Planning for Distributions from Qualified Retirement Plans and IRAs

Louis A. Mezzullo
PLANNING FOR DISTRIBUTIONS FROM
QUALIFIED RETIREMENT PLANS AND IRAs

By

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October 3, 1995

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I. GENERAL CONSIDERATIONS

A. Client's Objectives.

1. The client's objectives need to be determined with respect to the distribution of his or her benefits held in a qualified retirement plan or individual retirement account (IRA) both during lifetime and after death.

   a. The client's objectives will be restricted by the provisions in the plan that may limit the methods of payment available and the time when payments may be made.

       (1) Lump sum distributions may not be available.

       (2) Distributions before retirement may not be permitted.

       (3) The options available at retirement may be limited.

          (a) For example, the period over which the benefit may be paid in installments may be limited to ten years.

b. The client's objectives may also be restricted by I.R.C. §§ 401(a)(11) and 417 added by the Retirement Equity Act of 1984 (REA).

(1) The Code requires the client's spouse to consent to beneficiary designations that do not name him or her as the primary beneficiary of some or all of any death benefits under a qualified retirement plan and to any form of payment during the client's lifetime other than a qualified joint and survivor annuity (except for certain defined contribution plans). See I.R.C. §§ 401(a)(11) and 417.

(2) The consent must designate a beneficiary and a form of benefit that may not be changed without the spouse's consent, unless the spouse signs a general consent. Treas. Reg. § 1.401(a)-20, Q&A 31(a), (b) and (c).

(a) However, if the participant names a revocable trust as the beneficiary with the spouse's consent, the participant may change the beneficiaries of the trust without the spouse's consent. Treas. Reg. § 1.401(a)-20, Q&A 31(a).

(3) The spouse's consent must acknowledge the effect of the election and must be witnessed by a plan representative or a notary public. I.R.C. § 417(a)(2)(A)(iii).

(4) Under a general consent a spouse may expressly permit a participant to change the beneficiary designation or form of payment or both without any requirement of further consent by the spouse.

(a) A general consent is not permitted unless the plan specifically permits such a consent.

(b) A general consent must acknowledge that the spouse has the right to limit his or her consent to a specific beneficiary and a specific
optional form of benefit and that the spouse voluntarily elects to relinquish both of these rights (or, if applicable, either of these rights).

Treas. Reg. § 1.401(a)-20, Q&A 31(c).

(5) A participant’s waiver of a qualified joint and survivor annuity or qualified preretirement survivor annuity and the spouse’s consent to the waiver will be valid only if made during specific election periods.

(a) The waiver of a qualified joint and survivor annuity may be made only during the 90-day period ending on the first day of the period for which the first payment is to be made (the annuity starting date), and only after a notice explaining the qualified joint and survivor annuity has been distributed to the participant. I.R.C. §§ 417(a)(3)(A) and (6)(A).

i) Unless the participant makes an irrevocable election, the participant, with the spouse’s consent, should be able to change the form of benefit after the annuity starting date.

(b) Under the statute, a waiver of a qualified preretirement survivor annuity can be made only on or after the first day of the plan year in which the participant reaches age 35. I.R.C. § 417(a)(6)(B).

i) In the case of a participant who has not reached age 35, the regulations permit a waiver to be made, but the participant must execute a new waiver after reaching age 35. Treas. Reg. § 1.401(a)-20, Q&A 33(b).
ii) The age 35 provision does not apply to plans that are not required to provide the qualified preretirement survivor annuity and qualified joint and survivor annuity.

(a) The spouse may consent at any time to a waiver of his or her right to the death benefit, which is the participant's entire non-forfeitable accrued benefit in such a plan. Treas. Reg. § 1.401(a)-20, Q&A 33(a).

(c) The participant must be permitted to revoke his or her election during the applicable election period. I.R.C. § 417(a)(1)(A)(ii); Treas. Reg. § 1.401(a)-20, Q&A 30.

(d) The plan may require that the spouse's consent to a waiver of the qualified preretirement or joint and survivor annuity not be revocable. Treas. Reg. § 1.401(a)-20, Q&A 30.

(6) A beneficiary designation executed before August 23, 1984, naming someone other than the spouse as the primary beneficiary, whether or not the spouse consented to the designation, is not valid to deprive the spouse of his or her REA rights. Treas. Reg. § 1.401(a)-20, Q&A 43.

(7) A consent to a waiver signed before a marriage (such as in a premarital agreement) is not a valid consent according to the regulations. Treas. Reg. § 1.401(a)-20, Q&A 28.

(a) Although one state court has held that a premarital agreement may serve as a valid waiver of the spouse's REA rights, Estate of Hopkins, 574 N.E.2d 230 (Ill App 1991), cert. denied, 580 N.E.2d 115 (Ill. 1991), a number of federal

(b) A New York court, in Kartiganer v. Bloom, 599 N.Y.S.2d 188 (1993), held that a beneficiary designation signed by an unmarried participant was not nullified when the participant subsequently married, so that when the participant died the person named under the beneficiary designation rather than the spouse was entitled to the participant’s death benefits. This case is obviously contrary to REA. See Treas. Reg. § 1.401(a)-20, Q&A 25(a), which states that a deemed waiver by an unmarried participant is null and void if the participant marries.

(c) In most of these situations, the problem would have been avoided if the plan document required that, in order to be entitled to a death benefit under REA, the spouse must be married to the participant throughout the one-year period ending on the date of the participant’s death. See I.R.C. § 417(d), which permits a plan to contain such a requirement.

(d) In an unpublished case, Callahan v. Hutsell, et al., 1993 U.S. App. Lexis 34005 (6th Cir. 1993), remanding 813 F. Supp. 541 (WDKY 1992), the Court of Appeals indicated that a premarital agreement that complied with the consent requirements of REA,
specifically, the agreement was in writing, it expressly permitted the participant to designate any beneficiary he or she desired, it acknowledged the effect of the election, and it was witnessed by a notary public, could serve as a valid consent under REA. In this case, the Court found that the consent was ineffective because it failed to comply with the plan requirement that it be furnished to the plan administrator. Nevertheless, the Court held that even though the premarital agreement did not satisfy the plan requirement, the agreement might still be enforceable against the surviving spouse under state contract law.

(8) A defined contribution plan, other than a money purchase pension plan, is not required to provide the qualified survivor annuities if it meets the following requirements:

(a) The plan provides that the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan by reason of a loan outstanding to such participant) is payable in full on the death of the participant to the participant's surviving spouse (or, if there is no surviving spouse or the surviving spouse consents as described above, to a designated beneficiary);

(b) Such participant does not elect to receive the benefit in the form of a life annuity; and

(c) With respect to such participant, the plan is not a direct or indirect transferee of a transfer after December 31, 1984 from a plan that is required to provide the qualified joint and survivor annuity and qualified preretirement survivor annuity.
When there has been such a transfer, if the transferee plan separately accounts for the transferred assets and income therefrom, the balance of the participant’s account is not subject to the survivor annuity rules. I.R.C. § 401(a)(11)(B)(iii), flush language.

I.R.C. § 401(a)(11)(B); Treas. Reg. § 1.401(a)-20, Q&A 3(a) and 5.

In addition, an Employee Stock Ownership Plan (ESOP) is not subject to the qualified survivor annuity rules to the extent a participant has a right to demand a distribution of employer securities. Treas. Reg. § 1.401(a)-20, Q&A 3(c).

IRAs and Simplified Employee Pension Plans (SEPPs) are not subject to the spousal consent rules. Treas. Reg. § 1.401(a)-20, Q&A 3(d).

B. Penalties and Additional Taxes.

1. Additional tax on premature withdrawals.

a. A ten-percent additional income tax is imposed on premature distributions, which are distributions before the participant reaches age 59½ unless an exception applies. I.R.C. § 72(t).

b. The most important exceptions are distributions after the death or disability of the participant, a distribution that is rolled into an IRA or a qualified retirement plan, a distribution to an alternate payee pursuant to a qualified domestic relations order (QDRO), a periodic distribution, and a distribution after a participant separates from service after reaching age 55. I.R.C. § 72(t)(2)(A)(ii), (iii), (iv) and (v).

(1) The exceptions for a distribution to an alternate payee pursuant to a QDRO and distributions after separation from service after reaching age 55 do not
apply to distributions from IRAs. I.R.C. § 72(t)(3)(A).

(2) The exception for periodic payments applies to any distribution that is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the participant or the joint lives (or joint life expectancies) of the participant and his or her designated beneficiary. I.R.C. § 72(t)(2)(A)(iv).

(a) In the case of a distribution from a qualified retirement plan, the periodic payment exception applies only if the participant separates from service. I.R.C. § 72(t)(3)(B).

(b) If the exception for periodic payments applies, and the series of payments is subsequently modified for a reason other than the death or disability of the participant before the later of: (x) the end of the five-year period beginning with the date of the first payment or (y) the date the participant attains age 59½, then the participant’s tax in the year of modification will be increased by an amount equal to the additional tax, plus interest, that would have been imposed if the exception had not applied from the beginning. I.R.C. § 72(t)(4)(A).

2. Excise tax on excess retirement distributions and accumulations.

a. A 15-percent excise tax is imposed on distributions from qualified retirement plans and IRAs received during a calendar year in excess of the annual threshold amount, which is the greater of (i) $150,000, or (ii) $112,500, indexed at the same time and in the same manner as the dollar limit on annual benefits under a defined benefit plan. (The indexed amount is $150,000 for 1995.) I.R.C. §§ 4980A(a) and (c)(1) and Temp. Treas. Reg.
§ 54.4981A-1T, Q&A a-2; IRS News Release IR-94-117.

(1) If the participant elects lump sum treatment, the threshold amount applied to the lump sum is increased to five times the annual threshold amount ($750,000 or $562,500, as indexed ($750,000 for 1995)). I.R.C. § 4980A(c)(4) and Temp. Treas. Reg. § 54.4981A-1T, Q&A c-1(a)(3)(iii).

(2) If a lump sum distribution is received from one plan and installment payments are received under a different type of plan, both the increased threshold amount and the annual threshold amount are available in the same year. Temp. Treas. Reg. § 54.4981A-1T, Q&A c-1(a)(3)(iii).

(a) All pension plans (including money purchase pension plans) sponsored by the same employer are treated as the same type of plan;

(b) All profit sharing plans sponsored by the same employer are treated as the same type of plan; and

(c) All stock bonus plans sponsored by the same employer are treated as the same type of plan.

(3) The following distributions are not included for purposes of determining the excess retirement distribution tax:

(a) Distributions that are rolled into an IRA or qualified retirement plan;

(b) Distributions after the death of the participant;

(c) Distributions to an alternate payee under a QDRO if included in the alternate payee's income;

(d) Distributions of annuity contracts;

(e) Distributions of the participant's after-tax employee contributions;
(f) Distributions to satisfy certain anti-discrimination requirements;

(g) Distributions for medical expenses; and

(h) Distributions of after-tax contributions to IRAs.

I.R.C. § 4980A(c)(1) and Temp. Treas. Reg. § 54.4981A-1T, Q&A a-4(a) and a-7.

b. An additional 15-percent estate tax is imposed on an individual’s excess retirement accumulation. I.R.C. § 4980A(d)(1).

(1) An individual’s excess retirement accumulation is the excess, if any, of:

(a) The value of the decedent’s interest in all qualified retirement plans, annuity plans, tax-sheltered annuities, and IRAs (determined as of the date of death or the alternate valuation date if an election is made under I.R.C. § 2032); over

(b) The present value (as defined under rules prescribed by the Secretary of the Treasury as of the applicable valuation date) of a single life annuity that would have been payable to the decedent based on the decedent’s age at death, with annual payments equal to the annual threshold amount (as in effect in the year in which death occurs).

I.R.C. § 4980A(d)(3).

(2) There are four items that are excluded for purposes of determining the amount of excess retirement accumulations:

(a) The value of any death benefits payable by the plan;

   i) The amount of death benefits is defined as the excess of the sum of any death benefits
payable under the plan plus other benefits payable with respect to the decedent over the total value of benefits payable with respect to the decedent immediately before his or her death.

(a) This amount will usually be the excess of the face value of any life insurance policies held by the plan insuring the participant over the cash value of the policies.

(b) The $5000 death benefit under I.R.C. § 101(b) is not excluded.

(b) The amount of the deceased individual's unrecovered investment in the contract;

(c) The amount of any portion of the deceased individual's interest in a qualified retirement plan that is payable under a QDRO to an alternate payee in whose income the amount is includible; and

(d) The amount of the deceased individual's interest in a qualified retirement plan or IRA by reason of the death of another individual, unless the spousal election to defer the excise tax has been made.

I.R.C. § 4980A(d)(4) and (5) and Temp. Treas. Reg. § 54.4981A-1T, Q&A d-6.

(3) The excise tax on excess retirement accumulations is not deductible for federal income tax purposes but is deductible from the federal gross estate. I.R.C. §§ 691(c)(1)(C) and 2053(c)(1)(B).

(4) In addition, the excise tax is not offset by the unified credit or reduced
by the marital or charitable deduction. I.R.C. § 4980A(d)(2).

(5) Because community property laws are disregarded, the nonparticipant spouse’s community property interest in the decedent’s benefit is not excluded for purposes of determining the amount subject to the tax. I.R.C. § 4980A(d)(4)(A)

C. A participant that had an accrued benefit which equaled or exceeded $562,500 on August 1, 1986 was permitted to make a grandfather election that in effect exempted the accrued benefit as of that date from the 15-percent excise tax on excess retirement distributions and accumulations. Temp. Treas. Reg. § 54.4981A-1T, Q&A b-1 and b-2.

(1) The election was required to be made before the due date, including extensions, for filing the participant’s 1988 federal income tax return. The election was required to be made on a Form 5329 filed with the participant’s 1987 or 1988 federal income tax return or with the federal estate tax return of a deceased participant. Temp. Treas. Reg. § 54.4981A-1T, Q&A b-3.

(2) If the election was made, the annual threshold amount was limited to the indexed amount. Because the indexed amount is now equal to $150,000, there will no longer be any detriment to a living participant who has made the election. Temp. Treas. Reg. § 54.4981A-1T, Q&A b-4(a).

3. Minimum distributions.

a. A 50-percent penalty tax is imposed on the amount of a required distribution that is not actually distributed. I.R.C. § 4974(a).

b. Beginning with the participant’s required beginning date (RBD), which is April 1 of the calendar year following the calendar year in which the participant attains age 70½,
payment of the participant’s benefit must be made in a lump sum or must be made over:

(1) The life of the participant;

(2) The joint lives of the participant and a designated beneficiary;

(3) A period not extending beyond the life expectancy of the participant; or

(4) A period not extending beyond the joint and last survivor expectancy of the participant and a designated beneficiary.


c. If a participant dies before reaching his or her RBD, the minimum distribution rules require that the deceased participant’s plan benefits or IRAs be distributed by December 31 of the fifth calendar year following the year in which the participant’s death occurs, unless an exception applies. I.R.C. § 401(a)(9)(B)(ii); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-2.

(1) If payments are to be made to a designated beneficiary other than the participant’s spouse and the payments begin not later than December 31 of the calendar year after the calendar year in which the participant died, the payments may be paid over the life of the designated beneficiary or over a period certain not extending beyond the life expectancy of the designated beneficiary.

(2) If the payments are to be made to the spouse of the participant, the payments may be made over the life of the participant’s spouse or over a period not extending beyond the spouse’s life expectancy, provided that the payments begin by the later of:

(a) December 31 of the calendar year immediately following the calendar
year in which the participant died;

or

(b) December 31 of the calendar year in which the participant would have attained age 70½.

(3) If the spouse is the designated beneficiary and has named a beneficiary to receive any remaining benefits at his or her death, and the surviving spouse dies before required payments begin, the first exception to the five-year distribution rule will apply (permitting the benefit to be paid over the beneficiary’s lifetime or life expectancy).

I.R.C. §§ 401(a)(9)(B)(iii) and (iv); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-3.

d. If the participant dies on or after his or her RBD but before the entire benefit has been distributed, the remaining portion of the benefit must be distributed at least as rapidly as under the method of distribution in effect at the date of the participant’s death. I.R.C. § 401(a)(9)(B)(i).

C. Income Tax Consequences.

1. Special averaging.

a. The distribution may be eligible for five-year special averaging. See I.R.C. § 402(d)(4) for the rules concerning special averaging treatment.

b. Under a transition rule, a participant who attained age 50 before 1986 is entitled to elect five-year averaging using current income tax rates, ten-year averaging using 1986 income tax rates, or capital gain treatment for the portion of the distribution attributable to service before 1974, at a 20 percent rate. Tax Reform Act of 1986 (TRA 86) § 1122(h)(3), (5) and (6) and Technical and Miscellaneous Revenue Act of 1988 (TAMRA) § 1011A(b)(15).
2. Rollovers.

a. After 1992, as a result of the Unemployment Compensation Amendments of 1992 (Unemployment Act), the eligibility rules for qualifying for rollover treatment are liberalized.

(1) Any distribution from a qualified retirement plan (including annuities described in I.R.C. §§ 403(a) and 403(b)) is eligible for rollover treatment except:

(a) A distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) for the life or life expectancy of the employee or the joint lives or joint life expectancies of the employee and the employee's designated beneficiary or for a specified period of ten years or more;

(b) Any distribution to the extent that the distribution is required under the minimum distribution rules contained in I.R.C. § 401(a)(9); and

(c) Various special types of distributions specified in Temp. Treas. Reg. § 1.402(c)-2T, Q&A 4.


(2) A qualified retirement or annuity plan must permit participants to elect to have any distribution that is eligible for rollover treatment transferred directly to a qualified retirement plan or IRA specified by the participant. Unemployment Act § 522(a)(1) adding I.R.C. § 401(a)(31).

(3) Withholding is imposed at the rate of 20 percent on any distribution that is eligible to be rolled over but is not
transferred directly to a qualified retirement plan or IRA, regardless of whether the recipient intends to roll over the distribution. Unemployment Act § 522(b)(1), amending I.R.C. § 3405 by adding new subsection (c).

3. There is generally no reason to leave the benefits in the plan instead of transferring them to an IRA if permitted under the plan, unless by leaving the benefits in the plan they will be protected from creditors or will achieve a higher rate of return.

a. The Supreme Court decision in Patterson v. Shumate, 112 S Ct 2242 (1992), decided on June 15, 1992, upheld the Fourth Circuit's decision in Shumate v. Patterson, 943 F.2d 362 (4th Cir. 1991), that a participant's interest in an ERISA qualified pension plan may be excluded from the bankruptcy estate pursuant to 11 USC § 541(c)(2).

(1) Prior decisions by several federal Circuit Courts of Appeals had held that qualified retirement plan benefits may be completely excluded from the bankruptcy estate under ERISA's nonalienation prohibition. See, e.g., In re Moore, 907 F.2d 1476 (4th Cir. 1990); In re Lucas, 924 F.2d 597 (6th Cir. 1991), cert denied 111 S Ct 2275 (1991); Velis v. Kardanis, 949 F.2d 78 (3d Cir. 1991); In re Harline, 950 F.2d 669 (10th Cir. 1991).

(2) Courts of Appeals in other circuits had held otherwise. See, e.g., In re Goff, 706 F.2d 574 (5th Cir. 1983); In re Graham, 726 F.2d 1268 (8th Cir. 1984); In re Daniel, 771 F.2d 1352 (9th Cir. 1985); In re Lichstrahl, 750 F.2d 1488 (11th Cir. 1985); and In re Le Feber, 906 F.2d 330 (7th Cir. 1990).

(3) An exclusion or exemption for IRAs will depend upon state law.

(4) What is meant by an "ERISA qualified pension plan" is not entirely clear. See, e.g., In the Matter of Robert L.
Branch, No. 92-3269 (7th Cir. 1994), where the court ruled that a plan in which the only participant was the employer was not an ERISA qualified pension plan because it was not subject to ERISA, citing ERISA Reg. § 2510.3-3.

D. Deferral.

1. If the client can afford to do without the cash in his or her qualified retirement plan or IRA, then the receipt of the distribution should be deferred for as long as possible.

   a. The amount that would have been paid in income tax on the current distribution will continue to be invested.

   b. The income tax on the earnings of the entire amount, including the amount that would have been paid as income tax on a current distribution, will be deferred until the distribution is actually made, causing the amount retained in the plan or IRA to increase more rapidly.

   c. Deferral may cause some of the benefits to become subject to the 15-percent tax on excess retirement distributions and accumulations; however, the benefit of the tax-free accumulation of income should offset this cost after a few years.

   d. Deferral may also cause the benefits to be taxed at a higher tax rate if Congress raises rates. Again, the benefit of the tax-free accumulation of income should offset this cost after a few years.

2. Once the participant has reached his or her RBD, the selection of a form of payment and a designated beneficiary will determine the period over which the payments can be made.

   a. The maximum deferral will be obtained if the participant elects to have his or her benefit paid over a period certain equal to the joint and last survivor expectancy of the participant and his or her spouse.
b. The participant should elect to have only the participant’s life expectancy recalculated each year for purposes of determining the minimum distribution under I.R.C. § 401(a)(9).

(1) Under the proposed regulations dealing with the minimum distribution rules, if the payment of the participant’s benefit is to be made over the life expectancy of the participant or the joint life expectancies of the participant and the participant’s spouse, the life expectancies of both of them will be recalculated unless either or both of them elect not to have life expectancies recalculated or the plan has a no-recalculation default provision. I.R.C. § 401(a)(9)(D) and Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-7(c).

(2) If the life expectancy of either spouse is being recalculated, when that spouse dies, his or her life expectancy will be zero in the following year. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(a).

(3) Consequently, if the life expectancies of both spouses are being recalculated, at the death of the surviving spouse the entire remaining benefit would have to be distributed before December 31 of the year following the year in which the individual died.

c. By not electing to have the life expectancy of the spouse recalculated, the shortest period over which the payments will be made will be the spouse’s life expectancy, even if both spouses die before the end of the spouse’s life expectancy.

d. By electing to have the life expectancy of the participant recalculated each year, the participant can be assured that the payout period will last at least as long as the participant is alive, regardless of when the participant dies.

(1) If the spouse dies first and his or her life expectancy was not being
recalculated, his or her life expectancy will continue to be used in determining the payout to the participant.

(2) If the participant is in poor health or has a family history of early deaths, the participant should also elect out of recalculation.

e. If the participant dies first, then the spouse may, if permitted under the plan or IRA, withdraw the balance of the benefit and roll it into his or her own IRA (or treat the participant’s IRA as his or her own), allowing the spouse to defer receipt of any additional payments until his or her RBD and to elect a new payment period and a new designated beneficiary. I.R.C. § 402(c)(9); Prop. Treas. Reg. § 1.408-8, Q&A A-4(b). See also Priv. Ltr. Rul. 9311037.

(1) The spouse should elect to have his or her life expectancy recalculated to assure that payments will continue as long as he or she is alive.

(2) Even though the payout period during the spouse’s life will be limited by the minimum distribution incidental death benefit rule, which in effect treats the designated beneficiary as no more than ten years younger than the spouse, once the spouse dies the period will be determined by the designated beneficiary’s life expectancy, regardless of his or her age. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-3A(b)(1).

E. Transfer Tax: Considerations.

1. Avoiding irrevocable elections during the client’s lifetime will avoid current gift taxes.

   a. An irrevocable election by a participant or any failure of a participant to act, either of which results in any part of his or her IRA or benefit under a qualified retirement plan being payable to someone other than himself or herself, is treated as a taxable gift under the gift tax provisions after the

(1) A gift of an interest in a qualified retirement plan benefit would not qualify for the annual exclusion because it would not be a present interest.

(a) Because of the nonalienation rule under I.R.C. § 401(a)(13)(A), the beneficiary could not have a present interest in the benefit unless the designation was made pursuant to a QDRO, in which case the irrevocable designation should not be treated as a taxable gift.

(2) A gift of a present interest in an IRA would cause the participant to recognize current income on the gifted amount, and perhaps a ten-percent additional income tax if the participant is under age 59½.

(3) The consent to a waiver of a qualified preretirement or joint and survivor annuity by a participant’s spouse will not be treated as a transfer of property by gift. I.R.C. § 2503(f).

(a) In a community property state, the waiver of a spouse’s community property interest in the participant’s benefit may be a taxable gift if the value of the community property interest exceeds the value of the spouse’s rights under REA.

b. Under TAMRA, a transfer to a spouse of an interest in a joint and survivor annuity in which only the spouses have any right to receive any payments before the death of the surviving spouse generally will qualify for the marital deduction as QTIP property, unless the participant irrevocably elects out of QTIP treatment. TAMRA § 6152(b) which added I.R.C. § 2523(f)(6).

2. The transition rule with respect to the exclusion of benefits under qualified retirement plans and
IRAs from estate tax should be considered if the client separated from service before 1983, in the case of the unlimited exclusion, or before 1985, in the case of the $100,000 exclusion or if, in either case, the client was in pay status (receiving benefits) and had irrevocably elected the form of benefit payment.

a. The unlimited exclusion from the federal gross estate that existed prior to 1983 was reduced to $100,000 as a result of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) for decedents dying after December 31, 1982. TEFRA § 245(a).

(1) A transition rule continued to exclude the entire amount of retirement benefits payable on account of the death of a decedent who was a participant in any plan, who was receiving benefits on December 31, 1982, and who also had elected irrevocably the form of benefit before January 1, 1983. TEFRA § 245(c).

(2) TRA 86 amended this transition rule to permit an unlimited exclusion to the estate of a participant who separated from service before January 1, 1983, even though the benefits were not payable pursuant to an irrevocable election and the participant was not receiving benefits, as long as the participant did not change the form of benefit before his or her death. TRA 86 § 1852(e)(3).

(3) The Internal Revenue Service would probably take the position that the amendment to the transition rule applies only to distributions from qualified retirement plans and not to IRAs, based on Rev. Rul. 92-22, 1992-1 C.B. 313, in which it so held with respect to the $100,000 exclusion.

b. The Deficit Reduction Act of 1984 (DEFRA) repealed the $100,000 exclusion for participants dying after December 31, 1984. DEFRA § 525(a).
(1) DEFRA contained a transition rule that retained the $100,000 exclusion for a decedent who was receiving benefits on December 31, 1984 and who, before July 18, 1984, irrevocably elected the form of retirement benefit. DEFRA § 525(b).

(2) TRA 86 amended this transition rule to permit the $100,000 exclusion to the estate of a participant who separated from service before January 1, 1985, even though the benefits were not payable pursuant to an irrevocable election and the participant was not receiving benefits, as long as the participant did not change the form of benefit before his or her death. TRA 86 § 1852(e)(3).

(3) In Rev. Rul. 92-22, 1992-1 C.B. 313, the Internal Revenue Service limited the change in the transition rule to distributions from qualified retirement plans only, based on the "separated from service" language in the amendment to the transition rule (since the rules dealing with distributions from an IRA are not dependent upon the IRA account holder's separation from service) and the Senate Finance Committee Report, which clearly states that IRA benefits are not entitled to the amended transition rule. See also TAM 9144046.

3. The marital deduction will defer the payment of transfer taxes until the death of the surviving spouse.

   a. An outright distribution from a qualified retirement plan or IRA directly to the spouse (assuming he or she is a United States citizen) will qualify for the marital deduction whether or not the spouse decides to use a spousal rollover.

   (1) A spouse may roll a distribution from a qualified retirement plan into an IRA that he or she treats as his or her own. I.R.C. § 402(c)(9).
b. If the surviving spouse has the right to withdraw the entire balance of the decedent's accrued benefit, the accrued benefit should qualify for the marital deduction even if the surviving spouse leaves the accrued benefit in the plan. Rev. Rul. 82-184, 1982-2 C.B. 215; Treas. Reg. § 20.2056(b)-5(f)(6).

(1) Treas. Reg. § 20.2056(b)-5(f)(6) states that the requirements for the life estate/general power of appointment exception to the nondeductible terminable interest rule are satisfied if the surviving spouse has the right, exercisable in all events, to have the principal distributed to him or her at any time during his or her life.

(2) Because there is no constructive receipt for income tax purposes with respect to amounts held in a qualified retirement plan or IRA, the spouse will not be taxed on any of the amount held in the plan until he or she makes an actual withdrawal. I.R.C. § 402(a)(1).

c. Prior to TAMRA, it was widely held that a survivor annuity should qualify for the marital deduction since no one else had the right to receive the property upon the death of the spouse.

(1) Section 6152(a) of TAMRA clarified this point by adding paragraph (7)(C) to I.R.C. § 2056(b), requiring QTIP treatment for a survivor annuity included in the participant's estate under I.R.C. § 2039 if only the surviving spouse has the right to receive payments before the death of the surviving spouse unless the executor affirmatively elects out of QTIP treatment.

(a) Such a transfer will not qualify if the personal representative
irrevocably elects out of QTIP treatment.

(b) This provision generally is effective for decedents dying after December 31, 1981, but if an estate tax return was filed before November 11, 1988 that treated a survivor annuity payable to the spouse as not qualifying for the marital deduction, the filer of the return had to elect to treat the survivor annuity as QTIP property before November 11, 1990. TAMRA § 6152(c).

(c) Query whether the automatic QTIP treatment applies to payments made in a form other than a life annuity; for example, periodic payments over a period certain equal to the life expectancy of the decedent and the decedent's spouse.

i) It is arguable that the form of payment in such a case is not an annuity.

ii) On the other hand, if automatic QTIP treatment applies only to life annuities, the provision would be unnecessary since such a life annuity for the spouse's lifetime is not a nondeductible terminable interest unless the executor is directed by the decedent's will (or trust agreement) to purchase the annuity.

iii) In Priv. Ltr. Rul. 9204017 the Service held that a payment over a 15-year period would qualify for the marital deduction as QTIP since only the surviving spouse had a right to receive payments before his or her death.

d. Even if someone is entitled to receive payments after the death of the spouse, the
interest may still qualify for the marital deduction under the QTIP rules.

(1) This may be the case when installment payments are to be made over a period certain. If the spouse dies before the end of the period, the remaining payments will go to someone else.

(2) The Technical Corrections Act of 1982 amended the QTIP rules to permit an annuity to be treated as an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified) to the extent provided in regulations. I.R.C. § 2056(b)(7)(B)(ii), flush language.

(3) Under proposed regulations, the value of the deductible interest was determined by comparing the annual payment with a yield on the value of the benefit using the current interest rate under section 2031 (which is 120 percent of the federal mid-term rate). Prop. Treas. Reg. § 20.2056(b)-7(e) and (h), Examples 10 and 11; I.R.C. § 7520; added by TAMRA § 5031(a).

(4) Unfortunately, § 1941 of the Energy Policy Act of 1992, Pub. L. 102-486, amended I.R.C. § 2056(b) and I.R.C. § 2523(e) and (f) to limit the term "specific portion" to mean a portion determined only on a fractional or percentage basis. When final regulations concerning qualified terminable interest property and other marital deduction issues were issued on February 28, 1994, the preamble indicated that the Internal Revenue Service recognized that some aspects of the 1992 legislation should be the subject of separate proposed regulations under I.R.C. § 2056(b)(7). The Service specifically invited comments on the application of the Energy Policy Act of 1992 to the treatment of annuities as described in the last sentence of I.R.C. § 2056(b)(7)(B)(ii). Consequently, it
is not clear at this point whether an annuity payable out of a fund that does not qualify for the automatic QTIP election will nonetheless qualify if an election is made. Under a transitional rule, the final regulations permit a right to an annuity to qualify as originally permitted under the proposed regulations for a person dying on or before October 24, 1992. Treas. Reg. § 20.2056(b)-7(e).

e. A lump sum distribution to a marital deduction trust (e.g., a life estate/general power of appointment trust (I.R.C. § 2056(b)(5)) or a QTIP trust (I.R.C. § 2056(b)(7))) will qualify for the marital deduction.

f. The assets attributable to the participant’s benefit could be retained in the trust of the qualified retirement plan under a subtrust that qualifies for the marital deduction as a life estate/general power of appointment trust, a QTIP trust, or an estate trust. Ltr. Rul. 8843033.

(1) Under this technique, the I.R.C. § 401(a)(9) minimum distribution rules would also have to be met.

g. The benefits may be paid in installments to a trust designed to qualify for the marital deduction. See Section II.B.1. of this outline for a detailed discussion of the Internal Revenue Service’s current position on qualified plan benefits and IRAs payable in installments to a trust designed to qualify for the marital deduction.

h. No marital deduction is allowed if the surviving spouse is not a United States citizen (effective for decedents who died after November 10, 1988) except for property passing to a qualified domestic trust (QDOT). TAMRA § 5033, adding I.R.C. § 2056(d).

(1) The Omnibus Budget Reconciliation Act of 1989 (OBRA 89) authorizes the Treasury to issue regulations that would qualify annuities (including qualified
(2) If a qualified retirement plan or IRA is treated as a QDOT, the minimum distribution rules will eventually require principal distributions that will be subject to estate tax as if included in the deceased participant's estate unless paid to another QDOT. I.R.C. § 2056A(b).

(3) Final regulations dealing with QDOTs were adopted on August 21, 1995. Treas. Reg. § 20.2056A-4(c) provides that a nonassignable annuity or other payment, which includes a qualified retirement plan or IRA, will be treated as passing in the form of a QDOT if the surviving spouse agrees either to pay the deferred estate tax on the corpus portion of each distribution or to transfer the corpus portion to a QDOT.

i. Query whether a nonparticipant spouse's community property interest in the benefit qualifies for the marital deduction if the nonparticipant spouse dies before the participant spouse, who is then entitled to the entire benefit, although it may not be currently payable under the plan.

4. The distribution may be made to a credit shelter trust or to beneficiaries other than the spouse if the client does not have other assets sufficient to use all of his or her unified credit.

5. The impact of the generation-skipping transfer tax should be taken into account when naming beneficiaries who are in a generation more than one generation below the participant.

a. In planning for distributions from qualified retirement plans and IRAs, the objectives should be to avoid the GST tax and to use the $1 million GST exemption available to each person or person's estate when appropriate.
b. If a participant makes an irrevocable election during his or her lifetime to have some or all of the plan benefits or IRAs payable to a skip person after the participant's death, he or she will not be able to allocate currently any of his or her GST exemption to the value of the benefit payable to the skip person if the benefit will be includible in the participant's federal gross estate. I.R.C. § 2642(f).

F. Review of Information.

1. The advisor should review information with respect to each plan in which the client participates in order to determine both the amount of the client's benefits under the plan and the options available to the client.

   a. The summary plan description should be reviewed.

   b. All current benefit statements should be reviewed.

   c. In most cases, the advisor should review the plan itself, since the summary plan description may not be current or accurate, and may not contain all the options or relevant provisions concerning the payment of benefits.

      (1) The plan document may not yet be amended to comply with TRA 86 and subsequent legislation, since the Internal Revenue Service has extended the deadline for amending the plan document to comply with TRA 86 until the end of the plan year beginning in 1994. Internal Revenue Service Notice 92-36 (August 7, 1992), 1992-2 C.B. 364.

2. The client's personal information should be reviewed.

   a. Current financial information should be reviewed.

   b. The projected future financial needs of the client and the client's beneficiaries should be considered.
c. The client's will and other estate planning documents should be reviewed and should be consistent with the designation of beneficiaries for plan benefits and IRAs.

d. The health of the client, the client's spouse and other beneficiaries should be reviewed.

G. Ethical Considerations.

1. There may be a need in many cases for the spouse to be advised by independent counsel if he or she is asked to sign a consent to a waiver of the qualified preretirement survivor annuity, qualified joint and survivor annuity, or death benefit, unless the designated beneficiary is an irrevocable trust and the spouse is the sole income beneficiary.

2. The advisor, regardless of his or her profession, may be incompetent to advise the client with respect to distributions from qualified retirement plans and IRAs because of the complexity of the law and the advisor's lack of knowledge and experience in the area.

II. PLANNING BEFORE RETIREMENT: BENEFICIARY DESIGNATIONS

A. Spouse as Beneficiary.

1. The payment of the plan benefit or IRA balance in a lump sum to the surviving spouse (assuming the spouse is a citizen of the United States) will qualify the benefits for the marital deduction for estate tax purposes.

   a. The same result will be achieved if the surviving spouse has the right to withdraw the entire benefit or IRA balance at any time.

2. If permitted under the plan, the spouse may roll the benefits into an IRA or may treat the decedent's IRA as his or her own IRA, thereby deferring payment of income tax. I.R.C. § 402(c)(9).

   a. The spouse can wait until April 1 of the calendar year following the calendar year in which he or she reaches age 70½ to begin receiving distributions.
b. Withdrawals from the IRA before the spouse reaches age 59½ will be subject to the ten-percent additional income tax unless an exception applies. I.R.C. § 72(t).

c. The spouse may also name a beneficiary for any remaining benefit at his or her death, thereby extending the payment period.

d. If the spouse has not rolled the benefits into his or her own IRA or treated the decedent’s IRA as his or her own, the ten-percent additional income tax will not apply to withdrawals before he or she reaches age 59½. I.R.C. § 72(t)(2)(A)(ii).

   (1) However, the spouse must begin to receive distributions by the end of the year in which the participant would have reached age 70½. I.R.C. § 401(a)(9)(B)(iv)(I).

   (2) In addition, if the participant died before his or her RBD, usually April 1 following the calendar year in which the participant reaches age 70½, the surviving spouse may designate a beneficiary to receive any benefits remaining in the plan at the surviving spouse’s death if he or she dies before payments must commence to the surviving spouse. In this case, the remaining benefit or IRA can be paid over the beneficiary’s lifetime or life expectancy. I.R.C. § 401(a)(9)(B)(iv)(II).

3. If the participant reached age 59½ before he or she died, the spouse may also elect five-year averaging (or ten-year averaging and capital gain treatment if the participant reached age 50 before 1986) for a distribution qualifying as a lump sum distribution under I.R.C. § 402(d)(4). TAMRA § 1011A(b)(15), amending TRA 86 § 1122(h)(5).

4. The spouse may elect to defer the 15-percent excise tax on excess retirement accumulations. I.R.C. § 4980A(d)(5). See Section IV.A.1. of this outline for a discussion of this election.
5. Spousal consent under REA may be required after the participant's death to elect out of the qualified preretirement survivor annuity if the payment is to be made in a lump sum. See Section I.A.1.b. of this outline for a detailed discussion of the consent requirements.

6. Designating the spouse as the sole beneficiary may result in overfunding the marital deduction if the retirement benefits are a substantial part of the estate, in which case the spouse may disclaim the receipt of some or all of the benefits if appropriate. See Section IV.A.2. of this outline for a discussion of disclaiming qualified retirement plan benefits and IRAs.

7. Under the minimum distribution rules, if the participant dies before his or her RBD, the payments do not have to commence until the participant would have reached age 70½ if the benefit is left in the participant's qualified retirement plan or IRA. I.R.C. § 401(a)(9)(B) (iv)(I).

a. The spouse may also name a new beneficiary and if he or she dies before payments must commence, the payments may be made over the beneficiary's life or life expectancy. I.R.C. § 401(a)(9)(B)(iv)(II).

8. Designating the spouse as the beneficiary of a lump sum distribution will not provide for professional management of the funds unless the spouse engages advisors or transfers the funds to a trust with someone else as trustee.

9. The designation of the spouse as the sole beneficiary may not be appropriate if the participant has children by prior marriages.

B. Marital Trust as Beneficiary

1. Qualifying for the marital deduction becomes more complicated when the qualified retirement plan benefit or IRA is to be paid to a trust that is designed to qualify for the marital deduction as either a QTIP trust or a life estate/general power of appointment trust.

a. Such a beneficiary designation would be desirable when the participant wants to
provide for the needs of his or her spouse during his or her lifetime and to defer the payment of the estate tax on the benefit until the spouse dies, but also wants to control the disposition of any benefit remaining at the spouse's death.

(1) Only the QTIP trust will enable the participant to obtain the marital deduction and, at the same time, control the disposition of any benefit or IRA remaining at the spouse's death.

b. Revenue Ruling 89-89 held that the decedent's executor could elect to treat a decedent's IRA as QTIP property.

(1) The facts presented in the ruling were as follows:

(a) The decedent elected an IRA distribution requiring the principal balance to be distributed in equal annual installments over the surviving spouse's life expectancy to a testamentary QTIP trust and the income earned on the undistributed balance of the IRA to be paid annually to the trust;

(b) The trust agreement required that both the income earned on the undistributed portion of the IRA that the trust received from the IRA and the income earned by the trust on the distributed portion of the IRA had to be paid currently to the decedent's spouse; and

(c) The executor elected QTIP treatment for both the trust and the IRA.


(2) Unfortunately, this revenue ruling may lead one to conclude that a QTIP election would need to be made for an IRA and that equal annual installments of principal would have to be made from the IRA to a trust that otherwise qualifies for the marital deduction to
qualify the value of the IRA for QTIP treatment.

(a) It would be impossible to have equal annual installments of principal from an IRA that consists of investments that may either appreciate or depreciate in value.

(b) Principal distributions should have no effect on qualifying for the marital deduction.

(c) It should not be necessary to make a QTIP election with respect to an IRA payable to a QTIP trust, which is an asset of the trust. One is not typically required to make a QTIP election with respect to property interests that are held by or payable to a QTIP trust.

i) On the other hand, the Internal Revenue Service's position may be based on a concern that a QTIP election with respect to an IRA or qualified retirement plan benefit is necessary to assure that any remaining balance in the IRA account or plan benefit is included in the surviving spouse's estate under I.R.C. § 2044.

ii) Even without a QTIP election, the IRA account balance or remaining plan benefit should be included in the surviving spouse's estate because it will be treated as part of the trust at the spouse's death.

(d) If the spouse has a right to require the trustee to convert the assets of the QTIP trust to income-producing property or to distribute other trust assets equal to the income that would have been produced by the unproductive property, the value of an IRA or plan benefit payable to the trust
should qualify for the marital deduction regardless of whether current income from the IRA or plan benefit is required to be paid to the trust. Treas. Reg. § 20.2056(b)-5(f)(4) and (5).

i) Normally the beneficiary of an IRA has the right to withdraw the entire account balance at any time.

c. In TAM 9220007 (January 30, 1992), the Internal Revenue Service held that the value of an IRA payable to a QTIP trust was not eligible for QTIP treatment because none of the authorized distribution options at the date of the decedent’s death gave the surviving spouse a qualified income interest for life.

(1) The trustee’s subsequent addition of an option that met the QTIP requirements did not qualify the IRA for QTIP treatment according to the Internal Revenue Service because the property must "pass" from the decedent for the benefit of the spouse in a form satisfying all the QTIP requirements as of the date of death and cannot be contingent upon actions taken after death. But see Estate of Clayton v. Commissioner, 976 F.2d 1486 (5th Cir. 1992), rev’g 97 TC 327 (1991), where the Fifth Circuit rejected the Service’s position that all the property available for the election had to qualify for QTIP treatment, not just the property for which the election was actually made. See also Estate of Robertson v. Commissioner, 15 F.3d 779 (8th Cir. 1994), and Estate of Spencer v. Commissioner, No. 93-1997 (6th Cir., 1995), rev’g T.C. Memo 1992-579.

(2) The Internal Revenue Service ruled that the IRA could not be treated as an asset of the QTIP trust, but had to be treated as a trust itself and therefore the IRA had to satisfy all the requirements of a QTIP trust.
d. In Priv. Ltr. Rul. 9245033 (August 11, 1992), the Internal Revenue Service held that an IRA qualified as QTIP where the IRA paid all its income (or the required minimum distribution, if greater) annually to the marital trust which, in turn, treated the IRA income as income for trust accounting purposes and paid all its income annually to the spouse. The same result was reached in Priv. Ltr. Ruls. 9416016 and 9321059.

e. As a result of the Internal Revenue Service’s position, the conservative approach when it is desirable to name a QTIP trust as the beneficiary of a qualified retirement plan benefit or IRA is as follows:

(1) The form of payment designation for the qualified retirement plan benefit or IRA should provide that the QTIP trust be paid each year the greater of (x) the income generated by the assets representing the accrued benefit in the qualified retirement plan or in the IRA or (y) the required minimum distribution determined under I.R.C. § 401(a)(9).

(2) The trustee of the QTIP trust should have the right under both the beneficiary designation form and the QTIP trust agreement to require the plan trustee or IRA sponsor to convert nonincome-producing or low income-producing assets into income-producing assets or assets producing adequate income.

(a) In the case of a defined benefit plan, which does not provide for a specific account that represents the deceased participant’s accrued benefit, the trustee of the QTIP trust should have the right to treat a certain amount of the value of the accrued benefit as income each year, perhaps based on the state’s income and principal act.

(b) The trustee should also be given the right under both the beneficiary designation and the
QTIP trust agreement to withdraw the accrued benefit or IRA balance at any time so that the trustee could withdraw an amount equal to the income that would have been produced if the assets were producing adequate income.

(3) The QTIP trust agreement should provide that the part of any distribution from a qualified retirement plan or IRA that represents income will be paid to the spouse in the same manner as any income generated by other assets held by the trust and no expenses that would be chargeable against principal will be charged against the income element of the distribution.

(4) The spouse should have the right under the trust agreement to require the trustee of the QTIP trust to make nonincome-producing assets income producing or to convert nonincome-producing assets to income-producing assets.

(a) The trustee of the QTIP trust should have the right under the trust agreement to distribute other assets of the trust to satisfy this request.

(5) A QTIP election should be made for both the trust and the qualified retirement plan benefit or IRA, by listing the plan benefit or IRA on Schedule M of Form 706.

(6) This approach will defer the payment of principal from the qualified retirement plan or IRA as long as permitted under the minimum distribution rules, thereby deferring the payment of tax on the principal and retaining the principal in a tax-free vehicle.

(7) This approach will also ensure that the principal when paid to the trust is not paid out to the spouse unless required under an ascertainable standard (or some
other standard) contained in the trust agreement.

(a) However, from an income tax standpoint, it may be preferable to distribute the principal to the spouse, who is likely to be in a lower income tax bracket than the trust, which reaches the 39.6 percent bracket when it has $7,650 of taxable income in 1995, while the spouse does not reach the 39.6 percent bracket until he or she has $256,500 of taxable income in 1995 (or $128,250 for a married individual filing a separate return).

2. If the marital trust is the beneficiary, rollover treatment will be foreclosed unless the spouse has the right to revoke the trust or a lifetime power to withdraw assets from the trust. See Priv. Ltr. Ruls. 9401039, 9302022, 9235058, 9047060, 9016067, and 8920045.

3. If the participant reached age 59½ before he or she died, five-year averaging (or ten-year averaging and capital gain treatment if the participant reached age 50 before 1986) will be available if the distribution qualifies as a lump sum distribution under I.R.C. § 402(d)(4).

4. The spouse may not be eligible to elect to defer the 15-percent excise tax on excess retirement accumulations, unless the Internal Revenue Service takes the position that as long as the spouse is the sole beneficiary during his or her lifetime, the election to defer may be made.

5. Spousal consent to waive his or her rights under REA will be required.

6. The spouse may disclaim his or her interest in the trust, with the benefits then being paid to a credit shelter trust or directly to other beneficiaries.

7. According to the proposed regulations under the minimum distribution rules, in order for the spouse to be treated as a designated beneficiary for purposes of avoiding the five-year
distribution rule, the trust must satisfy certain requirements.

a. Generally, a trust must meet the following requirements at the later of the date the trust is named as a beneficiary or the RBD in order for the beneficiaries of the trust to be treated as designated beneficiaries under the minimum distribution rules:

(1) The beneficiaries of the trust who are beneficiaries with respect to the trust’s interest in the participant’s benefit are identifiable from the trust instrument;

(2) The trust is a valid trust under state law or would be except for the fact that there is no corpus;

(3) The trust is irrevocable; and

(4) A copy of the trust instrument is provided to the plan administrator.

Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-5.

b. It is hoped that the final regulations will eliminate all these requirements except the first and will simply require that the plan administrator be informed of the name or names and age or ages of the beneficiaries of the trust who are being treated as designated beneficiaries.

(1) The Internal Revenue Service has indicated that the account holder of an IRA is the plan administrator for this purpose. Priv. Ltr. Rul. 9037048.

(2) Fortunately, it appears that the Internal Revenue Service may have reached the conclusion that the trust must only become irrevocable upon the participant’s death, even if it occurs after the RBD. Letter Rulings 9321032 and 9322005.

(a) Both letter rulings contain the following conclusion:
In order for the beneficiaries of the Trust to be considered the designated beneficiaries for purposes of Section 401(a)(9)(A), the Trust must be irrevocable as of the later of the date the Trust is irrevocably named the beneficiary of the IRA or the IRA owner's beginning date. Since the IRA beneficiary designation may remain revocable until the earlier of the IRA owner's beginning date or his date of death, it is the earlier of these dates that is the date at which the Trust must become irrevocable. (Emphasis added.)

(b) Because the IRA owner should be permitted to change the beneficiary designation after the required beginning date but before the IRA owner's death, the trust does not have to become irrevocable until his or her death.

i) Under the facts of the two letter rulings, the IRA document required the designation to be irrevocable as of the RBD.

(c) Although the proposed regulation states that the payout period cannot be extended after the RBD, the beneficiary actually entitled to receive the benefits may be changed after the RBD.

i) Under the minimum distribution rules, if the IRA owner changes the beneficiary and the new beneficiary's life expectancy is longer than that of the original designated beneficiary, the life expectancy of the original designated beneficiary will continue to be used for purposes of determining the minimum distribution.
ii) On the other hand, if the life expectancy of the new beneficiary is shorter than that of the original designated beneficiary, the life expectancy of the new beneficiary will be used for purposes of determining the minimum distribution. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-5(c).

iii) An exception to this rule applies if the designated beneficiary dies after the RBD and the alternate beneficiary's life expectancy is shorter than that of the deceased beneficiary. In this case the longer life expectancy of the deceased designated beneficiary will be used. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-5(e). Note that in this situation the IRA owner has not exercised any discretion with respect to the change in the beneficiary.

(d) This same analysis should apply to qualified retirement plans that permit the participant to change his or her designated beneficiary after the RBD.

c. Nevertheless, until further guidance has been issued by the Internal Revenue Service, the conservative approach would be to have the participant create an irrevocable trust on or before his or her RBD that would have the same terms as the participant’s revocable or testamentary trust.

(1) The participant, of course, would be free to change the designated beneficiary to another irrevocable trust or to individuals.

(2) The change in the beneficiary could not result in the lengthening of the payout
period, although it could shorten the payout period if the individual treated as the designated beneficiary were older than the individual originally treated as the designated beneficiary.

C. **Credit Shelter Trust as Beneficiary.**

1. The marital deduction will not be available.

2. Rollover treatment will not be available.

3. If the participant reached age 59½ before he or she died, five-year averaging (or ten-year averaging and capital gain treatment if the participant reached age 50 before 1986) will be available if the distribution qualifies as a lump sum distribution under I.R.C. § 402(d)(4).

4. The spouse will not be eligible to elect to defer the 15-percent excise tax on excess retirement accumulations.

5. Spousal consent to waive his or her rights under REA will be required.

   a. If the spouse has an income interest in or a power over the assets in the trust, the spouse’s consent should not be treated as a transfer with a retained interest or power under I.R.C. § 2036(a) or 2038 that would cause part of the trust to be included in the spouse’s estate because the spouse’s consent to waive his or her rights is not treated as a taxable gift under I.R.C. § 2503(f).

6. The trustee may be authorized to disclaim the right to the benefits, in which case the benefits could then be paid to the marital deduction trust or directly to the surviving spouse. See Keydel and Wallace, "The Revocable Trust--Disclaimer Method for Integrating Qualified Plan and IRA Death Benefits into an Estate Plan," 13 Probate Notes 158 (1987).

7. The requirements under the minimum distribution rules concerning trusts should be satisfied if the beneficiary or beneficiaries of the trust are to be treated as designated beneficiaries. See Section II.B.7. of this outline.
8. Such a designation may be appropriate if there are insufficient assets outside qualified retirement plans and IRAs to use the participant's remaining unified credit.

9. If there are other assets that will not be treated as income in respect of a decedent (IRD) which can be allocated to the credit shelter trust or directly to children or other beneficiaries, more wealth will escape estate taxation in the surviving spouse's estate if plan benefits and IRAs are allocated to the surviving spouse or a trust qualifying for the marital deduction since the spouse or the trust will be paying the income tax on the distributions rather than the credit shelter trust or the children.

D. Charity as Beneficiary.

1. If the participant is charitably inclined, naming a charity as a beneficiary may be advisable since the charity will not be subject to income tax when the benefits are received.

2. To avoid recognition of the income by the estate, the benefits should not be used by the personal representative of the estate to fund a pecuniary charitable bequest.

3. Although the plan benefits or IRA will be excluded from the federal gross estate as a charitable deduction, the 15-percent tax on excess retirement accumulations will apply to the benefits.

4. Spousal consent to waive his or her rights under REA will be required.

5. If only part of the benefits from a qualified retirement plan or an IRA are to be paid to a charity, a separate account or a separate share must be established after the RBD to permit the use of the life expectancies of other beneficiaries to be used for determining the payout period for the balance of the plan benefit or IRA.

a. A charity cannot be a designated beneficiary for purposes of the exception to the five-year distribution rule.
b. If a separate account or separate share is not established for the charity's portion of the benefit, the entire benefit must be distributed by December 31 of the calendar year that contains the fifth anniversary of the participant's death. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-5(a).

E. Allocating the Federal Estate Tax.

1. Since retirement plan benefits and IRAs generally will be includible in the federal gross estate for federal estate tax purposes, the source of payment of the federal estate tax (and state estate and inheritance taxes) as well as the 15-percent tax on excess retirement accumulations should be considered.

2. A state's apportionment statute may not apply to distributions from qualified retirement plans and IRAs or to the 15-percent excise tax on excess retirement accumulations.

3. Generally the testator's desires will be accomplished if the beneficiary of the benefits is required to pay any estate and excise taxes on the benefits he or she receives, except when the spouse is the beneficiary and the marital deduction is desired for the entire amount passing to the spouse.

   a. The payment of the estate and excise taxes directly from the qualified retirement plan or IRA will cause income to be recognized by the beneficiary or beneficiaries obligated to pay such taxes. Priv. Ltr. Rul. 9132021.

   b. The beneficiaries will be entitled to an IRD deduction under I.R.C. § 691(c) for the federal estate tax attributable to the income.

4. Requiring either the spouse or a marital deduction trust or a charity that is a beneficiary to pay the 15-percent excise tax on excess retirement accumulations will not increase the federal estate tax since the estate tax deduction for the tax offsets the reduction in the marital deduction because of the payment of the tax.
a. The same result would apply if a charitable beneficiary was required to pay the 15-percent excise tax.

5. There is no federal statute granting the estate a right to recover the excess retirement accumulation tax from a beneficiary.

a. A state's apportionment statute may require the beneficiary receiving the benefits to pay the excise tax.

b. The estate is liable for the excise tax. Temp. Treas. Reg. § 54.4981A-1T, Q&A d-8A.

(1) However, transferee liability rules under Chapter 11 apply, causing the beneficiary to be liable for the tax if the estate is insolvent.

(2) The reimbursement provisions of I.R.C. § 2205 also apply, entitling a beneficiary who has paid the tax to reimbursement from the estate.

(3) However, absent a provision in the decedent's will or in the applicable state apportionment law, the executor is not entitled to recover the excise tax from the beneficiary entitled to receive the benefits.

III. PLANNING AT RETIREMENT

A. Income Tax Planning.

1. The advisor should determine the most appropriate form of payment.

a. A lump sum payment may be available.

(1) A person who reached age 50 before January 1, 1986 may choose one of the following four methods for taxing the lump sum:

(a) Ten-year averaging plus long-term capital gain treatment on the pre-1974 portion (at a 20 percent maximum rate);
(b) Five-year averaging plus long-term capital gain treatment on the pre-1974 portion (at a 20 percent maximum rate);

(c) Ten-year averaging on the entire amount; and

(d) Five-year averaging on the entire amount.

(2) Five-year averaging will result in a lower effective tax rate than ten-year averaging once the total taxable amount exceeds $368,000 (using 1995 tax rates for five-year averaging).

b. The payment may be made in installments or in the form of an annuity.

(1) Payments may come from the assets in the plan.

(2) A commercial annuity could be purchased and distributed to the participant.

(3) The participant may roll over the benefits to an IRA or another qualified retirement plan.

2. Assuming that the participant’s goal is an equal amount of monthly income over a specified number of years and assuming the same rate of return under each method, the following observations can be made:

a. Larger amounts should be rolled into an IRA (or kept in the plan for periodic distributions) rather than taxed currently, unless a lump sum distribution will help avoid the 15-percent tax on excess retirement distributions or accumulations;

b. As the rate of return or payout period increases, the IRA rollover or leave-it-in-the-plan option produces higher after-tax monthly payments; and

c. If Congress increases tax rates or the taxpayer’s marginal rate increases, current
lump sum treatment may become a better alternative.

3. The participant may avoid the 15-percent excise tax on excess retirement distributions or excess retirement accumulations by having distributions commence sooner or made in larger amounts than otherwise required under the minimum distribution rules.

4. There are other considerations, such as:
   a. Spousal rights;
   b. The financial needs of the client;
   c. The client’s overall estate plan; and
   d. The health of the client, the spouse, and other beneficiaries.

B. Minimum Distribution Rules.

1. Commencing at the RBD, payment of the participant’s benefit must be made in a lump sum or must be made over:
   a. The life of the participant;
   b. The joint lives of the participant and a designated beneficiary;
   c. A period not extending beyond the life expectancy of the participant; or
   d. A period not extending beyond the joint and last survivor expectancy of the participant and a designated beneficiary. I.R.C. § 401(a)(9)(A).

2. Defined contribution plans.
   a. If the participant’s benefit is in the form of an individual account (such as an IRA, profit sharing plan, or money purchase pension plan), the minimum amount to be distributed with respect to each distribution calendar year (starting with the calendar year preceding the RBD) is determined by dividing the value of the participant’s benefit by the applicable life expectancy.
Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-1(a).

b. Except in the case of the first distribution calendar year, the minimum distribution must be distributed before the end of the distribution calendar year.

(1) The first required minimum distribution may be delayed until April 1 of the year following the year in which the participant reached age 70½ (the participant’s RBD).

c. The calendar year during which the RBD occurs may have two required distributions, one for the year in which the participant reached age 70½ and one for the following year (which is also the year in which the RBD occurs). Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-1(b).

d. In the case of an individual account, the benefit used to determine the minimum distribution amount is the account balance (whether or not vested) as of the last valuation date in the calendar year immediately preceding the distribution calendar year;

(1) Increased by contributions and/or forfeitures added to the account after the valuation date during such year or made after the valuation year but allocated as of a date in such valuation year; and

(2) Decreased by distributions from the account made after the valuation date during such year plus, in the case of the second distribution calendar year, any amount distributed before April 1 to meet the minimum distribution for the first distribution calendar year.

Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-5 and F-6(a).

e. Life expectancies are determined by use of the expected return multiples in Tables V and

(1) The participant’s age (and/or the age of his or her beneficiary) in the calendar year during which he or she attains age 70½ (the first distribution calendar year) is used. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-1(a).

(2) The life expectancy of the participant and the participant’s spouse may be recalculated annually. I.R.C. § 401(a)(9)(D).

(3) If a participant fails to elect not to have his or her life expectancy (and the life expectancy of his or her spouse, if applicable) recalculated each year, or the plan does not permit such an election and does not provide that the life expectancies of the participant and spouse will not be recalculated each year, then the life expectancy of the participant and/or the spouse must be recalculated each year. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-7(c).

(4) The election is irrevocable as of the RBD. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-7(c).

(5) A participant may elect or a plan may provide that the life expectancy of the participant may be recalculated while the life expectancy of the spouse is not and vice versa. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-7(b).

f. If more than one beneficiary is selected, the designated beneficiary with the shortest life expectancy is considered the designated beneficiary for purposes of determining the distribution period unless each beneficiary is a beneficiary with respect to a separate account or separate share. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-5(a).
3. Defined benefit plans.

a. For defined benefit plans, the distribution of the participant's accrued benefit in the form of an annuity must be made in periodic payments at intervals of not longer than one year. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-3(a).

b. In the case of an annuity for life (or a life annuity with a period certain not exceeding 20 years), the payments must commence on the RBD and, as long as the payments are made according to the scheduled intervals (at least annually), the minimum distribution rules will be satisfied. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-3(d)(1).

c. If the annuity is a period certain annuity without a life contingency (or is a life annuity with a period certain exceeding 20 years), the annuity will satisfy the minimum distribution rules only if the annual amount is distributed by the applicable date (the RBD for the first distribution calendar year and December 31 of each subsequent distribution calendar year).

(1) The annual amount is the amount that normally would be distributed during a 12-month period under the annuity.

(2) For example, if the annuity is a monthly annuity of $1000 per month, then $12,000 would have to be distributed by April 1 of the year following the first distribution calendar year, and an additional $12,000 would have to be distributed by December 31 of the second distribution calendar year (the year in which the participant's RBD occurs).

(3) Thereafter, as long as $12,000 is distributed in each distribution calendar year, the minimum distribution rules will be satisfied. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-3(d)(2).

4. The minimum distribution incidental death benefit (MDIB) rule.
a. Distributions from qualified retirement plans and IRAs also must satisfy the minimum distribution incidental death benefit (MDIB) rule. I.R.C. § 401(a)(9)(G); Prop. Treas. Reg. § 1.401(a)(9)-2, Q&A 4.

(1) This rule prevents a participant from naming a very young beneficiary for the purpose of deferring the payment over a longer period.

b. The new MDIB rule first applied in 1989 for qualified retirement plans and is based on tables set forth in the proposed regulations.

(1) In the case of an individual account plan or a period certain annuity without a life contingency, if the designated beneficiary is not the surviving spouse, the initial payout period may not exceed 25.3 years if the participant reaches age 70 after June 30 and 26.2 years if the participant reaches age 70 before July 1.

(a) The beneficiary in effect is treated as no more than ten years younger than the participant.

(b) The applicable divisor is determined under the table in the regulations each year based on the attained age of the participant in that year. Prop. Treas. Reg. § 1.401(a)(9)-2, Q&A 5(a).

(c) After the death of the participant, the beneficiary's life expectancy may be used instead of the factor provided under the MDIB rule. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-3A(b)(1).

(2) In the case of a joint and survivor annuity, if the designated beneficiary is not the spouse, the amount payable to the designated beneficiary after the death of the participant must be reduced if the participant is more than ten years older than the designated

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(3) If the spouse is the designated beneficiary, the MDIB rule is satisfied as long as the general minimum distribution rules are satisfied. Prop. Treas. Reg. § 1.401(a)(9)-2, Q&A 7(a).

IV. PLANNING AFTER DEATH

A. Options to Reduce or Avoid Taxes.

1. The spousal election under I.R.C. § 4980A(d)(5) should be considered if the value of the benefits exceeds the hypothetical annuity or grandfathered amount.

   a. The election is made by the spouse on a form attached to the estate tax return.

   b. It can be made only if the spouse is the beneficiary of all but a de minimis portion (at least 99 percent according to the Senate Finance Committee Report on TAMRA) of the decedent’s total retirement accumulation.

   c. If the election is made, any distributions received with respect to the decedent’s retirement accumulation would be aggregated with any retirement distributions that the spouse received on the spouse’s own behalf for purposes of computing the excess retirement distributions or accumulation tax with respect to the spouse.

   (1) The Committee Report on TAMRA § 1011A(g)-(k), adding I.R.C. § 4980A(d)(5), permitting the spousal election, indicates that the grandfathered amount of both the deceased spouse and the surviving spouse may be aggregated for the purpose of determining the excess retirement distributions and accumulation of the surviving spouse.

   d. Query whether a spouse who is the beneficiary of a trust that qualifies for the marital deduction can make the election not to have the excess retirement accumulation tax apply
if the trust is the sole beneficiary of the decedent’s retirement benefits.

e. In determining whether the spouse should make the election, the following factors should be taken into account:

(1) The amount of the spouse’s retirement benefits;

(2) The amount that the spouse will need to withdraw either to satisfy his or her needs or to satisfy the minimum distribution rules under I.R.C. § 401(a)(9);

(3) The spouse’s age;

(4) The spouse’s health; and

(5) The fact that there may be no federal estate tax at the death of the first spouse to die because of the use of the unlimited marital deduction, resulting in an effective rate equal to the full 15 percent.

f. For example, if the amount of the decedent’s excess retirement accumulation is small and the value of the surviving spouse’s retirement benefits is large, it may be better to pay a small tax on excess retirement accumulations at the death of the first spouse to die to avoid the tax on excess retirement distributions made to the surviving spouse during lifetime and the tax on excess retirement accumulations in the surviving spouse’s estate.

g. Under the temporary regulations, if a surviving spouse who does not make the election to defer the tax rolls a distribution with respect to the decedent’s qualified retirement plan or IRA into the spouse’s IRA and commingles these amounts with his or her own contributions, then all distributions from the spouse’s IRA will be subject to the excess retirement distributions or accumulation tax, even though the decedent’s benefits were already subject to the excess retirement accumulation
2. **The use of a disclaimer should be considered.**

   a. The Internal Revenue Service, in GCM 39858, ruled that a disclaimer of qualified retirement plan benefits that satisfied the requirements of I.R.C. § 2518(b) and state law was neither a prohibited assignment or alienation under I.R.C. § 401(a)(13) or ERISA § 206(d) nor an assignment of income. Identical treatment was accorded IRAs under I.R.C. § 408(b).

      (1) However, no opinion was expressed whether a transfer of plan benefits that was not a qualified disclaimer under I.R.C. § 2518(b), including a transfer treated as a qualified disclaimer under I.R.C. § 2518(c)(3), would be a prohibited assignment or alienation and whether a transfer of plan benefits intended to qualify as a disclaimer under state law but that failed to qualify as such would be a prohibited assignment or alienation.

      (2) In Priv. Ltr. Rul. 9037048, the Internal Revenue Service ruled that a surviving spouse could make a qualified disclaimer under I.R.C. § 2518 of an interest in an IRA.

      (3) In Priv. Ltr. Rul. 9016026, the Service ruled that a surviving spouse could make a qualified disclaimer under I.R.C. § 2518 of an interest in a money purchase pension plan.

      (4) In addition, in Priv. Ltr. Rul. 8838075, the Service ruled that benefits under a profit sharing plan could be disclaimed under I.R.C. § 2518.

   b. The Service may take the position that the nine-month period within which a qualified disclaimer must be made of a surviving spouse's interest in a joint and survivor annuity begins to run on the participant's
annuity starting date (generally when the participant retires).

(1) The Service has taken the position that a completed gift to the participant's spouse occurs at the date a participant retires when the benefits under the Civil Service Retirement Act are payable in the form of a joint and survivor annuity. Priv. Ltr. Ruls. 8703016, 8715010, and 8721013.

(2) The nine-month period should run from the date of death if the participant is permitted under the plan to change the beneficiary at any time before his or her death, unless the participant has made an irrevocable beneficiary designation. This result would be consistent with GCM 39858's recognition of a spouse waiving a preretirement survivor annuity after the participant's death. As that GCM states: "There is no evidence that Congress intended to preclude a spouse from disclaiming or renouncing benefits under a qualified plan after the participant's death."

c. In PLR 9037048, the decedent elected to have payments made over the joint and last survivor expectancy of the decedent and his spouse upon reaching his RBD. After the decedent died, the spouse disclaimed her interest in both the IRA and the trust that was the alternate beneficiary. According to the Service, payments could continue to be made over the remaining period established by the decedent at his RBD.

3. Because the receipt of qualified retirement plan benefits and IRA accounts is taxable as income in respect of a decedent, such benefits should not be used to satisfy a pecuniary bequest, including a pecuniary bequest under a marital deduction formula. Otherwise, the estate will recognize current income equal to the present value of the receipt of those benefits when the right to receive the benefits is transferred to the beneficiary in satisfaction of the bequest. I.R.C. § 691(a)(2) and Treas. Reg. § 1.661(a)-2(f)(1).

b. A specific bequest of the right to the qualified retirement plan benefits or IRA also will avoid the acceleration of income.

(1) For example, the participant could name the credit shelter trust as the beneficiary of up to a specific dollar amount determined by a formula designed to use the participant’s remaining exemption equivalent.

B. Minimum Distribution Rules.

1. Death after the participant’s RBD.

a. If the participant dies on or after his or her RBD but before the entire benefit has been distributed, the remaining portion of the benefit must be distributed at least as rapidly as under the method of distribution in effect at the date of the participant’s death. I.R.C. § 401(a)(9)(B)(i).

b. For a distribution that begins before the participant’s death and that is being paid out over the lives of the participant and a designated beneficiary (or over a period not exceeding the joint and last survivor expectancy of the participant and a designated beneficiary), the designated beneficiary whose life expectancy is being used to determine the period must be the person entitled to the remaining portion after the participant’s death. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A B-4.

c. If the life expectancy of the participant and the participant’s surviving spouse is being recalculated each year, the entire balance must be distributed before December 31 of the calendar year immediately following the calendar year of the death of the survivor of the participant and the spouse, since the proposed regulations treat the life expectancy of the participant or the participant’s spouse as zero in the year following his or her death when life
expectancies are being recalculated. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(a).

2. Death before the participant’s RBD.

a. If the participant dies before his or her RBD, the entire interest must be distributed by December 31 of the calendar year that contains the fifth anniversary of the death of the participant. I.R.C. § 401(a)(9)(B)(ii); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-2.

b. There are two exceptions to the above five-year distribution rule.

(1) For payments to a nonspouse beneficiary, if the payments begin not later than December 31 of the calendar year after the calendar year in which the participant died, the payments may be paid over the life of the designated beneficiary or over a period not extending beyond the life expectancy of the designated beneficiary.

(2) For payments to the spouse of the participant, the payments may be made over the life of the participant’s spouse or over a period not extending beyond the spouse’s life expectancy, if the payments begin by the later of:

(a) December 31 of the calendar year immediately following the calendar year in which the participant died; or

(b) December 31 of the calendar year in which the participant would have attained age 70½.

I.R.C. §§ 401(a)(9)(B)(iii) and (iv); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-3.

c. If the surviving spouse is the beneficiary, he or she has additional options.

(1) In the case of a qualified retirement plan, he or she can roll the
distribution into an IRA that will be treated as his or her own IRA, and wait until he or she reaches age 70½ to commence receiving benefits. I.R.C. § 402(c)(9).

(2) If the surviving spouse is the beneficiary of an IRA, the spouse may elect to treat the IRA as the spouse’s own IRA or roll the IRA into a new IRA, which will be treated as the spouse’s IRA.

(a) As in the case of a rollover from a qualified retirement plan, the surviving spouse can wait until he or she reaches age 70½ to begin receiving distributions. I.R.C. § 408(d)(3)(C)(ii) and Prop. Treas. Reg. § 1.408-8, Q&A A-4(b).

(b) The election to treat an IRA as the spouse’s IRA will be deemed to have been made if the amounts are not distributed pursuant to the minimum distribution rules that would apply to the benefit after the original IRA owner’s death or if the spouse contributes additional amounts that are subject to the minimum distribution requirements as applied to the spouse’s own plan benefits and IRAs. Prop. Treas. Reg. § 1.408-8, Q&A A-4(b).

d. If the surviving spouse dies before the distribution has begun, then the five-year distribution rule and the exception to the five-year distribution rule apply as if the surviving spouse were the participant. I.R.C. § 401(a)(9)(B)(iv)(II); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-5.

(1) In determining whether distributions have commenced to the surviving spouse, payments made before the date the payments are required to begin are to be disregarded. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-6(a).
(2) The spouse may designate a beneficiary to take any remaining benefits.

(a) The designated beneficiary exception to the five-year distribution rule will be available.

(b) The spousal exception to the five-year distribution rule, however, will not be available.

Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-5.

(3) Payments to a child are treated as payments to the surviving spouse (and will, therefore, not disqualify the spouse from electing the spousal exception to the five-year distribution rule) if payments of the benefit will be made only to the spouse after the child reaches majority. I.R.C. § 401(a)(9)(F).

e. The proposed regulations provide rules for determining whether the five-year distribution rule or one of the exceptions applies. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-4.

(1) In the case of a plan that does not specify the method:

(a) If the surviving spouse is the beneficiary, the spousal exception to the five-year distribution rule applies; and

(b) If the beneficiary is other than the surviving spouse, the five-year distribution rule applies.

Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-4(a).

(2) A plan may adopt a provision specifying which of the two methods applies if the participant dies before his or her RBD. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-4(b).
(3) A plan may permit a participant or a beneficiary to elect a method. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-4(c).

(a) Except in the case of the spousal exception, the election must be made not later than December 31 of the calendar year following the calendar year of the participant’s death; otherwise, the entire benefit must be distributed by December 31 of the calendar year that contains the fifth anniversary of the participant’s death.

(b) In the case of the spousal exception, while the proposed regulations state that the election must be made before December 31 of the earlier of the calendar year in which the participant would have reached age 70½ or the fifth anniversary of the participant’s death, as a practical matter, the spouse will usually be able to withdraw the benefit earlier if desired, so that the failure to make an election will not bind the spouse to a payment over his or her life expectancy, beginning at the date the participant would have reached age 70½.

3. The proposed regulations also specify which individuals or trusts may be designated as a beneficiary for purposes of the exception to the five-year distribution rule and for determining the payout period when the participant reaches his or her RBD.

a. Only individuals and certain types of trusts may be designated beneficiaries. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-2A and D-5.

b. An estate or a charitable organization may not be a designated beneficiary. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-2A(a).

c. If the participant’s benefit is payable to a person solely because of state law, the
person will not be treated as a designated beneficiary. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-2(a).

d. The designation may be made by the participant (or the surviving spouse) or, if no designation is made, then pursuant to the terms of the plan. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-1.

e. Designated beneficiaries are generally determined as of the RBD. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-3(a).

f. If there is no designated beneficiary, the five-year distribution rule applies if the participant dies before the RBD and only the participant’s life expectancy can be used for determining the minimum distribution once the participant reaches his or her RBD. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-2A(b).

g. If a group of multiple beneficiaries includes those that qualify as designated beneficiaries and at least one that does not qualify as a designated beneficiary and separate accounts or shares have not been established, the participant will be deemed not to have selected a designated beneficiary and the five-year distribution rule will apply. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-5(a).

h. Since a payment to a trust that meets the requirements under the minimum distribution rules discussed in Section II.B.7. of this outline qualifies as a distribution for purposes of the minimum distribution rules, the trust is not required to redistribute the payment to a beneficiary. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A H-7.

i. A designated beneficiary of a separate account or a separate share will be treated as the participant’s designated beneficiary with respect to such separate account or separate share. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A H-2(b).

(1) A separate account in an individual account plan is a portion of a
participant's benefit determined by an acceptable separate accounting, including allocating investment gains and losses, and contributions and forfeitures, on a pro rata basis in a reasonable and consistent manner between such portion and any other benefits. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A H-2A(a).

(2) A benefit in a defined benefit plan is separated into segregated shares if it consists of separate identifiable components that may be separately distributed. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A H-2A(b).

j. Generally, if a beneficiary can be changed after the participant's death, the beneficiary will not be treated as a designated beneficiary. However, the surviving spouse may have the right to change the beneficiary who will receive the benefits if the spouse dies before benefits are required to begin. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-5(f).

V. COMMUNITY PROPERTY LAW CONSIDERATIONS*

A. Introduction.

1. In a community property state, a participant's spouse is generally deemed under state law to own a share of the participant's interest in a qualified retirement plan or IRA.

   a. Under a qualified retirement plan, as the benefit is earned during the marriage it generally accrues to the married couple as community property. Bowman v. Bowman, 217 Cal. Rptr. 174 (4th Dist. 1985); Estate of

*The material on community property is based on a draft of a proposed addition to a study entitled "Handbook on Distributions from Qualified Retirement Plans and Individual Retirement Accounts" developed by the American College of Trust and Estate Counsel Employee Benefits in Estate Planning Committee. The draft was prepared by Edward F. Martin of New Orleans, Louisiana, with the assistance of Edward V. Brennan of San Diego, California.

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.. b. There is also significant authority that IRAs are subject to community property laws. See, for example, In Re Estate of MacDonald, 794 P.2d 911 (Cal. 1990); but compare Stewart v. Estate of Stewart, No. 352-680, 1st J.D.C. Caddo Parish, La. (decided February 24, 1988) (no community property ownership of IRA) with Succession of Bgan, 543 So.2d 940 (La. Ct. App. 5th Cir. 1989) (community property principles do apply to IRAs), and with Succession of McVay, 476 So.2d 1070 (La. Ct. App. 3d Cir. 1985) (the IRA was separate but an accounting was due for the community investment).

(1) Although § 408(g) indicates that the requirements for IRAs are applied without regard to any community property laws, it is unlikely that Congress intended community property rights to be recognized in qualified retirement plans but not IRAs.

(2) The reference to community property was probably intended to allow a participant in a community property state to use 100 percent of his or her earnings for purposes of determining the amount that can be contributed to an IRA and to prevent a nonworking spouse from making IRA contributions based on the earnings of the working spouse.

2. The statutory and case law of the community property states is not well developed or uniform concerning the rights of either a participant's spouse upon divorce or the distributees or beneficiaries of a participant's spouse who dies before the benefit has been distributed from the plan.
B. **The Spouse’s Community Property Interest in Qualified Retirement Plans.**


2. REA granted a participant’s spouse certain rights in qualified retirement plans, which are discussed in Section I.A.1.b. of this Outline.

3. REA also allowed a participant’s spouse to enforce his or her community property rights through a QDRO. See § 414(p).

4. Even in a harmonious marital situation, a QDRO can provide tax and estate planning benefits.

   a. Payments made to a spouse as an alternate payee pursuant to a QDRO are not included in excess retirement distributions of the participant that are subject to the 15-percent penalty tax. § 4980A(c)(2)(B).

   b. A QDRO may double the amount exempt from the 15-percent penalty tax on excess retirement accumulations. § 4980A(d)(4)(B)(i).

   c. Payments pursuant to a QDRO are not subject to the ten-percent additional income tax on premature distributions. § 72(t)(2)(C).

   d. Distributions to a spouse or former spouse who is an alternate payee under a QDRO can be rolled into the alternate payee’s IRA. § 402(e)(1)(B).

   e. A spouse or former spouse who is an alternate payee under a QDRO may also elect special averaging. § 402(d)(4)(J).
f. A division of a participant's qualified retirement plan benefits pursuant to a QDRO can provide flexibility in the allocation of the benefits between a marital trust and a credit shelter trust, especially when the spouse dies first.

5. QDROs are most often used in the case of marital dissolutions.

6. A QDRO may require that the spouse receive his or her interest before the participant has separated from service, as long as the participant has reached his or her earliest retirement age. § 414(p)(4).

   a. As mentioned above, the spouse can roll the distribution into an IRA.

   b. By taking an immediate distribution from the participant's plan, the spouse is able to retain rights in the benefits even if the spouse dies before the participant dies or begins receiving benefits.

7. The heirs or beneficiaries of the spouse may have difficulty in enforcing any interest given to them under the will of the spouse or inherited from the spouse.

   a. A QDRO probably cannot be used for purposes of enforcing these rights.

      (1) The fact that § 402(e)(1)(A) taxes the participant on any distributions made pursuant to a QDRO other than to a spouse or former spouse indicates that the only other intended recipients would be dependents of the participant.

         (a) It would be a strange result if the participant had to pay income taxes on distributions made to children of a deceased spouse's previous marriage.

      (2) The Labor Department issued two ERISA opinion letters on December 4, 1990, 90-46A and 90-47A (CCH Pension Reporter ¶ 23,816Z), stating that a state's probate court order dividing and
segregating a portion of the pension benefit of a participant for the estate of the deceased spouse did not qualify as a QDRO.

(a) The opinions are based on a finding that the intent of Congress in developing the QDRO procedure was to assure greater opportunity for women (whether employees or homemakers) to receive private pension income.

(b) The legislative history, according to the Labor Department, indicated that, in enacting these provisions, Congress focused on the division of pension benefits in a marital dissolution or dependent support situation.

(3) Under REA, a QDRO can be obtained only by a spouse or former spouse, not by his or her successors at death.

(4) In *Ablamis v. Roper*, 937 F.2d 1450 (9th Cir. 1991), the court held that ERISA's anti-alienation provisions preempted California's community property law except to the extent a participant's spouse could enforce his or her rights pursuant to a QDRO. The court then held that a QDRO only applied to domestic relations cases and not to probate proceedings. There was a strong dissent.

8. Consequently, a spouse should consider exchanging his or her interest in the participant's qualified retirement plan benefits and IRAs for other property.

9. If the participant dies first, the spouse will be entitled to receive either a survivor annuity or the entire accrued benefit of the deceased participant under REA.

   a. This right is not dependent upon community property laws, but upon the express provisions of REA.
b. The rights of a former spouse under a QDRO protecting his or her community property interest is superior to the right of the participant's surviving spouse under REA to a survivor annuity or the participant's accrued benefit. § 414(p)(5).

10. It may be possible for the heirs or legatees of a deceased spouse to make a claim against property outside the plan.

C. The Spouse's Community Property Interest in IRAs.

1. Although the Internal Revenue Code does not prohibit paying amounts to third parties from an IRA, the participant will be subject to immediate income taxation and possibly the ten-percent additional income tax on premature distributions.

   a. The IRA cannot be put into the spouse's name during the participant's lifetime.

   b. Since a QDRO does not apply to an IRA, it cannot be used to divide the IRA in a tax-free division.

2. In a divorce, the spouse's share of the participant's IRA can be transferred tax-free to his or her own IRA. § 408(d)(6).

3. There is no federal law that prevents the heirs or legatees of a participant's spouse from claiming their share from the participant's IRA, and such a claim has been upheld by the California Supreme Court in In Re Estate of MacDonald, 794 P.2d 911 (Cal. 1990).

   a. Such a payment would cause immediate taxation to the participant and, if the participant is under age 59 1/2, a ten-percent additional income tax.

4. Under REA, a participant can designate anyone as the beneficiary of his or her own IRA without the spouse's consent, since IRAs are not subject to REA.

   a. The participant's spouse may be entitled to claim his or her community property interest after the death of the participant if he or
she is not named the beneficiary of at least that amount.

D. Gift and Estate Taxes.

1. If the participant dies first, only half of the value of qualified retirement plans and IRAs that is community property is includible in his or her estate.

a. The spouse is entitled to the other half of the qualified retirement plan benefits and IRAs, but if they pass to someone other than the surviving spouse, he or she may be deemed to have made a gift.

b. If the spouse is the sole beneficiary, there will be no estate tax due either on the participant’s share, because of the marital deduction, or on the spouse’s share, because he or she has not lost any ownership rights.

c. Although § 2503(f) exempts from the gift tax the waiver by the spouse of the right to benefits granted under REA, it does not apply to the spouse’s community property interest in the benefit.

(1) In most (if not all) cases, the value of the spouse’s rights under REA will exceed the value of his or her community property interest in the benefits.

d. A former spouse with a community property interest in a qualified retirement plan who fails to obtain a QDRO before either the participant’s death or his or her own death may be deemed to have made a taxable gift of his or her community property interest in the plan.

(1) Adequate consideration paid to the spouse will avoid this result.

2. If the spouse dies first, his or her community property interest in qualified retirement plans and IRAs will be included in his or her gross estate.

a. If the participant succeeds to the spouse’s community property interest either under the
spouse's will or automatically based on the theory that the state laws of inheritance are completely preempted by ERISA, then the marital deduction should be available.

(1) However, an argument could be made that a benefit payable to a participant who is not in pay status may not qualify for the marital deduction because the participant is not entitled to receive the income annually.

b. If the spouse does not transfer his or her interest to the participant, it will not qualify for the marital deduction and will be subject to estate tax.

(1) The estate tax may be payable at a time when the benefit itself is not available since the participant may not be entitled to a current distribution.

(2) None of the deferral provisions generally available to an estate would be available with respect to the tax on the community property interest in the qualified retirement plan.

3. If the spouse dies first and the participant is not the beneficiary of the spouse's community property interest in the participant's IRA, the marital deduction will not be available and the participant's interest in the IRA will be clouded by the claims of the spouse's estate.

a. Any distributions to the beneficiaries of the deceased spouse will still be taxable to the participant.

4. In most cases the participant's spouse should leave his or her interests in qualified retirement plans and IRAs outright to the participant.

a. If this disposition will overfund the marital deduction, an alternative beneficiary should be named, such as a credit shelter trust, so that the participant could disclaim some or all of the benefit.
5. In most cases the participant should name the spouse as the beneficiary of qualified retirement plan benefits and IRAs.

   a. See Section II.A. of this Outline for a full discussion of the considerations in making the spouse the sole beneficiary of qualified retirement plan benefits and IRAs.

   b. The designation should include a contingent disposition that would apply if the spouse dies first or disclaims the outright designation.

      (1) The contingent disposition might provide that the spouse's interest would pass outright to him or her, and the participant's interest would pass to a credit shelter trust in which the surviving spouse could receive an income interest.

      (2) This designation takes advantage of the participant's unified credit without causing the spouse to make a gift as to his or her half.
EXHIBIT A

ILLUSTRATION OF TAX CONSEQUENCES

Mrs. Smith, a widow, has accumulated $2 million in a pension plan. She dies in 1995 at age 65, survived by all her children and a grandchild. She was a resident of a state that only has a pick-up type estate tax (that is, the estate tax is equal to the federal estate tax credit for estate and inheritance taxes paid to the state). She has designated a trust that is held exclusively for the benefit of her grandchild as the recipient of the plan benefits, which are to be paid in a lump sum. The grandchild's interest in the trust is vested and will be included in the grandchild's federal gross estate.

Mrs. Smith had a grandfathered amount of $1 million (the value of her accrued benefit as of August 1, 1986) and she made the grandfather election on Form 5329. The annual excess retirement distribution limit of $150,000 x 6.945096 (the annuity factor at age 65 using an interest rate assumption of 10.4 percent) results in a present value of an annuity of $150,000 for her life (determined as if she had not died) equal to $1,041,764. Since this amount is greater than her grandfathered amount of $1 million, it will be used for purposes of determining the amount of excess retirement accumulations. (Mrs. Smith could have withdrawn her grandfathered amount before death and her estate would have been entitled to reduce her remaining plan benefit by the value of the hypothetical annuity.) Note her accrued benefit grew to $2 million from August 1, 1986 until 1995 because of continued benefit accruals.

Mrs. Smith's federal gross estate is $6 million, and therefore the marginal federal estate tax rate is 55 percent. The generation-skipping transfer (GST) tax rate is also 55 percent. The trust's marginal combined federal and state income tax rate is 43 percent (taxable income of a trust in excess of $7650 is taxed at 39.6%). Mrs. Smith had used her GST exemption before her death. Assume that Mrs. Smith's will contains a tax apportionment clause that reduces a bequest by any estate taxes attributable to the bequest as well as the 15-percent penalty tax attributable to any qualified retirement plan or IRA benefits.

**Calculation of Applicable Taxes**

Benefits passing to Grandchild’s Trust before any taxes $2,000,000

Amount subject to excise tax 958,236
($2,000,000 - $1,041,764, the amount not subject to the excise tax)
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise tax rate</td>
<td>15%</td>
</tr>
<tr>
<td>Excise tax on excess retirement accumulations</td>
<td>143,735</td>
</tr>
<tr>
<td>Balance subject to estate tax</td>
<td>1,856,265</td>
</tr>
<tr>
<td>(The excise tax is deductible for estate tax purposes)</td>
<td></td>
</tr>
<tr>
<td>Estate tax rate</td>
<td>55%</td>
</tr>
<tr>
<td>Combined Federal and State Estate tax</td>
<td>$1,020,945.75</td>
</tr>
<tr>
<td>Combined estate tax and excise tax</td>
<td>$1,164,680.75</td>
</tr>
<tr>
<td>Amount passing to Grandchild's Trust after estate and excise taxes</td>
<td>$835,319.25</td>
</tr>
<tr>
<td>($2,000,000 - $1,164,680.75)</td>
<td></td>
</tr>
<tr>
<td>Because the GST Tax in the case of a direct skip</td>
<td></td>
</tr>
<tr>
<td>is tax exclusive (i.e., it is determined by</td>
<td></td>
</tr>
<tr>
<td>applying the 55% GST Tax Rate to the amount</td>
<td></td>
</tr>
<tr>
<td>passing after the GST Tax), the GST Tax can be</td>
<td></td>
</tr>
<tr>
<td>determined by applying the following formula:</td>
<td></td>
</tr>
<tr>
<td>Amount passing to the</td>
<td></td>
</tr>
<tr>
<td>recipient before the GST tax</td>
<td></td>
</tr>
<tr>
<td>minus</td>
<td></td>
</tr>
<tr>
<td>Amount passing to the</td>
<td></td>
</tr>
<tr>
<td>recipient before the GST tax</td>
<td></td>
</tr>
<tr>
<td>1+ GST tax rate</td>
<td></td>
</tr>
<tr>
<td>equals</td>
<td></td>
</tr>
<tr>
<td>GST tax</td>
<td></td>
</tr>
<tr>
<td>$835,319.25 divided by 1.55 (1+ GST tax rate) = $296,403.60</td>
<td></td>
</tr>
<tr>
<td>Amount subject to income tax</td>
<td>$896,802.45</td>
</tr>
<tr>
<td>($2,000,000 less the IRD deduction of</td>
<td></td>
</tr>
<tr>
<td>$1,103,197.55, which is the sum of the GST tax</td>
<td></td>
</tr>
<tr>
<td>($296,403.60) and the federal estate tax</td>
<td></td>
</tr>
<tr>
<td>($806,793.95)). Note that the IRD deduction is</td>
<td></td>
</tr>
<tr>
<td>limited to the federal estate tax; consequently,</td>
<td></td>
</tr>
<tr>
<td>the total federal and state estate tax of $1,020,945.75 attributable to the</td>
<td></td>
</tr>
<tr>
<td>$2,000,000 of IRD must be reduced by the state death tax credit</td>
<td></td>
</tr>
<tr>
<td>attributable to the same amount, which is $214,151.80. Note also that the</td>
<td></td>
</tr>
<tr>
<td>excise tax is not deductible for purposes of computing the</td>
<td></td>
</tr>
<tr>
<td>federal income tax</td>
<td></td>
</tr>
<tr>
<td>Combined Federal and state income tax rate</td>
<td>43%</td>
</tr>
<tr>
<td>Tax</td>
<td>Amount</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>-------------</td>
</tr>
<tr>
<td>Combined Federal and state income tax</td>
<td>$385,625.05</td>
</tr>
<tr>
<td>Amount Left</td>
<td>$153,290.60</td>
</tr>
</tbody>
</table>

**Summary of Taxes**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original Amount</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Excise Tax</td>
<td>($143,735)</td>
</tr>
<tr>
<td>Combined Federal and State Estate Tax</td>
<td>($1,020,945.75)</td>
</tr>
<tr>
<td>GST Tax</td>
<td>($296,403.60)</td>
</tr>
<tr>
<td>Combined Federal and State Income Tax</td>
<td>($385,625.05)</td>
</tr>
<tr>
<td>Total Taxes</td>
<td>($1,846,709.40)</td>
</tr>
<tr>
<td>Amount Left (About 7.6 percent of the total)</td>
<td>$153,290.60</td>
</tr>
</tbody>
</table>
EXHIBIT B

FORMS

The following sample beneficiary designation forms and trust language forms are merely suggestions and should not be used unless the drafter fully understands the rules applicable to distributions from qualified retirement plans and IRAs. State law must be considered, since state law may affect the interpretation of the beneficiary designation forms or the trust language and may give a surviving spouse or other individual certain rights with respect to a participant's benefit in a qualified retirement plan or IRA. The Retirement Equity Act provisions granting to surviving spouses rights in the participant’s qualified retirement plan benefits must also be considered. In the case of a qualified retirement plan benefit, because the spouse is not the beneficiary and the form of payment is not a qualified preretirement survivor annuity, beneficiary designation Forms II, III, IV and V must have the consent of the participant’s spouse, in writing, which must be either notarized or witnessed by a plan representative. The participant’s spouse must also consent to Form I in the case of a qualified retirement plan benefit other than a defined contribution plan that is exempt from the preretirement survivor annuity requirements, since the payment will be made in a lump sum rather than in the form of a survivor annuity. Finally, the plan itself must be reviewed carefully to be sure that the desired beneficiary designation is permitted under the plan.

Form I, which provides for an outright distribution of the plan benefit or IRA to the surviving spouse, will be used most often, particularly when there is a happy marriage and the participant has sufficient assets to fund a credit shelter trust. Form II will be used where the participant wishes to provide for the surviving spouse during his or her lifetime, but wants to retain as much of the benefit as possible to pass to the participant’s children by a prior marriage or other beneficiaries. Form II should satisfy the Internal Revenue Service’s ruling position concerning the payment of qualified retirement plan benefits and IRAs to QTIP trusts. Form III will be used in the same situations as Form II, but it does not comply with the current position of the Internal Revenue Service with respect to the payment of plan benefits and IRAs to a QTIP trust.

Form IV will be used when the plan benefit is the asset that will fund the credit shelter trust. Note that this form can be combined with the other forms when only a portion of the plan benefit or IRA is required to fund the credit shelter trust. The beneficiary designation may be made to a trust before it is divided into two trusts, one designed to qualify for the marital deduction and one designed to be a credit shelter trust. In such a case, the
trust will usually have a formula to determine the percentage of
the trust assets to be allocated to each trust. However, if the
plan benefit or IRA is paid to a trust before its division, the
trust may not be treated as satisfying the current requirements
under the proposed regulations that the beneficiaries of the trust
ten to the plan benefit or IRA be identifiable. Consequently,
if the plan benefit or IRA is paid directly to the trust before it
is divided, the entire benefit will be required to be paid to the
trust by the end of the fifth year after the year in which the
participant dies, if the participant dies before the participant’s
required beginning date. This five-year rule may not apply if the
spouse is the sole income beneficiary of both trusts while he or
she is alive. In addition, it could be argued that other
beneficiaries will become identifiable once the trustee has
allocated the assets, including the plan benefit or IRA, and the
allocation should relate back to the participant’s death. If some
of the plan benefit or IRA is allocated by the spouse as the
executor or trustee, or under a power given to him or her by the
participant, to a marital trust that gives the spouse a power to
withdraw all of the principal, the surviving spouse may be able to
withdraw the benefit and roll it into his or her own IRA.

The final beneficiary form deals with a bequest to a
charitable organization. The forms are not meant to exhaust all
the possible beneficiary designations a participant may wish to
consider. The sample trust language forms are designed to qualify
the plan benefit or IRA for the marital deduction. Note these
forms may not be appropriate once the participant has reached his
or her required beginning date. At that point the participant will
be required to name a designated beneficiary for purposes of
determining the payout period. If the participant dies after the
RBD, the payments to the designated beneficiary after the
participant’s death must continue at least as rapidly as under the
method in effect before the participant’s death. However, a
surviving spouse may roll the plan benefit or IRA into his or her
own IRA or treat a decedent’s IRA as his or her own IRA. Finally,
as with any sample forms, there is no guarantee that these forms
are appropriate in any particular case or that they satisfy federal
or state law.
FORM I: BENEFICIARY DESIGNATION FOR QUALIFIED RETIREMENT PLAN BENEFIT OR INDIVIDUAL RETIREMENT ACCOUNT NAMING SURVIVING SPOUSE AS PRIMARY BENEFICIARY AND TRUST AS SECONDARY BENEFICIARY

My [benefit or IRA] shall be distributed in a lump sum to my [husband or wife] if my [husband or wife] survives me and does not disclaim [his or her] right to receive the [benefit or IRA]. If my [husband or wife] survives me but disclaims [his or her] right to receive such [benefit or IRA] pursuant to a qualified disclaimer as defined in I.R.C. § 2518(b) or (c)(3), my [benefit or IRA] shall be distributed to the trustee of the marital trust created under the trust created by me as of __________, in installments, payable at least annually, equal to the greater of (x) the income generated or deemed to be generated by the [benefit retained in the plan or IRA] or (y) the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. If my [husband or wife] does not survive me, or if my [husband or wife] survives me and disclaims both [his or her] right to receive the [benefit or IRA] outright and [his or her] right under the marital trust created under the trust agreement to receive the [benefit or IRA] pursuant to a qualified disclaimer as defined in I.R.C. § 2518(b) or (c)(3), my [benefit or IRA] shall be distributed to the trustee of the family trust created under the trust created by me as of __________, in installments, payable at least annually, equal to the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. If the [benefit or IRA] is payable to a trust, my trustee shall have the right at any time to withdraw all or any part of the remaining [benefit or IRA] or to designate a beneficiary of the trust to receive any remaining payments directly and to have the right to withdraw at any time all or any part of the remaining [benefit or IRA].

NOTE: If a trustee is also a beneficiary, the right to designate a beneficiary of the trust to receive any remaining benefits directly and to withdraw the remaining benefits should be restricted. See also Forms II-IV and VI.
If my [husband or wife] survives me, my [benefit or IRA] shall be distributed to the QTIP trust created under the trust created by me as of __________, in installments, payable at least annually, equal to the greater of (x) the income generated or deemed to be generated by the [benefit retained in the plan or IRA] or (y) the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. If my [husband or wife] does not survive me, my [benefit or IRA] shall be distributed to the trustee of the family trust created under the trust created by me as of __________, in installments, payable at least annually, equal to the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. My trustee shall have the right at any time to withdraw all or any part of the remaining [benefit or IRA] or to designate a beneficiary of the trust to receive any remaining payments directly and to have the right to withdraw at any time all or any part of the remaining [benefit or IRA].

NOTE: This designation should satisfy the current position of the Internal Revenue Service with regard to qualifying payments to a QTIP trust for the marital deduction. The executor may be required to elect QTIP treatment for the plan benefit or IRA in order to qualify the benefit or IRA for the marital deduction.
FORM III: BENEFICIARY DESIGNATION FOR QUALIFIED RETIREMENT PLAN BENEFIT OR INDIVIDUAL RETIREMENT ACCOUNT NAMING QTIP TRUST AS PRIMARY BENEFICIARY AND FAMILY TRUST AS SECONDARY BENEFICIARY WITH DISCRETION IN TRUSTEE TO ACCELERATE PAYMENTS

If my [husband or wife] survives me, my [benefit or IRA] shall be distributed to the QTIP trust created under the trust created by me as of [date], in installments, payable at least annually, equal to the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. If my [husband or wife] does not survive me, my [benefit or IRA] shall be distributed to the trustee of the family trust created under the trust created by me as of [date], in installments, payable at least annually, equal to the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. My trustee shall have the right at any time to withdraw any part or all of the remaining [benefit or IRA] or to designate a beneficiary of the trust to receive any remaining payments directly or to have the right to withdraw at any time all or part of the remaining [benefit or IRA].

NOTE: The current position of the Internal Revenue Service is that the form of payment itself must qualify for the marital deduction. However, the plan benefit or IRA should qualify for the marital deduction as long as the spouse has the right to require any unproductive property be converted into productive property and the trustee has the right to accelerate payments from the plan or IRA. See Treas. Treas. Reg. § 20.2056(b)-5(f)(4).
FORM IV: BENEFICIARY DESIGNATION FOR QUALIFIED RETIREMENT PLAN BENEFIT OR INDIVIDUAL RETIREMENT ACCOUNT NAMING CREDIT SHELTER TRUST AS PRIMARY BENEFICIARY

My [benefit or IRA] shall be distributed to the trust created by me as of ____________, in installments equal to the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. My trustee shall have the right at any time to withdraw all or any part of the remaining [benefit or IRA] or to designate a beneficiary of the trust to receive any remaining payments directly and to have the right to withdraw at any time all or any part of the remaining [benefit or IRA].

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FORM V: DESIGNATION OF A CHARITABLE BENEFICIARY
TO RECEIVE BENEFITS UNDER A QUALIFIED RETIREMENT PLAN OR IRA

I direct that [all or _____ percent] of my [benefit or IRA] be distributed in a lump sum to the XYZ charitable organization.

NOTE: In order to qualify the charity's interest as a separate account or separate share under the minimum distribution rules, the charity's portion should be designated as a fraction or percentage rather than a specific dollar amount once the participant has reached his or her RBD. Otherwise, only the participant's life expectancy can be used in determining the required minimum distribution once the participant reaches the RBD. [See Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-5.] Specifying a dollar amount should constitute a separate share if the participant dies before his or her RBD, since the specific dollar amount would constitute a fraction of the IRA at that point and would then be distributed outright to the charity, leaving the balance to be paid out over the designated beneficiary's life expectancy or, if the spouse is the beneficiary, to be rolled into a spousal IRA. In addition, the qualified retirement plan benefits or IRAs should not be used to satisfy a pecuniary charitable bequest to avoid recognition of income by the estate.
FORM VI: PROVISION IN TRUST AGREEMENT WHEN TRUSTEE OF A TRUST IS GIVEN THE RIGHT UNDER A QUALIFIED RETIREMENT PLAN OR IRA BENEFICIARY DESIGNATION TO ACCELERATE WITHDRAWALS TO QUALIFY FOR THE MARITAL DEDUCTION

My [husband or wife] shall have the right to direct my trustee of the marital trust to make any unproductive property productive or to convert any unproductive property into income-producing property within a reasonable time. In lieu of making the property productive or converting the unproductive property, my trustee may distribute quarterly to my [husband or wife] other assets from the marital trust the value of which is equal to the income that would have been produced during the calendar quarter if the property had been made productive or converted into income-producing property. Unproductive property shall include any benefit held in a qualified retirement plan as defined in I.R.C. § 401(a), any qualified retirement annuity as defined in I.R.C. § 403(a) or 403(b), and any individual retirement account as defined in I.R.C. § 408(a), but only if and to the extent that income generated or deemed to be generated by the plan benefit, annuity, or account is not distributed to the trust at least annually.
FORM VII: PROVISION IN TRUST AGREEMENT
TO BE INCLUDED IN DIRECTIONS TO TRUSTEE
TO QUALIFY FOR THE MARITAL DEDUCTION

I direct my trustee to treat distributions from any qualified retirement plan as defined in I.R.C. § 401(a), any qualified retirement annuity as defined in I.R.C. § 403(a) or 403(b), or any individual retirement account as defined in I.R.C. § 408(a) as income of the trust to the extent that the distribution represents income generated or deemed to be generated by such plan or individual retirement account, notwithstanding the treatment of such portion of the distribution under any law concerning the determination of income and principal for trust accounting purposes and my trustee shall not charge to such income any expense properly chargeable to the nonincome portion of the distribution. In addition, my trustee shall have the right in his or her or its sole discretion to withdraw any part or all of the remaining qualified plan benefit or individual retirement account or to direct that the plan benefit or individual retirement account be paid directly to the beneficiary of the trust who is entitled to the income of the trust and to give such beneficiary the right to withdraw at any time all or any part of the [benefit or individual retirement account].
Mary Smith is a participant in a money purchase pension plan sponsored by the Good Products Company, where she has been an employee for more than 40 years. She is currently a corporate officer. She has no intention of retiring as long as her health, which is currently excellent, permits her to work. She has participated in the Good Products Company Money Purchase Pension Plan for 25 years. Her 65th birthday was May 29, 1993. She has come to you on December 8, 1994 for advice on naming a beneficiary to receive benefits if she dies before her required beginning date (April 1, 1999). Fifty percent of the value of her benefit is currently payable to John in the form of a qualified preretirement survivor annuity, with the balance payable to her estate under the plan's default rule. The value of her accrued benefit as of December 31, 1993 was $1,500,000. Mary made the grandfather election with respect to her plan benefit for purposes of the 15-percent excise tax on excess retirement distributions and accumulations. The value of her accrued benefit on August 1, 1986 was $1 million.

Mary has been happily married to John for 40 years. They do not contemplate that their relationship will ever change. John is a retired sales representative, who was a participant in a defined benefit plan sponsored by the personal service corporation he owned. He received his benefit under the plan in the form of a lump sum distribution at age 60, when he liquidated the corporation. He elected to roll the entire distribution into an individual retirement account. The balance in his IRA is currently $800,000. John, who is about three years younger than Mary, reached age 62 on January 15, 1993. John did not make the grandfather election with respect to his plan benefit because the value of his benefit on August 1, 1986 was less than $562,500. Mary and John have one child, Anne, who reached age 34 in 1993. Both are United States citizens.
QUESTION I-1.

If Mary has other assets to fund a credit shelter trust, who should be the beneficiary of her plan benefit? [See Section II.A. of the outline and Form I.]

ANSWER:

Mary should name John as her beneficiary. This will be the most appropriate choice in situations where the client is happily married and has sufficient assets outside of qualified retirement plan benefits and IRAs to fund a credit shelter trust. Naming the spouse as the beneficiary gives the surviving spouse a number of options and defers the payment of estate tax until the death of the surviving spouse. The following are considerations when naming John as a beneficiary of a lump sum payment or giving him the right to withdraw all of the plan benefit at any time.

1. The payment of the plan benefit in a lump sum to John (since he is a citizen of the United States) will qualify the benefit for the marital deduction for estate tax purposes.
   a. The same result will be achieved if John leaves the benefit in the plan, but he has the right to withdraw the entire benefit at any time.

2. If the plan permits a lump sum distribution, John may roll the plan benefit into his own IRA, thereby deferring payment of income tax on the plan benefit.
   a. He can wait until April 1 of the calendar year following the calendar year in which he reaches age 70½ to begin receiving distributions from his IRA.
   b. If John were younger, any withdrawals from the IRA before he reached age 59½ would be subject to the ten-percent additional income tax unless an exception applied.

(1) If he had not rolled the plan benefit into his own IRA, and instead had taken withdrawals from the plan, the ten-percent additional income tax would not apply to withdrawals before he reached age 59½.
c. John may also name a beneficiary, such as his daughter Anne, to receive the balance in the IRA remaining at his death, and have the IRA paid over their joint and last survivor expectancy subject to the minimum distribution incidental death benefit rule.

3. Because Mary reached age 50 before 1986, John may also elect five-year averaging, ten-year averaging, and capital gain treatment for a distribution qualifying as a lump sum distribution.

4. John may elect to defer the 15-percent excise tax on excess retirement accumulations, although he may be better off to pay the excise tax on Mary’s benefit if she were to die now so that her benefit would no longer be subject to the excise tax. Otherwise distributions of her benefit would be combined with distributions from his IRA for purposes of determining the amount of excess retirement distributions subject to the 15-percent excise tax and any benefit remaining at his death would be combined with his IRA for determining the amount of excess retirement accumulations subject to the 15-percent excise tax at his death. If John does elect to defer the excise tax, he will be entitled to use Mary’s $1 million grandfathered amount to reduce the tax.

5. Because the benefit is in a money purchase pension plan, John’s consent under REA will be required to elect out of the qualified preretirement survivor annuity if the benefit is to be paid in a lump sum after Mary’s death.

6. Designating John as the sole beneficiary may result in overfunding the marital deduction if the plan benefit is a substantial part of Mary’s estate, in which case John may disclaim the receipt of some or all of the benefit if appropriate.

7. Under the minimum distribution rules, if Mary dies before her RBD, the payments do not have to commence until she would have reached age 70½ if the benefit is left in the plan.

a. John may also name a new beneficiary and if he dies before payments must commence, the
payments may be made over the beneficiary’s life or life expectancy.

8. Designating John as the beneficiary of a lump sum distribution will not provide for professional management of the funds unless he engages advisors or transfers the funds to a trust with someone else as trustee.

9. Designating John as the sole beneficiary might not be appropriate if Mary had children by prior marriages.

QUESTION I-2.

If Mary does not have any other assets to fund a credit shelter trust, who should be the beneficiary? [See Section II.C. of the outline and Form IV.]

ANSWER:

In this situation, Mary could name a trust designed to be excluded from John’s gross estate as the beneficiary of her benefit to the extent necessary to take full advantage of the unified credit equivalent (currently $600,000). Although it is not entirely clear from the proposed regulations dealing with the minimum distribution rules, it should be possible for Mary to name a trust as the beneficiary of her plan benefit that, upon her death, will be divided into two shares. One share, which would equal the excess of any plan benefit not required to take advantage of the unified credit, would be paid either outright to John or to a trust designed to qualify for the marital deduction. The other share would be paid to a trust that would be a typical credit shelter trust. Because John would be the beneficiary of both the marital deduction trust and the credit shelter trust, it should be possible to have the plan benefit payable to the trusts over his life expectancy. He may roll any of the plan benefit going to him outright into his own IRA. In addition, he may roll the portion of the plan benefit payable to the marital deduction trust into his own IRA if he has the discretion as executor or trustee to allocate the plan benefit to the marital deduction trust and he has the right to withdraw the balance payable to the marital deduction trust. John could then wait until his required beginning date before beginning to receive the plan benefit. In most cases, naming John as the primary beneficiary, with a credit shelter trust as the alternate beneficiary, will give John the opportunity to decide at Mary’s death whether the transfer tax benefit of a credit shelter trust outweighs the income tax benefit of a rollover of the entire benefit to John’s own IRA.
In order to have a beneficiary of a trust treated as a designated beneficiary for purposes of the minimum distribution rules, the proposed regulations require the trust to satisfy the following four requirements at the later of the date the trust is named as a beneficiary or the RBD.

1. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the participant's benefit must be identifiable from the trust instrument.

2. The trust must be a valid trust under state law or would be except for the fact that there is no corpus.

3. The trust must be irrevocable.

4. A copy of the trust instrument must be provided to the plan administrator.

It is hoped that the final regulations will eliminate all of these requirements except the first and will simply require that the plan administrator be informed of the name or names and age or ages of the beneficiaries of the trust who are being treated as designated beneficiaries. Recently, the Service has hinted that at least two of these requirements will be easier to satisfy. First, the Service has indicated that because the account holder of an IRA is the "plan administrator," as long as he or she has a copy of the trust instrument, the fourth requirement is satisfied. Second, the Service appears to have reached the conclusion that the trust must only become irrevocable upon the participant's death, even if it occurs after the RBD. See Letter Rulings 9321032 and 9322005. Both letter rulings contain the following conclusion:

In order for the beneficiaries of the Trust to be considered the designated beneficiaries for the purpose of Section 401(a)(9)(A), the Trust must be irrevocable as of the later of the date the Trust is irrevocably named the beneficiary of the IRA or the IRA owner's beginning date. Since the IRA beneficiary designation may remain revocable until the earlier of the IRA owner's beginning date or his date of death, it is the earlier of these dates that is the date at which the Trust must become irrevocable.

Under the facts of the two letter rulings, the IRA document required the designation be irrevocable as of the RBD. This is not a typical requirement. When the IRA owner is permitted to change the beneficiary designation after the required beginning date, the trust should not have to become irrevocable until his or her death, unless the participant has made an irrevocable beneficiary designation. Although under the proposed regulations the payout
period cannot be extended after the participant reaches his or her RBD, the beneficiary actually entitled to receive the benefits may be changed. If the IRA owner changes the beneficiary and the new beneficiary’s life expectancy is longer than that of the original designated beneficiary, the life expectancy of the original designated beneficiary will continue to be used for purposes of determining the minimum distribution. On the other hand, if the life expectancy of the new beneficiary is shorter than that of the original designated beneficiary, the life expectancy of the new beneficiary will be used for purposes of determining the minimum distribution after the change. An exception to this rule applies if the designated beneficiary dies after the RBD and the alternate beneficiary’s life expectancy is shorter than that of the deceased beneficiary. In this case the longer life expectancy of the deceased designated beneficiary will be used. In this situation the IRA owner has not exercised any discretion with respect to the change in the beneficiary. This same analysis should apply to qualified retirement plans that permit the participant to change his or her designated beneficiary after the RBD.

If the trust fails to satisfy these requirements, the participant will be treated as having no designated beneficiary. In such a case, the entire benefit or IRA would have to be paid out by the end of the year containing the fifth anniversary of the participant’s death if the participant died before his or her RBD and once the participant reaches the RBD, payments may be made only over his or her life expectancy. Consequently, the safe approach until the Service issues more guidance would be to have the participant execute an irrevocable trust on or before the participant’s RBD. The participant, of course, could change the beneficiary designation at any time, although if the new designated beneficiary were older than the original designated beneficiary, the payout period would be shortened. In no case will the payout period be increased.

The following additional considerations must be kept in mind if the credit shelter trust is named as the beneficiary:

1. The marital deduction will not be available.
2. Rollover treatment will not be available.
3. Because Mary reached age 50 before 1986, five-year averaging, ten-year averaging, and capital gain treatment will be available if the distribution qualifies as a lump sum distribution.
4. John will not be eligible to elect to defer the 15-percent excise tax on excess retirement accumulations.
5. John's consent to waive his rights under REA will be required.

6. The trustee may be authorized to disclaim the right to the benefits, in which case the benefits may then be paid to a marital deduction trust or directly to John, depending upon the beneficiary designation form.

7. Designating the credit shelter trust as beneficiary is appropriate if Mary has no other assets to fund the credit shelter trust.

8. If there are other assets that will not be treated as income in respect of a decedent (IRD) which can be allocated to the credit shelter trust or directly to children or other beneficiaries, more wealth will escape estate taxation in John's estate if the plan benefit is allocated to him or a trust qualifying for the marital deduction since John or the trust will be paying the income tax on the distributions rather than the credit shelter trust or the children.

**QUESTION I-3.**

Assume that, instead of being married for 40 years to John, Mary's first husband died when Mary was 55 and she married John when she was 60. Assume also that Anne is Mary's daughter by her prior marriage. How might these facts affect Mary's choice of a designated beneficiary, assuming that the plan benefit constitutes most of Mary's wealth? [See Section II.B. of the outline, and Forms II, III, VI and VII, and Exhibit E.]

**ANSWER:**

Mary should consider naming a QTIP trust as the beneficiary of her plan benefit. If she wants to qualify the plan benefit for the marital deduction in order to defer the federal estate tax on the benefit as long as possible, but does not want to give John control over the plan benefit remaining at his death, she should name a trust designed to qualify for the marital deduction as the beneficiary. Because her goal is to eliminate John's control over the plan benefit, the trust should be a qualified terminable interest property (QTIP) trust. Only a QTIP trust assures Mary of ultimate control over the disposition of any remaining assets in the trust at John's death, including any plan benefit that was treated as principal and retained in the trust and any balance remaining in the plan. An estate trust, which qualifies for the marital deduction, requires that any remaining assets in the trust be payable to John's estate. A life income/general power of
appointment trust requires that John have the right either to withdraw the assets from the trust during his lifetime or to designate where the assets in the trust will go at his death.

Qualifying the plan benefit for the marital deduction when it is payable to a QTIP trust may require the benefit to be paid out faster than required under the minimum distribution rules. Under one published revenue ruling and a number of private letter rulings, the beneficiary designation form required the plan or IRA to distribute annually to the trust all income generated by the decedent's accrued benefit or IRA.

For example, in Revenue Ruling 89-89, the Service held that the decedent's executor could elect to treat a decedent's IRA as QTIP property. In that ruling, the decedent elected an IRA distribution requiring the principal balance to be distributed in equal annual installments over the surviving spouse's life expectancy to a testamentary QTIP trust and the income earned on the undistributed balance of the IRA to be paid annually to the trust. The trust agreement required that both the income earned on the undistributed portion of the IRA that the trust received from the IRA and the income earned by the trust on the distributed portion of the IRA had to be paid currently to the decedent's spouse. Finally, the executor elected QTIP treatment for both the trust and the IRA.

Unfortunately, this revenue ruling may lead one to conclude that a QTIP election would need to be made for an IRA and that equal annual installments of principal would have to be made from the IRA to a trust that otherwise qualifies for the marital deduction to qualify the value of the IRA for QTIP treatment. It would be impossible to have equal annual installments of principal from an IRA that consists of investments that may either appreciate or depreciate in value. In addition, principal distributions should have no effect on qualifying an asset for the marital deduction. It should not be necessary to make a QTIP election with respect to an IRA payable to a QTIP trust, which is an asset of the trust. One is not typically required to make a QTIP election with respect to property interests that are held by or payable to a QTIP trust.

On the other hand, the Internal Revenue Service may believe that a QTIP election with respect to an IRA or qualified retirement plan benefit is necessary to assure that any remaining balance in the IRA or plan benefit is included in the surviving spouse's estate under I.R.C. § 2044. However, the IRA balance or remaining plan benefit should be included in the surviving spouse's estate under I.R.C. § 2044 without a separate QTIP election, because it will be treated as an asset of the trust at the spouse's death.
If the spouse has a right to require the trustee to convert the assets of the QTIP trust to income-producing property or to distribute other trust assets equal to the income that would have been produced by the unproductive property, the value of an IRA or plan benefit payable to the trust should qualify for the marital deduction regardless of whether current income from the IRA or plan benefit is required to be paid to the trust. Normally the beneficiary of an IRA has the right to withdraw the entire account balance at any time and in many qualified retirement plans the beneficiary may have the same right.

In TAM 9220007 (January 30, 1992), the Internal Revenue Service held that the value of an IRA payable to a QTIP trust was not eligible for QTIP treatment because none of the authorized distribution options contained in the decedent's beneficiary designation form gave the surviving spouse a qualified income interest for life. The Service held that the trustee's subsequent addition of an option that met the QTIP requirements did not qualify the IRA for QTIP treatment since the property must "pass" from the decedent for the benefit of the spouse in a form satisfying all the QTIP requirements as of the date of death and cannot be contingent upon actions taken after death. In Estate of Clayton v. Commissioner, the Fifth Circuit rejected the Service's position that all the property available for the election had to qualify for QTIP treatment, regardless of whether the executor actually made the election. See also Estate of Robertson v. Commissioner and Estate of Spencer v. Commissioner. In TAM 9220007, the Service also ruled that the IRA account could not be treated as an asset of the QTIP trust, but had to be treated as a trust itself and therefore had to satisfy all the requirements of a QTIP trust.

As a result of the Internal Revenue Service's position, the conservative approach when it is desirable to name a QTIP trust as the beneficiary of a qualified retirement plan benefit or IRA is as follows:

1. The form of payment designation for the qualified retirement plan benefit or IRA should provide that the QTIP trust be paid each year the greater of (x) the income generated by the assets representing the accrued benefit in the qualified retirement plan or in the IRA or (y) the required minimum distribution determined under I.R.C. § 401(a)(9).

2. The trustee of the QTIP trust should have the right under both the beneficiary designation and the QTIP trust agreement to require the plan trustee or IRA sponsor to convert nonincome-producing or low income-producing assets into income-producing assets or assets producing adequate income.
a. In the case of a defined benefit plan, which does not provide for a specific account that represents the deceased participant's accrued benefit, the trustee of the QTIP trust should have the right to treat a certain amount of the value of the accrued benefit as income each year, perhaps based on the state's income and principal act.

b. The trustee should also be given the right under both the beneficiary designation and the QTIP trust agreement to withdraw the accrued benefit or IRA balance at any time so that the trustee could withdraw an amount equal to the income that would have been produced if the assets were producing adequate income.

3. The QTIP trust agreement should provide that the part of any distribution from a qualified retirement plan or IRA that represents income will be paid to the spouse in the same manner as any income generated by other assets held by the trust and no expenses that would be chargeable against principal will be charged against the income element of the distribution.

4. The spouse should have the right under the trust agreement to require the trustee of the QTIP trust to make nonincome-producing assets income producing or to convert nonincome-producing assets to income-producing assets.

a. The trustee of the QTIP trust should have the right under the trust agreement to distribute other assets of the trust to satisfy this request.

5. A QTIP election should be made for both the trust and the qualified retirement plan benefit or IRA, by listing the plan benefit or IRA on Schedule M of Form 706.

This approach will defer the payment of principal from the qualified retirement plan or IRA as long as permitted under the minimum distribution rules, thereby deferring the payment of tax on the principal and retaining the principal in a tax-free vehicle. This approach will also ensure that the principal when paid to the trust is not paid out to the spouse unless required under an ascertainable standard (or some other standard) contained in the trust agreement. However, the payment of income must commence immediately after the participant's death, even though under the minimum distribution rules the payments would not have to begin.
until the participant would have reached age 70%. In addition, depending upon the surviving spouse's age and the earnings rate of the account, the required minimum distribution may be less than the income generated by the plan benefit or IRA.

There are additional considerations if the marital trust is the beneficiary.

1. Rollover treatment will be foreclosed unless John has the right to revoke the trust or a lifetime power to withdraw assets from the trust.

2. Because Mary reached age 50 before 1986, five-year averaging, ten-year averaging, and capital gain treatment will be available if the distribution qualifies as a lump sum distribution.

3. John may not be eligible to elect to defer the 15-percent excise tax on excess retirement accumulations, unless the Internal Revenue Service takes the position that as long as he is the sole beneficiary during his lifetime, the election to defer may be made.

4. John’s consent to waive his rights under REA will be required.

5. If John disclaims his interest in the trust, the benefit may then be paid to a credit shelter trust or directly to other beneficiaries, such as Anne.

6. The four requirements under the minimum distribution rules concerning trusts should be satisfied if the five-year distribution rule is to be avoided.

QUESTION 1-4.

Will Mary have to obtain John’s consent if she names someone other than John as the beneficiary of her plan benefit? [See Section I.A.1.b. of the outline.]

ANSWER:

Yes, John will have to consent to the payment of the benefit to someone other than him because of the Retirement Equity Act of 1984. The consent must designate a beneficiary and a form of benefit that may not be changed without John’s consent, unless he signs a general consent. His consent must acknowledge the effect
of the election and must be witnessed by a plan representative or a notary public.

John may sign a general consent, which expressly permits Mary to change the beneficiary designation or form of payment or both without again obtaining John’s consent. A general consent is not permitted unless the plan specifically permits such a consent. The general consent would have to acknowledge that John had the right to limit his consent to a specific beneficiary and a specific optional form of benefit and that he had voluntarily elected to relinquish both of these rights (or, if applicable, either of these rights). If Mary, with John’s consent, names a revocable trust as the beneficiary, she could later change the beneficiaries or other terms of the trust without his consent.

Mary’s waiver of a qualified joint and survivor annuity or qualified preretirement survivor annuity and John’s consent to the waiver will be valid only if made during specific election periods. The waiver of a qualified joint and survivor annuity may be made only during the 90-day period ending on the first day of the period for which the first payment is to be made to Mary (referred to as the annuity starting date), and only after Mary has received a notice explaining the qualified joint and survivor annuity. Unless Mary makes an irrevocable election, she may, with John’s consent, change the form of benefit after the annuity starting date.

Under the Code, a waiver of a qualified preretirement survivor annuity can be made only on or after the first day of the plan year in which the participant reaches age 35. In the case of a participant who has not reached age 35, the regulations permit a waiver to be made, but the participant must execute a new waiver after reaching age 35. The age 35 provision does not apply to plans, such as certain profit sharing plans, that are not required to provide the qualified preretirement survivor annuity and qualified joint and survivor annuity. The spouse may consent to a waiver of his or her right to the death benefit, which is the participant’s entire non-forfeitable accrued benefit in such a plan, at any time.

The participant must be permitted to revoke his or her election during the applicable election period, although the plan may require that the spouse’s consent to a waiver of the qualified preretirement or joint and survivor annuity not be revocable.

A beneficiary designation executed before August 23, 1984, naming someone other than the spouse as the primary beneficiary, whether or not the spouse consented to the designation, is not valid to deprive the spouse of his or her REA rights. In addition, a consent to a waiver signed before a marriage (such as in a premarital agreement) is not a valid consent according to the regulations. Although one state court has held that a premarital
agreement may serve as a valid waiver of the spouse's REA rights, Estate of Hopkins, a number of federal courts have upheld the position taken in the regulations.

Recently, a New York court, in Kartiganer v. Bloom, held that a beneficiary designation signed by an unmarried participant was not nullified when the participant subsequently married, so that when the participant died the person named under the beneficiary designation rather than the spouse was entitled to the participant's death benefits. This case is obviously contrary to the regulations, which state that a deemed waiver by an unmarried participant is null and void if the participant subsequently marries. See also the Callahan case where the Sixth Circuit held that a spouse who signed a premarital agreement waiving her right to the participant's benefits may be required to give up her right pursuant to the contract. Also, the court stated that a premarital agreement may qualify as a valid waiver if it satisfied both the statutory requirements and any plan requirements.

In most of these situations, the problem would have been avoided if the plan document required that, in order to be entitled to a death benefit under REA, the spouse must be married to the participant throughout the one-year period ending on the date of the participant's death. Although such a requirement is permitted under the Code, many plans do not contain such a requirement because of the difficulty in administering such a provision. The plan administrator would have to determine when a participant married his or her spouse before making any payments to the spouse after the participant's death. If a participant who is about to marry is entering into a premarital agreement, the beneficiary designation form for the plan should be signed and notarized (or witnessed by a plan administrator) and attached to the premarital agreement, and the premarital agreement, along with the attachment, should be furnished to the plan administrator. Based on dicta in the Callahan case, this may be sufficient to render the premarital agreement an effective waiver of the future spouse's rights to the participant's plan benefits. It may also be possible to condition the receipt of other economic benefits provided to the fiancée under the premarital agreement on the fiancée's cooperation in signing any required waivers after the marriage.

A defined contribution plan, other than a money purchase pension plan, is not required to provide the qualified survivor annuities if it meets the following requirements:

1. The plan provides that the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan by reason of a loan outstanding to such participant) is payable in full on the death of the participant to the participant's surviving spouse (or, if there is
no surviving spouse or the surviving spouse consents as described above, to a designated beneficiary);

2. Such participant does not elect to receive the benefits in the form of a life annuity; and

3. With respect to such participant, the plan is not a direct or indirect transferee of a transfer after December 31, 1984 from a plan that is required to provide the qualified joint and survivor annuity and qualified preretirement survivor annuity. When there has been such a transfer, if the transferee plan separately accounts for the transferred assets and income therefrom, the balance of the participant's account is not subject to the survivor annuity rules.

In addition, an Employee Stock Ownership Plan (ESOP) is not subject to the qualified survivor annuity rules to the extent a participant has a right to demand a distribution of employer securities. IRAs and Simplified Employee Pension Plans (SEPPs) are not subject to the spousal consent rules at all.

QUESTION 1-5.

Assume that Mary desires to leave $500,000 to the University of Richmond to establish a chair in estate planning and the only other asset in her own name is stock in IBM that has a basis of $100,000 and a current fair market value of $500,000. Could Mary's desire to make this bequest affect her decision concerning the choice of a designated beneficiary? [See Section II.D. of the outline, and Form V, and Exhibit D.]

ANSWER:

Mary should use part of the plan benefit to satisfy her desire to make a gift to the University.

1. When the participant desires to make a substantial gift to charity, naming a charity as a beneficiary of qualified retirement plan benefits and IRAs may be advisable since the charity will not be subject to income tax when the benefit or IRA is paid to the charity. Because the IBM stock will get a step-up in basis while the plan benefit will not, if John receives the stock, he may immediately sell the stock without recognizing any taxable income, but would have taxable income to the extent of any plan
benefit received in excess of any IRD deduction for estate tax attributable to the benefit.

2. To avoid recognition of the income by the estate, the benefits should not be used to fund a pecuniary charitable bequest, unless the will requires the use of the benefit to satisfy the bequest, which would create a set-aside deduction under I.R.C. § 642(c)(2). For example, Mary's estate would recognize $500,000 of taxable income if her executor uses part of her plan benefit to satisfy a $500,000 cash bequest to the University contained in Mary's will.

3. Although the portion of plan benefit payable to the University will be excluded from Mary's federal gross estate as a charitable deduction, it will be included in determining the amount of excess retirement accumulations subject to the 15-percent excise tax.

4. John's consent to waive his rights under REA will be required.

5. If only part of her plan benefit is to be paid to the University, a separate account or a separate share should be established after her RBD in order to use the life expectancies of other designated beneficiaries for purposes of determining the required minimum payment of Mary's remaining benefit.

PART II

Assume that four years have elapsed (it is now April 1998), and Mary is now seeking your advice on how to receive her benefits, since she will be required to begin receiving her benefits on or before April 1, 1999 (her required beginning date). Mary wants to defer the receipt of any distributions from the plan for as long as possible, since her current compensation from Good Products allows her and John to live according to the standard which the two of them have enjoyed for a number of years.

QUESTION II-1.

In what form should Mary begin to receive her benefits? [See Section I.D.2. of the outline.]
ANSWER:

If Mary and John can afford to do without the cash in her plan, then withdrawal of the plan benefit should be deferred as long as possible under the minimum distribution rules. The amount that would have been paid in income tax on a current distribution will continue to be invested. The income tax on the earnings of the entire amount, including the amount that would have been paid as income tax on a current distribution, will be deferred until the distribution is actually made, causing the amount retained in the plan to increase more rapidly. Because of the deferral, some of the benefit may be subject to the 15-percent tax on excess retirement distributions and accumulations. Deferral may also cause the future distributions to be taxed at a higher tax rate if Congress again raises rates. However, the benefit of the tax-free accumulation of income should offset the effect of the excise tax and higher rates after a few years.

Once Mary has reached her required beginning date, she should elect to have the benefit paid over a period certain equal to the joint and last survivor expectancy of Mary and John. Mary should elect to have only her life expectancy recalculated each year for purposes of determining the required distribution. Under the proposed regulations dealing with the minimum distribution rules, if the payment of the participant's benefit is to be made over the life expectancy of the participant or the joint life expectancies of the participant and the participant's spouse, the life expectancies of both of them will be recalculated unless the participant elects not to have either or both life expectancies recalculated. If the life expectancy of either spouse is being recalculated, when that spouse dies, his or her life expectancy will be zero in the following year. Consequently, if the life expectancies of both spouses are being recalculated, at the death of the surviving spouse the entire remaining benefit would have to be distributed before December 31 of the year following the year in which the individual died.

By not electing to have the life expectancy of John recalculated, the minimum period over which the payments will be made will be John's life expectancy, even if Mary and John both die before the end of John's life expectancy. Note that John's life expectancy would be 18.4 years, the life expectancy of a person age 67 (John will be 67 in the year in which Mary reaches 70½). By electing to have the life expectancy of Mary recalculated each year, Mary can be assured that the payments will continue as long as she is alive, regardless of when John dies. If John dies first and his life expectancy was not being recalculated, his life expectancy will continue to be used for purposes of determining the required distribution to Mary.
If Mary dies first, then John may, if permitted under the plan, withdraw the balance of the benefit and roll it into his own IRA, allowing him to defer receipt of any additional payments until his required beginning date, which will be April 1, 2002, the year following the year in which he will reach age 70½. He may now elect to have his life expectancy recalculated to assure that payments will continue as long as he is alive. He may also name Anne as his designated beneficiary and have the payments made over their joint and last survivor expectancy. Even though the payout period during his life will be limited by the minimum distribution incidental death benefit rule, which in effect treats Anne as no more than ten years younger than John, once he dies the required distribution to Anne will be based on Anne’s remaining life expectancy.

**QUESTION II-2.**

When should Mary begin receiving her benefits? (Should she wait until her required beginning date to receive the first payment?) [See Sections I.B.3.b. and III.B.2.b. of the outline.]

**ANSWER:**

Mary’s required beginning date, as mentioned, is April 1, 1999. If she waits until 1999 to receive the first distribution, she will be required to receive two distributions in 1999, one before April 1, 1999, to satisfy the required distribution for the year in which she reached age 70½ (1998), and another distribution by December 31, 1999, to satisfy the required distribution for the year 1999. This could result in some of the plan benefit being subject to the 15-percent excess retirement distribution tax and may push Mary into a higher federal income tax bracket.

In Questions II-3 through II-6, assume that John makes a spousal rollover.

**QUESTION II-3.**

If Mary dies before John, what will be the effect of naming his daughter Anne, who is now age 40, as his designated beneficiary on the amount of the required payments to John once he reaches his RBD? [See Section III.B.4. of the outline.]

**ANSWER:**

As a result of the minimum distribution incidental death benefit rule, while John is alive, Anne will be treated as no more than ten years younger than John for purposes of determining the period over which the payments must be made. For example, in calculating the required distribution that must be paid to John for
the year in which he reaches 70%, he will be treated as age 70 (his birthday is January 15) and Anne will be treated as age 60, resulting in a divisor of 26.2, which is the joint life and last survivor expectancy of a person 70 years old and a person 60 years old.

QUESTION II-4.

If Mary dies before John, and John dies in the year 2000 (before his RBD, which is April 1, 2002), and he has named Anne as his designated beneficiary, over what period must the remaining balance be paid to Anne? [See Section IV.B.2.b(1) of the outline.]

ANSWER:

The payments may be made to Anne over her life expectancy if the payments commence by December 31, 2001 (the calendar year following John’s death).

QUESTION II-5.

If Mary dies before John and John dies on June 1, 2002 (after his RBD), over what period must the remaining balance be paid to Anne? [See Section III.B.4.b(1)(c) of the outline.]

ANSWER:

Although Anne will be treated as no more than ten years younger than John for purposes of determining the required distribution to John during his lifetime, once John dies, Anne’s remaining life expectancy can be used. In this case, Anne would be 43, and her remaining life expectancy would be 39.6. Her life expectancy was 40.6 in the year in which John reached age 70½ (2001), when she was age 42. Because her life expectancy may not be recalculated, her life expectancy in 2002 would be 39.6 because one year has elapsed since John reached age 70½.

QUESTION II-6.

When must Anne begin receiving the payments after John dies? [See Section IV.B.1.a. and 2.b(1) of the outline.]

ANSWER:

Regardless of whether John dies before or after his RBD, Anne must begin receiving payments before December 31 of the year following John’s death. However, if John died after his RBD but before receiving his required distribution for the year in which he died, Anne would be required to receive the required distribution that would have been paid to John if he had not died.
QUESTION II-7.

Assume that Mary does not own any other investments in her own name, so that the only asset available to fund a credit shelter trust is the plan benefit. How could this affect the choice of a designated beneficiary? [See Section II.C. of the outline; see the answer to Question I-2.]

ANSWER:

If Mary names a credit shelter trust as the beneficiary of some or all of her plan benefits, the trust must satisfy the requirements under the proposed regulations in order for a beneficiary of the trust to be treated as a designated beneficiary.

QUESTION II-8.

Assume that, instead of being married for 40 years to John, Mary's first husband died when Mary was 55 and she married John when she was 60. Assume also that Anne is Mary's daughter by her prior marriage. How might these facts affect Mary's choice of a designated beneficiary, assuming that the plan benefit constitutes most of Mary's wealth? [See Section II.B. of the outline; see the answer to Question I-3.]

ANSWER:

If Mary names a QTIP trust as a beneficiary of some or all of her plan benefits, the trust should satisfy the requirements under the proposed regulations dealing with I.R.C. § 401(a)(9) discussed in the answer to Question I-2 and the requirements for a QTIP trust discussed in the answer to Question I-3.

QUESTION II-9.

Will Mary have to obtain John's consent to any form of benefit other than a qualified joint and survivor annuity? [See Section I.A.1.b. of the outline; see the answer to Question I-4.]

ANSWER:

Because the plan is a money purchase pension plan, Mary's benefit must be paid in the form of a qualified joint and survivor annuity unless John consents to another beneficiary designation. Mary cannot withdraw any of her benefit without John's consent. Had the plan been a profit-sharing plan exempt from the joint and survivor annuity requirement, Mary could have withdrawn her benefit and rolled it into an IRA (or had it transferred directly into an IRA) and eliminated any of John's rights under REA.
QUESTION II-10.

Assume that Mary still desires to leave $500,000 to the University of Richmond to establish a chair in estate planning and her only other asset in her own name is stock in IBM that has a basis of $100,000 and a current fair market value of $500,000. Could Mary’s desire to make this bequest affect her decision concerning the choice of a designated beneficiary? [See Section II.D. of the outline.]

ANSWER:

See the answer to Question I-5.

QUESTION II-11.

If Mary designates the University of Richmond as a beneficiary of some of her plan benefits, what additional considerations must be taken into account? [See Section IV.B.3.b. and i. of the outline.]

ANSWER:

Unless the University is entitled to a separate account, Mary will be treated as not having a designated beneficiary for purposes of determining the required distribution and will be required to receive the distribution of her benefit over her life expectancy only. The University should be treated as being entitled to a separate account if it is entitled to a fractional share or percentage of Mary’s benefit.
Example of the results achievable through deferral. Mary’s accrued benefit on December 31, 1993 was $1,500,000. When she reaches age 70½ in 1998 (her date of birth was May 29, 1928), she elects to receive her first required distribution on December 31, 1998 and to have the distribution paid over the joint and last survivor expectancy of her and John, with her life expectancy being recalculated each year but not John’s. John’s date of birth was January 15, 1931. The value of her accrued benefit on December 31, 1997, assuming no additional contributions on her behalf and an eight percent growth factor, is $2,040,733. The amount of the required distribution that Mary receives on December 31, 1998 is $92,761 ($2,040,733 ÷ 22.0, because their joint and survivor expectancy is 22.0 years based on their attained ages, 70 and 67, in 1998). Mary dies on June 15, 2002, after receiving four required distributions, for a total of $418,733. Assume that under the proposed regulations the required distribution Mary would have been required to take in 2002, $130,403, must be paid to John before the end of 2002. He has the balance, $2,362,388, transferred to his own individual retirement account and names their daughter, Anne, who is age 44 in 2003, as his designated beneficiary. John elects to have his life expectancy recalculated, and, of course, cannot elect to have Anne’s recalculated, even if this were desirable. The first required distribution to John, which he receives on December 31, 2003, is $96,819 ($2,362,388 ÷ 24.4). This is based on John’s age of 72 and on treating Anne as age 62, because Anne is treated as ten years younger than John under the minimum distribution incidental death benefit rule. Assume John dies on September 15, 2008, after receiving five required distributions, for a total of $578,390. He did not receive the 2008 required distribution before he died. The account balance as of December 31, 2007 was $2,882,560. Assume the required distribution John would have been required to take in 2008, $143,411, must be paid to Anne before the end of 2008. This leaves a balance on December 31, 2008 of $2,969,754. The required distribution that must be paid to Anne before the end of 2009 is $88,123, based on Anne’s remaining life expectancy of 33.7, determined by subtracting five from her life expectancy of 38.7 in 2003, when the payments commenced to John. The aggregate amount of the remaining payments over the period of Anne’s life expectancy is $15,458,870, again assuming an eight percent growth rate. If Anne dies before the end of the period, these payments will continue to Anne’s beneficiary for the balance of the period, since her life expectancy is not being recalculated (and in fact cannot be recalculated). The aggregate amount of all payments to Mary, John and Anne over the 44-year period (1998 through 2042) is $18,117,930. This assumes that any estate taxes and excise taxes on excess retirement accumulations are paid out of other sources.
Using qualified retirement plan benefits or individual retirement accounts (IRAs) to fund a charitable bequest has significant tax benefits. First, as with any charitable bequest, the IRA will be deductible for federal (and usually state) estate tax purposes if a charity is named as the beneficiary. Second, because a charitable organization generally is exempt from federal (and usually state) income taxation, unless it receives unrelated business income, the distribution of the IRA to the charitable organization will escape federal and state income taxation. A nonexempt beneficiary would have paid tax on the IRA when received.

Because an IRA is income in respect of a decedent, a beneficiary of a deceased account holder must treat the receipt of the IRA in the same manner as the account holder would have, i.e., as ordinary income. Income in respect of a decedent, generally speaking, is cash or other consideration received by a beneficiary of a decedent that would have been includible in the decedent’s gross income for federal income tax purposes had he or she survived to receive the income. In addition to benefits from qualified retirement plans, and not to IRAs, will be noted below.

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While the discussion will deal primarily with IRAs, the same rules and consequences generally apply to using qualified retirement plan benefits for charitable giving. Certain rules pertaining only to qualified retirement plans, and not to IRAs, will be noted below.

See Hoyt, Transfers From Retirement Plans to Charities and Charitable Remainder Trusts: Laws, Issues and Opportunities, 13 Va. Tax Law Rev. 641 (Spring, 1994), in which the author discusses the possibility that the beneficiary of a charitable remainder trust may recognize taxable income when retirement plan benefits or IRAs are paid to the trust, based on the economic benefit doctrine. However, the Internal Revenue Service has issued several private letter rulings that have held that a charitable remainder trust was not taxable on the receipt of an IRA or plan benefit. See, e.g., PLR 9253038 and PLR 9237020. Note that private letter rulings are directed only to the taxpayers who requested them and may not be used or cited as precedent.
retirement plans and IRAs, other examples of income in respect of a decedent are nonqualified deferred compensation, vacation pay, and installment payments on a note received pursuant to an installment sale.

A taxpayer who receives income in respect of a decedent subject to income tax is entitled to a deduction equal to the federal (but not state) estate tax attributable to the income. This deduction, which is not subject to the two-percent floor on miscellaneous itemized deductions, is determined by subtracting from the federal estate tax actually due the federal estate tax that would have been payable if all income in respect of a decedent, including IRAs, had not been included in the federal gross estate. The difference is then allocated proportionately to each item of income in respect of a decedent included in the decedent's federal gross estate.

Because federal taxes will reduce the amount received by a noncharitable beneficiary, the cost of making a charitable bequest is significantly less than the face amount of the bequest. A beneficiary of a $1,000,000 IRA subject to the maximum federal estate and income tax rates would receive $271,800 after the payment of federal estate and income tax, not taking into account state and local taxes. The federal estate tax is $550,000 ($1,000,000 x 55 percent), leaving $450,000 ($1,000,000 - $550,000) passing to the beneficiary before income taxes. The $450,000 would be subject to a 39.6 percent maximum federal income tax rate, resulting in a federal income tax of $178,200. The beneficiary would receive $271,800 ($450,000 - $178,200). If the account holder had named a charitable organization as the beneficiary of the $1,000,000 IRA, the net cost to the family of their foregone legacy would only be $271,800. That is the amount the family would have received net of federal estate and income taxes if family members had been designated as beneficiaries.

The actual cost to the family of the charitable bequest of the IRA is further reduced if there is a state estate or death tax and/or a state income tax, even if the state estate tax is only a "pick-up" tax equal to the exact amount that the estate receives as a credit for federal estate tax purposes. Although with a pick-up tax the total of federal and state estate taxes remains the same, the deduction for federal income tax purposes is limited to the federal estate tax. For example, if the credit is ten percent of the federal estate tax (a hypothetical figure), the deduction in the preceding example would be limited to $495,000 ($550,000 - $55,000 (ten percent of $550,000)), resulting in an income tax of $199,980 ($1,000,000 - $495,000 = $505,000; $505,000 x 39.6 percent = $199,980), and a balance to the family of $250,020 ($450,000 - $199,980).
The 15 percent excise tax on excess retirement accumulations that applies to the value of a decedent’s qualified retirement plan benefits or IRAs in excess of a certain amount will not be reduced or eliminated by a gift to charity. The amount that is not subject to the excise tax is the greater of the decedent’s remaining "grandfathered amount" as of August 1, 1986, if the grandfather election was made, or the value of a hypothetical annuity of $150,000 per year based on the decedent’s life expectancy on the day before he or she died. The dollar amount will increase after 1994 as the cost-of-living increases. However, because the excise tax on excess retirement accumulations is deductible for federal estate tax purposes, the overall estate tax will not be increased if the charity is required to pay the tax as the beneficiary of the IRA. Any portion of the charitable deduction that is lost is offset by the deduction for the excise tax.

For example, assume a decedent with a federal gross estate of $5,000,000, of which $2,000,000 is an IRA, bequeaths the IRA to a charity, subject to the payment of the 15 percent excise tax. Assume also that $1,000,000 of the IRA is subject to the 15 percent tax, resulting in an excise tax of $150,000. If the charity pays the tax, the charitable deduction will be $1,850,000 and the deduction for the excise tax will be $150,000, for a total deduction of $2,000,000. Because the charity is exempt from income tax, it can pay the tax using some of the IRA without incurring the income tax. Had a noncharitable beneficiary of the estate paid the excise tax, using part of the IRA as a source of the funds, the beneficiary would have incurred federal income tax on the amount withdrawn (including any additional amount withdrawn to pay the income tax).

If a charity is named as the beneficiary of the IRA, the surviving spouse will not be able to make an election that might otherwise avoid or postpone paying the excise tax on excess retirement accumulations. If the surviving spouse were the beneficiary of at least 99 percent of the balance of the decedent’s IRA, the spouse could elect not to have the excess retirement accumulation tax paid. Instead, the IRA of the decedent would be treated as the spouse’s IRA for purposes of determining the excess retirement distribution tax when distributions were made to the surviving spouse during his or her lifetime and the excess retirement accumulation tax when the surviving spouse died.

A qualified retirement plan benefit or IRA should not be used to satisfy a specific pecuniary bequest to a charity. If the IRA is used to satisfy such a bequest, the estate will recognize current income equal to the amount of the IRA paid to the charity to satisfy the bequest because the estate is treated, for income tax purposes, as receiving a distribution from the IRA and using it to satisfy its obligation to pay the pecuniary bequest. The same result would apply in the case of any other income in respect of a
decedent used to satisfy a specific pecuniary bequest. The estate's recognition of income can be avoided by naming the charity as the beneficiary of the IRA if the entire balance of an IRA is going to be paid to the charity. If the entire balance of an IRA is not going to be paid to the charity, the account holder should name the charity as a beneficiary of a specific fraction or percentage of the IRA. Designating the charity as the beneficiary of a fraction or percentage of an IRA will prevent the acceleration of the required payment of the balance of the other portions of the IRA to noncharitable beneficiaries. Because the beneficiary of each specified fractional share of the IRA will be treated as a "designated beneficiary" of that fraction under the minimum distribution rules, the payment of each beneficiary's share can be spread over that beneficiary's life expectancy.

The minimum distribution rules set limits on the ability to postpone indefinitely the payment of income tax on qualified retirement plan benefits and IRAs by requiring minimum distributions. In general, the entire plan benefit or IRA must be paid to the participant or account holder by April 1 of the calendar year following the calendar year in which the participant or account holder reaches age 70½ (referred to as the required beginning date). If the entire plan benefit or IRA is not distributed by the required beginning date, then the plan benefit or IRA must begin to be paid at that date over one of the following periods: (1) the life of the participant or account holder, (2) the lifetimes of the participant or account holder and his or her designated beneficiary, (3) a period certain not extending beyond the life expectancy of the participant or account holder, or (4) a period certain not extending beyond the joint and last survivor expectancy of the participant or account holder and his or her designated beneficiary. If the account holder elects to have the IRA paid over a period certain, the amount of the required minimum distribution is determined by dividing the value of the IRA as of the valuation date in the year prior to the year in which the distribution is to be made by the remaining period. A 50 percent excise tax is imposed on the amount of a required distribution that is not actually made.

Under the minimum distribution rules, if the account holder does not have a designated beneficiary to receive his or her IRA after his or her death, and the account holder dies before his or her required beginning date, the entire IRA must be paid out by the end of the fifth year following the year in which the account holder dies. If the account holder has a designated beneficiary, the payments can be spread over the life expectancy of the beneficiary if the payments begin by the end of the year following the account holder's death, except that in the case of a spouse, the payments do not have to begin until the account holder would have received age 70½.
Once the account holder has reached his or her required beginning date, if he or she is not treated as having a designated beneficiary, only the account holder’s life expectancy can be used for the purpose of determining the minimum required distribution. Consequently, the amount of the required minimum distribution will be larger than the amount that would have been required had the account holder been able to use the life expectancy of a designated beneficiary to determine the required minimum distribution. If the account holder dies after the required beginning date, the payment of the IRA may continue over the remaining life expectancy of the account holder, unless the life expectancy of the account holder was being recalculated each year. In that case, when there is no designated beneficiary, the balance of the IRA must be distributed to the person entitled to receive it before December 31 of the year following the year in which the account holder died.

Under the minimum distribution rules, a designated beneficiary must be an individual, including an individual who is a beneficiary of a trust that meets certain requirements. Because a charitable organization is not an individual, it does not qualify as a designated beneficiary. If a charitable organization is one of a number of beneficiaries of the account holder’s IRA, the account holder will be treated as not having designated a beneficiary unless the charitable organization is entitled to a separate account or separate share of the IRA. A fraction or percentage of the participant’s IRA will likely be treated as a separate share or separate account.

If the account holder wishes the charitable organization to receive only a specific dollar amount, the planning to avoid the acceleration of the payments to the noncharitable beneficiaries becomes more complicated. In this case, the account holder could designate the charitable organization as a beneficiary of a specific IRA, with a current value approximately equal to the amount the account holder desires to leave to the charity. Before the account holder reaches his or her required beginning date, the account holder can keep the IRA designated to go to the charity at the desired dollar amount by having the trustee or custodian of the IRA make a direct transfer of any excess amount to his or her other IRAs at the end of each year. If the account holder dies before his or her required beginning date, the charitable organization will receive the balance in the separate IRA or the specific dollar amount. Any remaining balance in the IRA not payable to the charity would have to be paid to the noncharitable beneficiary or beneficiaries by the end of the fifth year after the year in which the account holder died. Because the separate IRA would qualify as a separate account, the other IRAs of the decedent could be paid to the noncharitable beneficiaries over their life expectancies. Specifying a dollar amount of an IRA also should constitute a separate share if the participant dies before his or her RBD, since the specific dollar amount would constitute a fraction of the IRA
at that point and would then be distributed outright to the charity, leaving the balance to be paid out over the designated beneficiary's life expectancy or, if the spouse is the beneficiary, to be rolled into a spousal IRA.

Once the account holder reaches his or required beginning date, he or she would be required to begin withdrawing the required minimum distribution from the IRA benefitting the charity. In addition, the account holder could transfer any excess to another IRA if necessary to reduce the value of the IRA benefitting the charity to the desired amount. Although the minimum required distribution generally may be withdrawn from any of the taxpayer's IRAs, rather than from each IRA, the Internal Revenue Service may take the position that the required minimum distribution must be separately determined and withdrawn from each IRA if the designated beneficiary of each IRA does not have the same life expectancy. Otherwise, the taxpayer could take the entire required minimum distribution from the IRA having the oldest designated beneficiary or having no designated beneficiary. This would result in permitting the deferral of the income on the other IRAs for a longer period. However, the Service has apparently taken a different position as illustrated in the example in Notice 88-38, I.R.B. 1988-15. The account holder was allowed to withdraw the required minimum distribution, which was computed on the total of the account balances in three separate IRAs, each with a different designated beneficiary, from the two IRAs with the oldest designated beneficiaries.

In some instances, the account holder may wish to provide income to his or her spouse during the spouse's lifetime if the spouse survives the account holder, followed by the payment of any remaining balance in the IRA to a charitable organization at the death of the spouse. If the account holder is confident that the spouse will name the charitable organization as the beneficiary of the balance of the IRA remaining at the spouse's death, the spouse could be named the beneficiary to receive the IRA if the account holder dies before the spouse. The surviving spouse could then treat the IRA as his or her own IRA, and, under the minimum distribution rules, the spouse could wait until he or she reaches age 70½ before he or she would have to begin receiving distributions from the IRA. The spouse could name the charitable organization as his or her beneficiary. Because the charitable organization would not qualify as a "designated beneficiary" for purposes of the minimum distribution rules, the required payment to the spouse would be determined using only his or her life expectancy. When the surviving spouse dies, the balance in the IRA would be paid to the charitable organization. Although the IRA would be includible in the surviving spouse's gross estate for federal estate tax purposes, it would qualify for the charitable deduction. In addition, the charity, as a tax-exempt organization, would not pay any income tax on the receipt of the balance.
If the account holder is concerned that the spouse may have a change of heart and name someone else as the beneficiary of the IRA, the account holder may ensure that the balance in the IRA at the death of the surviving spouse will pass to the charitable organization through the use of either a qualified terminable interest property (QTIP) trust or a charitable remainder trust. A QTIP trust, which qualifies for the marital deduction for federal estate tax purposes, requires that all the income be paid to the surviving spouse at least annually and that no one other than the spouse receive anything from the trust while the spouse is alive. The IRA beneficiary designation would require that the greater of the income generated by the investments in the IRA or the required minimum distribution be distributed to the QTIP trust at least annually. The QTIP trust agreement would require that the income portion of the distribution be distributed directly to the spouse. Because the assets remaining in the trust at the surviving spouse’s death may be paid to a beneficiary designated by the first spouse to die, the first spouse can retain ultimate control of the disposition of the remaining assets, including the principal portion of the distribution from the IRA that is not distributed to the spouse. However, it is likely that any principal retained in the trust will be taxed at a higher rate than if distributed to the spouse. For a trust, taxable income in excess of $7,650 (for 1995) is taxed at the 39.6 percent maximum federal income tax rate, while the spouse would not reach the 39.6 percent rate until his or her taxable income exceeded $256,500 (for 1995). Although the assets remaining in the trust are includible in the surviving spouse’s gross estate for federal estate tax purposes, the value of any assets passing to a charitable organization would be deductible.

In a charitable remainder trust, one or more noncharitable beneficiaries are entitled to receive, at least annually, either a fixed dollar amount or a fixed percentage of the current value of the assets in the trust. No additional amounts may be paid from the trust until it terminates. Upon the death of the noncharitable beneficiary or the survivor of the noncharitable beneficiaries, the trust terminates, and the assets remaining in the trust are paid to one or more charitable organizations. If the surviving spouse is the only noncharitable beneficiary, the entire value of the IRA passing to the charitable remainder trust would be deductible from the federal gross estate when the account holder dies. The surviving spouse’s interest would qualify for the marital deduction and the charitable remainder interest would qualify for the charitable deduction. None of the balance of the IRA remaining at the death of the surviving spouse would be includible in his or her federal gross estate.

The decision as to which form of charitable bequest to use depends upon a number of factors. With the QTIP trust, the surviving spouse could be given the power to withdraw the principal for his or her needs or to make gifts to other beneficiaries of the
account holder, if this were desired. At the death of the surviving spouse, any remaining assets in the trust would pass to the charity pursuant to the direction of the account holder. Although any remaining balance in the IRA would be includible in the gross estate of the surviving spouse for federal estate tax purposes, it would also be deductible from the spouse’s federal gross estate as a charitable bequest.

A possible disadvantage of using a QTIP trust to accomplish the objectives of the account holder is the loss of the ability to defer the payment of the IRA to the trust over the surviving spouse’s life expectancy. Under one interpretation of the minimum distribution rules contained in the proposed regulations, the account holder would not be treated as having a designated beneficiary. As a result, if the account holder were to die before his or her required beginning date, the entire IRA would have to be paid to the QTIP trust by the end of the fifth year following the year of the account holder’s death. In addition, once the account holder reached his or her required beginning date, only his or her life expectancy could be used for purposes of determining the required distribution each year, rather than the joint and last survivor expectancy of the account holder and his or her spouse, which could have been used if the account holder had named the spouse as the designated beneficiary rather than the QTIP trust with the charitable organization as the remainder beneficiary.

This interpretation of the proposed regulations is based on the multiple beneficiary rule that applies if the account holder has named more than one beneficiary and one of the beneficiaries does not qualify as a designated beneficiary. In such a case, the account holder is treated as not having a designated beneficiary. Since a charitable organization cannot be a designated beneficiary according to the proposed regulations, an account holder will not have a designated beneficiary if he or she has multiple beneficiaries and one of them is a charitable organization. A charitable organization that is named as the remainder beneficiary of a QTIP trust will be treated as a beneficiary under the multiple beneficiary rule if it has a vested, rather than a contingent, right to the IRA. Because the charitable organization presumably will be in existence at the surviving spouse’s death, regardless of how long the spouse lives, it will be entitled to whatever IRA balance is remaining at the death of the surviving spouse, as well as any distributions treated as principal remaining in the QTIP trust. Therefore, the charitable organization could be viewed as having a vested right to the IRA.

See, e.g., Shumaker and Riley, Strategies for Transferring Retirement Plan Death Benefits to Charity, 19 ACTEC Notes 162 (Winter, 1993).
However, if the surviving spouse's life expectancy is not being recalculated, there would be no remaining balance in the IRA if the surviving spouse outlives his or her life expectancy. In addition, if the trustee of the QTIP trust has paid out all of the distributions from the IRA to the surviving spouse, including the principal, none of the IRA would pass to the charitable organization at the spouse's death. Viewed in this way, the charity's interest could be treated as contingent on the surviving spouse not outliving his or her life expectancy.

If there is concern that the charity's right will be vested, the acceleration of income can be avoided by using a charitable remainder trust, such as a charitable remainder unitrust, rather than a QTIP trust. Because the charitable remainder trust is tax exempt, there should be no income tax when the IRA is paid to the trust upon the account holder's death. The surviving spouse will generally pay income tax on the amount he or she receives from the charitable remainder trust each year.

There are at least three drawbacks to naming a charitable remainder trust as the beneficiary of an IRA. First, when the account holder reaches his or her required beginning date, the account holder can only use his or her own life expectancy for determining the amount of the required minimum distribution each year, since the charitable organization does not qualify as a designated beneficiary. Second, because no distributions other than the fixed dollar amount or fixed percentage is permitted to the surviving spouse from the charitable remainder trust, using a charitable remainder trust instead of a QTIP trust eliminates the ability of the trustee to make distributions to the surviving spouse for his or her support, health or other needs, as well as to enable the surviving spouse to make gifts to other beneficiaries. The flexibility to make distributions to the surviving spouse may not be important if the spouse has other funds available for his or her support, health or other needs. As for making gifts to noncharitable beneficiaries, estate taxes would be saved if the surviving spouse used funds that would otherwise be included in his or her federal taxable estate to make such gifts rather than assets that would eventually pass to a charitable organization. Third, because the spouse is not entitled to all but a de minimis portion of the account holder's IRA, the spouse will not be able to make the election to defer the payment of the 15-percent excise tax on excess retirement accumulations.

If the account holder is not married or has otherwise provided for his or her surviving spouse, but wishes to provide income for a child, naming a charitable remainder trust as beneficiary of his or her IRA may provide more income to the child during his or her lifetime than would an outright bequest of the IRA to the child. Because the bequest to a charitable remainder trust will result in a charitable deduction for estate tax
purposes, less federal estate tax will be payable upon the death of the account holder. In addition, the payment of the IRA to the charitable remainder trust will not cause immediate income taxation. Of course, the IRA could have been paid out over the child’s life expectancy had the child been the designated beneficiary. Both the income tax and the estate tax that would otherwise have been paid on the IRA will be available to be invested to provide income during the life of the child, and if desired by the account holder, the lifetime of the child’s surviving spouse. Some of the additional income can be used to purchase life insurance on the life of the child or the joint lives of the child and his or her spouse to replace the balance of the IRA that passes to the charitable organization when the child or the survivor of the child and his or her spouse dies. The proceeds would be payable to the child’s descendants or other intended beneficiaries. The amount paid from the charitable remainder trust to the child and spouse during their lifetimes will be taxable income in most cases.

The Retirement Equity Act of 1984 may require a married participant who intends to name a charitable organization, including a charitable remainder trust, as the beneficiary of qualified retirement plan benefits to obtain the consent of the spouse. Under the Act, if the participant dies before the participant begins receiving benefits under the plan, the participant’s spouse has the right to receive a portion of the participant’s benefit in the form of a qualified preretirement survivor annuity, which provides for annual or more frequent payments for his or her lifetime. In addition, once the participant begins receiving benefits under the plan, the benefits must be paid to the participant, and to the spouse if the spouse survives the participant, in the form of a qualified joint and survivor annuity. Under a qualified joint and survivor annuity, annual or more frequent payments are made to the participant during his or her lifetime, and if the spouse survives, annual or more frequent payments would continue to the spouse for his or her lifetime. Certain profit sharing plans are not required to provide the qualified joint and survivor annuity form of payment, but all of a participant’s vested account balance must be paid to the participant’s surviving spouse if the participant dies before withdrawing the account balance. These rules do not apply at all to IRAs. A surviving spouse may consent to a waiver of his or her right to the qualified preretirement survivor annuity if the participant dies before the participant begins receiving benefits, and to the right to have the participant’s benefit paid in the form of a qualified joint and survivor annuity once the participant begins receiving benefits. The consent must be witnessed by a notary public or plan representative.

An individual who has a considerable amount of wealth accumulated in IRAs or qualified retirement plan benefits, but does
not have other liquid assets, may consider withdrawing amounts from the IRAs or qualified retirement plans to fund a charitable remainder trust during his or her lifetime. The charitable deduction would reduce the current income tax on the amount withdrawn, and the account holder or participant would be entitled to receive payments from the charitable remainder trust during his or her lifetime. His or her surviving spouse could also be entitled to payments from the trust during his or her lifetime. The account holder would receive a charitable deduction for income tax purposes equal to the actuarial value of the charity’s interest. Withdrawing amounts from IRAs or qualified retirement plans before the participant’s required beginning date and increasing the amount withdrawn after the participant’s required beginning date over the required minimum distribution may avoid the 15-percent excess retirement distribution and excess retirement accumulation tax. In addition, the actuarial value of the charity’s interest would be deductible for gift tax purposes, thereby reducing the transfer tax base of the account holder or participant.

As can be seen, creative uses of charitable giving techniques can both reduce the federal and state income and transfer tax cost of receiving qualified retirement plan benefits and IRAs and provide more income to the participant’s or account holder’s beneficiaries. However, a number of technical rules must be considered when planning for distributions from qualified retirement plans and IRAs to avoid the payment of penalty taxes and unnecessary income and transfer taxes.

EXHIBIT E
FORM IRREVOCABLE TRUST AGREEMENT

I, ________________________, of the County/City of ________________________, Virginia, desiring to create a trust, agree with ________________ ("my Trustee"), as of ____________, 19__, as follows:

Article I. Creation of Trust. I have transferred and by this agreement do now transfer to my Trustee Ten Dollars ($10.00) in cash. All assets received by my Trustee shall be held in trust and managed and distributed in accordance with this agreement.

Article II. Provisions Governing Trust Benefits. My Trustee shall administer the trust assets upon these directions:

A. During my lifetime, retain the principal in trust and accumulate the net income of the trust, adding such income to principal annually.

B. If my wife ________________________ ("my wife") survives me, at my death, retain the principal of the trust and any income of the trust accumulated before my death on the following terms:

   1. Pay the net income to my wife during her lifetime in quarterly or more frequent installments and pay to her as much of the principal as my Trustee may deem appropriate for her support, other needs or comfort.

   2. Upon my wife's death, (x) distribute any accrued or undistributed income to my wife's executor or administrator and (y) distribute the principal of the trust to my then living descendants.

C. If my wife does not survive me, at my death, distribute the principal and any undistributed income of the trust to my then living descendants.

D. If at my death or my wife's death there is no living beneficiary designated to take the assets held in the trust, distribute the principal and any undistributed income of the trust (or only the principal if the accrued income is required to be distributed to my wife's executor or administrator pursuant to paragraph B.2 above) to the persons who would then be my distributees under the laws of Virginia then in effect as if I had then died without a will, unmarried and owning the assets.

E. Provisions for Interests Vesting in Beneficiaries Under Age Twenty-One. Notwithstanding the foregoing provisions, whenever any interest in a trust vests absolutely in a beneficiary under age
twenty-one, my Trustee may retain the interest upon a separate trust and pay to the beneficiary as much of the net income or principal as my Trustee may deem appropriate to provide for the beneficiary’s support, other needs or education until the beneficiary reaches age twenty-one, when the interest shall pass outright to the beneficiary. If the beneficiary dies before reaching that age, the interest shall constitute a part of the beneficiary’s estate. While the beneficiary is a minor, any part of the interest may be distributed to a custodian (selected by my Trustee) for the beneficiary under the Virginia Uniform Transfers to Minors Act (21). In addition, any part or all of the interest may be distributed to the custodial trustee of any trust created for the beneficiary under the Virginia Uniform Custodial Trust Act. These are powers only and do not prevent absolute vesting of the interest in the beneficiary.

Article III. Administrative Powers of My Trustee.

A. In addition to the powers granted by law, I grant to my Trustee those powers set forth in Section 64.1-57 of the Code of Virginia, and I incorporate that Code Section in this agreement by this reference. I expressly authorize my Trustee: to purchase assets from, and to lend money to, my executor or administrator or my wife’s executor or administrator, provided any such purchase shall be at arm’s length and any such loan shall bear adequate interest and security; and to merge any trust under this agreement with any trust having the same trustee and substantially the same dispositive provisions. If, at the time my Trustee is to make a distribution under any trust set up under this agreement to another trust, any beneficiary of the distributee trust is then entitled to a distribution of trust assets from the distributee trust, my Trustee may make the distribution directly to such beneficiary. If at any time after my death the size of any trust under this agreement is so small that, in the opinion of my Trustee other than any income beneficiary of the trust, the trust is uneconomical to administer, my Trustee other than any income beneficiary of the trust may terminate the trust and distribute the assets to the person or persons authorized to receive the trust income in such shares as my Trustee other than any income beneficiary of the trust may deem appropriate. The powers and discretion granted to my Trustee are exercisable only in a fiduciary capacity and may not be used to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of the duties of my Trustee.

B. If my wife survives me, then in funding or administering this trust, my Trustee shall not exercise any power in a manner that would infringe upon any legal requirement for the allowance of the estate tax marital deduction. If after my death but before the death of my wife the assets of this trust at any time consist substantially of unproductive property, my wife shall
have the right to direct my Trustee to make the property productive or convert it to productive property within a reasonable time. For this purpose, any balance in an Individual Retirement Account ("IRA"), as defined in Section 408(a) of the Internal Revenue Code, or benefit in a Qualified Retirement Plan, as defined in Section 401(a) of the Internal Revenue Code, shall be treated as unproductive property for any year in which all of the income generated by such IRA or Qualified Retirement Plan benefit is not distributed to my Trustee. In lieu of making property productive or converting unproductive property, my Trustee may distribute quarterly to my wife other assets from this trust, the value of which is equal to the income that would have been produced during the quarter if the property had been made productive or converted to income producing property. My Trustee shall have the right at any time to withdraw all or any part of the assets in any IRA or Qualified Retirement Plan that is made payable to this trust after my death and to designate the income beneficiary of the trust to receive any remaining payments directly or to have the right to withdraw at any time all or part of the remaining assets. My Trustee shall have the right to require the sponsor of any IRA or Qualified Retirement Plan that is made payable to this trust to make unproductive assets held in the IRA or Qualified Retirement Plan productive or to convert such assets to income-producing assets within a reasonable time. All income earned upon any IRA or Qualified Retirement Plan and made payable to this trust shall retain its character as income and be administered as such pursuant to this agreement. No expenses chargeable with respect to the principal of any distribution from an IRA or Qualified Retirement Plan shall be charged against the income portion of such distribution.

C. No Trustee shall have any voice as a Trustee in any decision concerning discretionary distributions of income or principal of any trust for the purpose of discharging a legal obligation of such Trustee or for such Trustee’s pecuniary benefit unless related to such Trustee’s needs for health, education, support or maintenance.

Article IV. **Irrevocable Agreement.** This agreement and the trusts created by this agreement shall be irrevocable, and this agreement shall not be altered, amended, revoked or terminated, in whole or part, by me.

Article V. **Rights to Add to the Trust.** I reserve for myself and for any other person the right to transfer to my Trustee assets that are acceptable to my Trustee. Any assets so transferred shall be held for the proportionate account of the trusts existing at the time of the transfer except to the extent that the transferor shall specify otherwise in the instrument effecting such transfer.
Article VI. Miscellaneous Provisions.

A. Distribution to Descendants. Whenever property is to be distributed to the descendants of a person (the "ancestor"), such property shall be divided into equal shares, one share for each then living descendant in the first generation below the ancestor in which at least one descendant is living, and one share for each deceased descendant in such generation who has a descendant then living. Each share created for a living descendant shall be distributed to such descendant. Each share created for a deceased descendant shall be divided and distributed according to the directions in the two preceding sentences until no property remains undistributed.

B. Disclaimers. Any beneficiary or the legal representative of any deceased beneficiary shall have the right, within the time period prescribed by law, to disclaim any benefit or power under this agreement. When property is to be distributed to the descendants of a person and one such descendant disclaims his interest in all or a portion of such property, the disclaimed interest, determined as if the disclaimant were living at the time of distribution, shall be distributed to the then living descendants of the disclaimant; provided, however, that if the disclaimant has no descendants then living, the interest shall be distributed as if the disclaimant had predeceased the event that results in the distribution of the property.

C. Marital Deduction Election. I authorize my executor under my will to elect that all or a fractional share of this trust qualify for the federal estate tax marital deduction. Without limiting the discretion of my executor, I anticipate that my executor will elect to qualify the entire trust unless other tax or administrative considerations make a different election appropriate in the opinion of my executor. Any fractional share of this trust for which no election is made shall be deemed to have passed to my wife for purposes of determining the fractional share of the assets in the residue of my estate that should be held in a marital deduction trust for my wife pursuant to any provision in a will or trust made by me before my death. If my executor elects to qualify a fractional share of this trust for the marital deduction, this trust shall be divided into two trusts, one for which the election has been made and one for which the election has not been made. No distribution of principal shall be made from the trust for which the election has not been made while assets remain in the trust for which the election has been made.

D. Payment of Taxes on My Wife's Death. If my wife does not negate the provisions of this paragraph by specific reference in her will to this paragraph, then my Trustee shall at my wife's death pay to or upon the order of my wife's executor or administrator from the principal of this trust a sum sufficient to
cover all estate or inheritance taxes payable at her death and attributable to this trust. This sum shall be the difference between (1) the taxes that are in fact payable at her death and (2) the taxes that would have been payable at her death if this trust had not been taxable at her death.

E. **Successor Trustee.** Should __________________ fail or cease to serve as my Trustee, I name __________________ to serve in his stead. If administration of the trust should be necessary in any jurisdiction where my Trustee is unable to serve, I give to my Trustee the power to designate any individual or corporation with trust powers to serve with my Trustee or in my Trustee’s stead. No successor Trustee shall be responsible for or required to inquire into the transactions of any predecessor Trustee and a successor Trustee may rely conclusively upon the accounts of a predecessor Trustee.

F. **Compensation of My Trustee.** Any corporate Trustee shall receive for its services the compensation for which it is willing to undertake similar services for others at the time such services are rendered, as evidenced by its published fee schedule in effect from time to time.

G. **Spendthrift Trust.** To the extent permitted by law, neither the principal nor income of any trust shall be liable for the debts of any beneficiary or, except to the extent otherwise specifically provided, to alienation or anticipation by a beneficiary.

H. **Effect of Adoption.** A person who has a relationship by or through legal adoption shall take under this agreement as if he had the relationship by or through birth, except that a person adopted after reaching age twenty-one and descendants of such a person shall not so take.

I. **Survivorship.** My wife shall be deemed for purposes of this agreement to have survived me if we die simultaneously or if there is no sufficient evidence (in the opinion of my Trustee) that my wife and I have died otherwise than simultaneously.

J. **Matters of Interpretation.** For simplicity, I have expressed pronouns and other terms in one number and gender, but where appropriate to the context these terms shall be deemed to include the other number and genders. This agreement is made or delivered in Virginia, and shall be governed by its laws. This agreement is signed in more than one counterpart, each of which is an original. The underlined headings are for convenience and shall not affect interpretation.
WITNESS the following signatures and seals:

_________________________________(SEAL)

_________________________________

_________________________________(SEAL)

_________________________________, TRUSTEE

COMMONWEALTH OF VIRGINIA
CITY/COUNTY OF ____________, to wit:

The foregoing instrument was acknowledged before me this _
day of ____________, 19__, by ___________________________.

________________________________________
Notary

My commission expires: _________________.

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