created upon the participant/Living Trust grantor's death, plan administrators and IRA custodians routinely accept a beneficiary designation: "To the then acting Trustee(s) of the Robert Smith Living Trust under trust agreement dated May 8, 2000, as amended". In the case of a Will, however, near fanatic resistance seems to be encountered when trying to get a plan administrator or IRA custodian to accept "The

Trustee named in Participant's Will" as the beneficiary. One way to finesse this is to provide for a special name for all trusts in the Will that could receive retirement plan benefits and then to use that name in the allocation paragraph contained in the Will (i.e., in the paragraph that instructs the Trustee regarding the distribution of the retirement plan benefits "passing to" the Trustee among the beneficiaries in the Will, including various trusts). Then the "Trustee of the [Special Name] Trust created in Participant's Will" can be listed as the beneficiary. This possible solution is also beneficial if the plan administrator/IRA custodian asks the participant to specify *the* section in the Will that creates "the Trust".

b. Some plan administrators and IRA custodians/trustees do not like "generic" trustee designations (for example: "To *the Trustee* named in Participant's Will"). They want the name, address and phone number of the Trustee (and the tax identification number of the trust). Obviously, this requirement is silly when naming a trustee who will only begin serving as trustee of trusts that are created upon the participant's death. The participant's death will occur some time in the future, and the person(s) who are currently named in the Will or Living Trust Agreement to serve as trustee may not in fact turn out to be "the Trustee" at that time. This plan administrator/IRA custodian requirement can usually be "finessed" by switching from a "generic" trustee designation to a "specific" trustee designation, such as "To John Jones, Trustee under the Will of [Participant's name] (or his successor)." The parenthetical is necessary if the specific trustee wording is used because, even though John Jones is currently the first named trustee in the Participant's Will, he may not, in fact, turn out to be the trustee at the time of the participant's death.

IRA CONTRIBUTION RULES

Tax Year	Contribution Limit if Under Age 50	Contribution Limit if Age 50 or Older
2004	$3,000	$3,500
2005	$4,000	$4,500
2006	$4,000	$5,000
2007	$4,000	$5,000
2008 and after	$5,000	$6,000

1. Contributions to both traditional IRAs and Roth IRAs can be made by the taxpayer for a particular year at any time during that year or by the due date (not including extensions) for filing the year's tax return (April 15 for a calendar year taxpayer). If an amount is contributed between January 1 and April 15, the IRA custodian must be informed as to which year (current or previous) the contribution is made.

2. Contributions to both traditional IRAs and Roth IRAs can only be made to the extent the taxpayer has compensation for the year. Compensation for this purpose includes amounts the taxpayer receives from his/her employer and also self-employment income and alimony income. If the taxpayer has no compensation income but is married to another taxpayer who does and joint tax returns are filed, then the taxpayer without compensation may contribute to an IRA based on the spouse's compensation.

3. Contributions to traditional IRAs may be deductible or not, depending on whether the taxpayer (or his/her spouse) is covered by a qualified retirement plan sponsored by his/her employer. Contributions to Roth IRAs are made on an after-tax basis (i.e., they are never deductible).

4. The amount that can be contributed to a Roth IRA is reduced by contributions made to a traditional IRA (excluding rollovers), an SEP IRA, and a "501(c)(18) plan", but not by contributions to a 401(k) plan or 403(b) plan (which are technically considered to be made by the employer).

5. Except for rollover IRAs and Roth conversions, contributions to IRAs must be made in cash.

6. There is no age limit on making a contribution to a Roth IRA. The ability to make contributions to traditional IRAs ceases in the year the taxpayer turns 70 ½.

7. For tax years beginning in a calendar year after 2008, the contribution limits shown for 2008 will be increased to reflect a cost of living adjustment (COLA). The COLA is determined under the rules of Code Section 1(f)(3), but substituting 2007 for 1992 as the base year from which the increase in the consumer price index is measured. If any amount so determined is not a multiple of $500, the amount is rounded to the next lower multiple of $500.

ROTH IRA CONTRIBUTION PHASEOUT

Filing Status	**Modified AGI***	
	phaseout begins	no deduction
married filing jointly	$150,000	$160,000
married filing separately and taxpayer lived with spouse during the year	$0	$10,000
anything other than above two	$95,000	$110,000

If the taxpayer's modified AGI is above the limits shown above, no contribution can be made to a Roth IRA (although nondeductible contributions to a traditional IRA may still be made).

If the taxpayer's AGI is between the ranges provided, the contribution amount is reduced proportionately. For example, if the taxpayer is married and files jointly and his modified AGI is $155,000 (half way between $150,000 and $160,000), the contribution limit is reduced by ½, so that the maximum contribution to a Roth IRA would be $1,500 (½ of $3,000).

There are 2 special rules relating to the phaseout calculation. (1) If the proportionate amount does not work out to an even $10 increment, it's rounded to the next higher $10 increment. For example, if the math produces a contribution amount of $1,473.50, this rule adjusts the amount to $1,480. (2) The contribution limit never goes below $200–as long as the modified AGI does not exceed the limit noted above, the minimum contribution is $200, even if the math produces an amount less than $200 (for example, $46).

*<u>Modified Adjusted AGI</u> for Roth contribution phaseout purposes is calculated by starting with adjusted gross income and then adding back the following items:
(i) income excluded because of the foreign earned income exclusion;
(ii) any exclusion or deduction for foreign housing;
(iii) interest income from series EE bonds that was excluded due to paying qualified higher education expenses;
(iv) any deduction claimed for student loan interest or qualified tuition and related expenses;
(v) any employer-paid adoption expenses; and
(vi) any deduction claimed for an annual (non-rollover) contribution to a traditional IRA.

Another important adjustment that is made to determine modified AGI for purposes of the Roth IRA contribution phaseout is that income reportable due to converting a traditional IRA to a Roth IRA is excluded.

A 6% excise tax applies to excess contributions made to a Roth IRA; however, any amount withdrawn on or before the due date for filing the tax return for the applicable year (April 15 for calendar year taxpayers) is treated as an amount *not* contributed.

CONVERSIONS OF TRADITIONAL IRAs TO ROTH IRAs

A traditional IRA (including an IRA rollover) can be converted to a Roth IRA if certain requirements are met. There are advantages and disadvantages to conversion.

Advantages of Conversion

1. Due to the income tax payment on conversion, the resulting Roth IRA is a "better" asset for estate planning purposes–it is worth more to Estate beneficiaries than a traditional IRA of the same value and is a better choice for funding trusts (because it is not a "pre-tax" asset). The way to make the Roth IRA truly "bigger" than the traditional IRA used in the conversion is to pay the income taxes due on conversion *from sources other than the IRA*.

2. Payment of the income taxes on the conversion reduces the size of the taxpayer's estate for estate tax purposes.

3. The minimum required distribution ("MRD") rules that apply to traditional IRA owners once they reach their required beginning date (generally, April 1 of the year following the year the IRA owner reaches age 70 ½) do not apply to Roth IRAs. The MRD rules don't apply until after the Roth IRA owner's death. Thus, if funds from the IRA are not needed during retirement (perhaps due to having a pension or other source of income), the IRA owner can increase the value of what his/her beneficiaries will receive by allowing the Roth IRA to continue to grow, tax-free, after the conversion.

4. Roth IRAs are more flexible than traditional IRAs. For example, distributions can be taken from a Roth IRA before age 59 ½ without suffering the 10% early withdrawal penalty applicable to traditional IRAs. Be aware, however, that if the Roth IRA was created by conversion of a traditional IRA, a "5 year rule" must be satisfied before early withdrawals from the Roth IRA will avoid penalty.

Disadvantages to Conversion

1. Income taxes must be paid on the conversion. In general, it is usually better to pay income taxes later, rather than sooner. Further, most taxpayers are in a higher income tax bracket at the time of the conversion than they are likely to be later on, so the tax is paid at a higher rate. In addition, if money from the traditional IRA must be used to pay the conversion tax and if the taxpayer is less than 59 ½ years old at the time, a penalty will apply.

2. If the tax free nature of taking withdrawals from the Roth IRA is so appealing that it causes the taxpayer to withdraw greater amounts each year than he/she would otherwise have withdrawn from the traditional IRA, there is a risk that the taxpayer will exhaust his/her funds too soon.

3. In some states, traditional IRAs may have creditor protection while Roth IRAs may not (Roth IRAs are protected in Texas).

ELIGIBILITY AND CONVERSION RULES

1. If the taxpayer is married filing separately, the taxpayer cannot convert a traditional IRA to a Roth IRA unless he/she lived apart from his/her spouse the entire year.

2. If the taxpayer's modified AGI is greater than $100,000, he/she is not eligible to make the Roth IRA conversion. This figure applies whether the taxpayer is single or married.

3. A qualified retirement plan cannot be converted directly to a Roth IRA–it would first need to be rolled over into an IRA rollover and then that IRA rollover could be converted to a Roth IRA.

4. Only traditional IRAs and SEP IRAs can be converted to a Roth IRA. A SIMPLE IRA can be converted to a Roth IRA, but only after the taxpayer has participated in the SIMPLE IRA for at least 2 years.

5. An "inherited IRA"(an IRA inherited by anyone other than the participant's spouse) cannot be converted to a Roth IRA. A spouse who inherits an IRA from the deceased participant must first do the spousal IRA rollover and then that spousal IRA rollover can be converted to a Roth IRA.

6. Partial conversions are allowable, but a taxpayer cannot convert only the nontaxable part of his/her IRA.

7. A taxpayer can convert a traditional IRA to a Roth IRA even if the taxpayer moved his/her traditional IRA from one custodian to another within the previous 12 months (this is an exception to the rule disallowing more than one IRA "rollover" in 12 months).

8. If a taxpayer under age 59 ½ was taking substantially equal periodic payments from a traditional IRA pursuant to the exception to the 10% early withdrawal penalty in Code Section 72(t), he/she is not precluded from converting his/her traditional IRA to a Roth IRA, but he/she must continue taking the periodic withdrawals (from the new Roth IRA) pursuant to the original payment scheme until over age 59 ½ to avoid triggering the 10% penalty on conversion.

9. The 10% early withdrawal penalty (applicable to distributions from traditional IRAs taken by a taxpayer who has not yet reached age 59 ½) is not triggered merely by making the Roth conversion; however, if money in the IRA is withdrawn "too soon" (see item 10) – perhaps to pay the income tax on the conversion – the penalty will be triggered.

10. Following the conversion to a Roth IRA, a penalty applies to all withdrawals taken "within 5 years" by a taxpayer under age 59 ½. "Within 5 years", however, does not mean within 60 months–a shorter period actually applies. The penalty applies if the withdrawal occurs before the first day of the fifth taxable year following the year of the conversion.

11. The same assets held in the traditional IRA must be rolled into the Roth IRA upon conversion. This is an exception to the rule that contributions to a Roth IRA must be made in cash (only).

12. Conversion of a traditional IRA to a Roth IRA triggers ordinary income tax on the amount in the IRA, excluding nondeductible contributions. Assets other than cash in the IRA are valued at their fair market value on the conversion date.

13. A taxpayer who is over 70 ½ and already taking MRDs from his/her traditional IRA can convert to a Roth IRA; however, in the year of the conversion, he/she cannot convert the MRD for that year (in other words, the amount of that year's MRD is ineligible for the conversion).

14. For years prior to 2005, the MRD due from the traditional IRA in the year of conversion has to be counted in determining whether the taxpayer's modified AGI exceeds the $100,000 limit. Beginning in 2005 and thereafter, the MRD for that year won't have to be taken into account for determining eligibility.

15. The deadline for converting a traditional IRA to a Roth IRA is December 31 of the particular year (not April 15 of the following year).

ROTH IRA DISTRIBUTION RULES

Distributions During Roth IRA Owner's Lifetime

1. The minimum required distribution ("MRD") rules that apply to traditional IRAs (and qualified retirement plans) *do not apply* to Roth IRAs.

2. Withdrawals from Roth IRAs are deemed to occur in the following order (unless the taxpayer made excess contributions): (i) regular contributions to the Roth IRA, (ii) rollovers/conversions to the Roth IRA from a traditional IRA, and (iii) earnings.

3. Withdrawals of contributions made to the Roth IRA (excluding rollovers/conversions from traditional IRAs) may be made at any time without paying tax or penalty. This is merely a return of the investment.

4. Withdrawals of rollover/conversion amounts won't incur any income taxes (because income taxes have already been paid on the conversion); however, early withdrawal penalties could apply for withdrawals "within 5 years" if the taxpayer is under age 59 ½ at the time of the withdrawal.

5. Withdrawals of earnings in the Roth IRA are subject to income tax unless the withdrawal is a "qualified distribution".

Taxation of Earnings that are Withdrawn from Roth IRA

Qualified Distributions

Earnings that are withdrawn from a Roth IRA will be treated as "qualified distributions" and, therefore, non-taxable if two tests are satisfied: a 5 year test and a type of distribution test.

5 Year Test: The test is met if the earnings are withdrawn after the first day of the 5th year following the year that the Roth IRA was established.

Type of Distribution: Earnings withdrawn due to any of the following reasons/situations will be non-taxable, assuming the 5 Year Test has been met: (i) distributions made after the taxpayer reaches age 59 ½; (ii) distributions made to a beneficiary after the Roth IRA owner's death; (iii) distributions made on account of disability; and (iv) qualified first-time home buyer distributions.

If Not Qualified Distributions

If earnings withdrawn from a Roth IRA are not *qualified distributions*, they will be subject to tax as ordinary income in the year received. Such a withdrawal may also trigger a penalty.

Withdrawals that meet the type of distribution test are not subject to a penalty, even if taxable as ordinary income. If the withdrawals fail both tests, then **both** income taxes and a 10% penalty will be triggered.

Roth IRAs Included in Owner's Estate

Roth IRAs are included in the estate of the Roth IRA owner at their fair market value on the date of death (or on the alternate valuation date, if applicable). Community property rules apply. Thus, Roth IRAs acquired or accumulated in Texas by a married Roth IRA owner are going to be community property.

Distribution rules after Roth IRA Owner's Death

1. The 10% early distribution penalty does not apply unless the spouse is the beneficiary and the spouse elects to treat the decedent's Roth IRA as his/her own and makes withdrawals that fail the 5 Year Test.

2. Beneficiaries of inherited Roth IRAs can withdraw the earnings tax-free, even if the beneficiary is under age 59 ½ and even if the decedent was under 59 ½–but only if the 5 Year Test is first satisfied. Withdrawals of other amounts (e.g., contributions and rollover/conversion amounts) are tax-free.

3. For a beneficiary of an inherited Roth IRA other than the spouse of the deceased Roth IRA owner, MRDs must be taken based on the MRD rules applicable to traditional IRAs in the situation where the participant/IRA owner dies before reaching his/her required beginning date. Thus, beneficiaries must either commence MRDs by December 31 of the year following the year of the Roth IRA owner's death, based on the beneficiary's life expectancy, or take all amounts out of the inherited Roth IRA by December 31 of the year that contains the 5th anniversary of the Roth IRA owner's death (the "5 year rule").

4. A spouse beneficiary can elect to treat the Roth IRA as his/her own, therefore becoming the new Roth IRA owner, with all rules so applied. As an alternative, a spouse beneficiary can take MRDs over his/her lifetime, but delay commencing MRDs until the deceased Roth IRA owner would have reached age 70 ½.