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Making Retirement Benefits Payable to Trusts

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Making Retirement Benefits Payable to Trusts

by

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A participant whose benefits are payable to a trust will not have a "designated beneficiary" unless the IRS's trust rules are complied with. The rules are not difficult to comply with if you plan for them, but are also easy to violate if you don't keep them in mind.

The IRS's Minimum Distribution Trust Rules

In this chapter, "proposed regulation" refers to Prop. Reg. § 1.401(a)(9)-1 (as modified December 30, 1997) unless otherwise specified. This chapter assumes that you have read Chap. 1.

IRS “trust rules” permit treating trust beneficiaries as DBs

Although the general rule is that a designated beneficiary (DB) must be an individual, the proposed regulations allow you to name a trust as beneficiary and still have a DB. These rules permit you to look through a trust instrument, and treat the trust beneficiaries as if they had been named directly as beneficiaries of the benefits, if the following four requirements are met:

1. The trust must be valid under state law.
2. The beneficiaries must be “identifiable from the trust instrument.”
3. “The trust is irrevocable or will, by its terms, become irrevocable upon the death of the” participant.
4. Certain documentation must be provided to “the plan administrator.”

If the participant (P) dies before the required beginning date (RBD), and the above four rules are satisfied, then, for purposes of § 401(a)(9), “distributions to the trust...will be treated as being paid to the appropriate beneficiary of the trust with respect to the trust’s interest in the employee’s benefit, and all beneficiaries of the trust with respect to the trust’s interest in the employee’s benefit will be treated as designated beneficiaries of the employee under the plan for purposes of determining the distribution period under” § 401(a)(9)(B)(iii) [distributions to non-spouse individual beneficiary] and (iv) [surviving spouse is the designated beneficiary].” Prop. Reg. § D-6.

Similarly, if the trust rules are satisfied as of the RBD, then, for purposes of distributions at and after the RBD, “distributions made to the trust will be treated as paid to the beneficiaries of the trust with respect to the trust’s interest in the employee’s benefit, and the beneficiaries of the trust will be treated as having been designated as beneficiaries of the employee under the plan.” Prop. Reg. § D-5(a).

However, just complying with these four rules does not in and of itself ensure that the “life expectancy” method will be available. For one thing, treating the trust beneficiaries as if they had been named as beneficiaries directly does not get you very far if the trust beneficiaries themselves do not qualify as “designated beneficiaries.” Accordingly, the “fifth rule” is that:

5. All beneficiaries of the trust must be individuals.
Finally, there is another rule, not contained in the "trust" portion of the proposed regulations, but applicable to retirement benefits generally, which may affect the eligibility of a particular trust to use the life expectancy method:

6. No person may have the power to change the beneficiary after the participant's death. Prop. Reg. § E-5(f).

The implications of this "sixth rule" are not yet fully established. See "Sixth Rule," below.

The rules are not terribly difficult to comply with in most typical estate planning situations. The obstacles to success are, first, that most people are unaware of these rules and, second, that the application of the rules to several commonly used trust provisions is unclear at best and unfavorable at worst.

**Effects of complying with (or flunking) the trust rules**

If a trust is named as beneficiary of retirement benefits, and all these rules are complied with, the individual trust beneficiaries will be treated as P's DBs for purposes of § 401(a)(9), and the following favorable results ensue.

First, if P dies before his RBD, the "five year rule" will not be the only choice for distribution of benefits; benefits can be distributed to the trust (under the rule dealing with multiple designated beneficiaries) (see "Who Are the Beneficiaries of a Trust?" below) over the life expectancy of the oldest trust beneficiary. Prop. Reg. § E-5(A)(1). If the rules are not complied with, then the five year rule will apply and all of the benefits must be distributed to the trust by the end of the year that contains the fifth anniversary of P's death.

Second, if P reaches his RBD alive, he can compute his minimum required distributions (MRDs) using the joint life expectancy of himself and the oldest trust beneficiary. Prop. Reg. § E-5(A)(1). If the rules are not complied with, MRDs will be based on P's life expectancy only.

Finally, if P's spouse is the primary trust beneficiary, some of the special favorable rules for spouse-beneficiaries may be available; see "When is a trust for the spouse the same as the spouse?" below.

**At what point compliance with these rules is tested**

The rules apply slightly differently depending on whether P dies before his RBD or reaches his RBD alive; these differences will be noted with respect to each requirement.

In general, in the case of death before the RBD, the requirements must be met as of the date of death (except the documentation requirement, which must be met by the end of the ninth month after death; see "Fourth Rule: documentation requirement: death before RBD," below).

In general, in the case of lifetime required distributions, the requirements must be met as of the RBD (or as of the date the trust is named as beneficiary, if later) and at all subsequent times (except the irrevocability requirement, which applies as of the date of death; see "The new requirement as to irrevocability," below).

Let us next look at each of the requirements in turn.
First Rule: trust must be valid under state law

The first requirement is that “The trust is a valid trust under state law, or would be but for the fact that there is no corpus.” Prop. Reg. § D-5(b)(1). This requirement presumably poses no obstacle in cases of death before the RBD.

If P does not die before the RBD, then the requirement must be met as of the RBD. Some practitioners are concerned that a testamentary trust is not a “valid trust under state law” as of the RBD if P is still alive, because the trust is not yet “in existence.” This concern is misplaced. This rule does not (and is not intended to) prohibit the use of testamentary trusts as beneficiaries of retirement benefits.

If the testamentary trust will be a valid trust under state law after P’s death (when it will be funded), then this requirement is satisfied. There is absolutely no requirement that the trust be “in existence” on the RBD. The clause “or would be [valid] but for the fact that there is no corpus” is clearly intended to negate the necessity of having a trust that is “in existence” on the RBD. The rule requires only that the trust, as it is written on the RBD, will be, once it receives the retirement benefits (i.e. once P has died), a legal trust that can be carried out in accordance with its terms under applicable state law.

The only trusts which would flunk this rule would be those which failed to meet some essential state law requirement of a valid trust—for example, a trust with no beneficiaries, or a trust which violated the rule against perpetuities.

Second Rule: beneficiaries must be identifiable

The requirement that the beneficiaries of the trust be “identifiable” means that it must be possible, at the applicable time, to determine who is the oldest person who could ever be a beneficiary of this trust. We need to ascertain who the oldest beneficiary is because it is the oldest beneficiary (or, as the IRS puts it, the “beneficiary with the shortest life expectancy”) whose life expectancy is used as the measuring period under the minimum distribution rules.

A beneficiary “need not be specified by name” so long as he is “identifiable.” Prop. Reg. § D-2. For example, a trust which provides that “all benefits will be distributed to my children” has “identifiable” beneficiaries; even though they are not named, the membership of the class of beneficiaries is fixed and determinable as of the date of P’s death.

“The members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible at the applicable time to identify the class member with the shortest life expectancy.” Prop. Reg. § D-2(a)(1). Thus, if the trust beneficiaries are “all my issue living from time to time,” the beneficiaries are “identifiable” even though the class is not closed as of the applicable date, since no person with a shorter life expectancy can be added later;
the oldest member of the class can be determined with certainty on the applicable date.

**Adoption of Adults**

Actually, there is one potential problem with even this simple and typical provision: if people who are issue by virtue of legal adoption are to be included on the same basis as "natural" issue, there is a potential for violating the rule. After P’s death, one of his issue could adopt someone who was born earlier than the person who was the oldest beneficiary of the trust at the time of P's death. It is not known whether the IRS would ever raise this "issue," but to avoid the problem, language can be included in the trust providing that older individuals cannot be later added to the class of trust beneficiaries by legal adoption; see Appendix B, form 7.3.

The rule that the beneficiaries must be "identifiable" is similar to the rule against perpetuities, in that the mere possibility that an older beneficiary could be added to the trust after the applicable date is enough to make the trust “flunk” this rule, regardless of whether any such older beneficiary ever is actually added.

Example: Kit leaves his IRA to a trust which is to pay income to his daughter Julia for her life, and after her death is to pay income to her widower (if any) for his life, with remainder to Kit’s grandchildren. Kit dies before his RBD, survived by Julia (who is divorced) and several grandchildren. His trust flunks this Second Rule, because Julia, after Kit’s death, could marry a new husband who was older than she. Thus an older beneficiary could be added to this trust after the applicable date.

Any trustee “spray power” or other “power of appointment” under which older beneficiaries could be added to the trust at a later date violates this rule. However, the possible later addition of “unidentifiable” beneficiaries (by means of a power of appointment or otherwise) can be ignored if it could occur, under the terms of the trust, only in case of the “premature” death of a prior beneficiary; see “Disregarding certain contingent beneficiaries,” below.

**Third Rule: irrevocability requirement: the old rule**

Under the proposed regulations issued in 1987, one of the “trust rules” was that a trust named as beneficiary of retirement benefits had to be irrevocable. This requirement applied as of the date of death, or, if earlier, as of P’s RBD.

This rule was a trap for the unwary, since most estate plans use revocable trusts (either revocable “living” trusts or testamentary trusts). Even for the wary it posed many estate planning complications. Now the IRS has dropped this requirement.

The original reason for this rule, presumably, was the plan administrator’s need for certainty as to the identity of the designated beneficiary. If the plan administrator made distributions to a participant based on the joint life expectancy of P and a beneficiary of a revocable trust, P could amend or revoke that trust without telling the plan administrator, and then the plan could be disqualified for failure to comply with the minimum distribution rules. The new proposed regulation (December 1997) solves this problem by making changes in the
documentation requirements; essentially, the burden is on P to inform the plan administrator of any amendments to the trust. See "Fourth Rule, continued: documentation requirement (at RBD)," below.

The new requirement as to irrevocability

The new “third rule” is: “The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.” Prop. Reg. § D-5(b)(2).

The requirement that the trust will become irrevocable “by its terms” upon the death of P is causing concern to some practitioners, who fear that a testamentary trust does not become irrevocable “by its terms” on the testator’s death—it becomes irrevocable de facto because the testator has died. Your author claims no special insight into the IRS’s reason for this wording, but nevertheless is confident that any typical testamentary trust or revocable living trust meets the requirement, based on the following logic:

1. The “terms” of a trust are not only those which are written in the instrument, but also include those which are automatically part of the trust by virtue of state law.

2. A deceased person cannot revoke his will, nor can his personal representative revoke it on his behalf; therefore, “by its terms,” a testamentary trust is “irrevocable” as of the testator’s death.

3. A deceased person cannot revoke an inter vivos trust he created, nor (unless the trust instrument expressly provides otherwise) can his personal representative revoke it. Therefore, a normal inter vivos trust created solely by P becomes irrevocable “by its terms” as of P’s death.

Although, in planning mode, it wouldn’t hurt to include in the trust a statement such as “This trust shall be irrevocable upon my death” (to appease possible future plan administrators and auditing IRS agents) this is certainly not necessary, since any testamentary trust or “living trust” automatically becomes irrevocable upon the testator’s or donor’s death, and therefore passes this test.

Unfortunately, it is not clear what the IRS is driving at with this rule; perhaps they are thinking of a situation where someone other than P has a power to “revoke” the trust after P’s death. For example, a surviving spouse with a community property interest in the retirement benefits might have that power, or P might have left his benefits to a trust which is “revocable” by his spouse or someone else, and these trusts would fail this rule.

Fourth Rule: documentation requirement (death before RBD)

The former requirement that certain documentation be provided to “the plan” was substantially modified by the revisions to the proposed regulations issued in December 1997. Under the new rule (Prop. Reg. § D-7), the time limit for supplying information about the
trust to the plan administrator is “the end of the ninth month beginning after the death of” P (not “as of” the date of death, as under the 1987 version of the proposed regulations). The person who must fulfill the documentation requirement is “the trustee of the trust” [i.e., the trust that is named as beneficiary]. And the documentation that must be supplied is either a copy of the trust instrument, or certain summary information about the trust beneficiaries (with an agreement to provide a full copy of the trust if requested). Under the prior version of the proposed regulations, providing a copy of the trust instrument was the only method of compliance allowed.

Supplying a copy of the trust would appear to be a simpler way of complying than providing a summary of who the beneficiaries are. However, some plans may decide to require the alternative method of compliance, since it relieves the plan administrator of the burden of reading the trust and determining whether it complies with all the technical requirements of the trust rules.

Here is an exact statement of the documentation that must be sent to the plan administrator in the case of a participant who dies before his RBD: “By the end of the ninth month beginning after the death of the employee, the trustee of the trust must either—

“(1) Provide the plan administrator with a final list of all of the beneficiaries of the trust (including contingent and remainderman beneficiaries with a description of the conditions on their entitlement) as of the date of death; certify that, to the best of the trustee’s knowledge, this list is correct and complete and that the requirements of paragraph (b)(1), (2) and (3) of D-5A [i.e., trust is valid under state law, trust will be irrevocable by its terms as of the date of P’s death, beneficiaries are identifiable] are satisfied as of the date of death; and agree to provide a copy of the trust instrument to the plan administrator upon demand; or

“(2) Provide the plan administrator with a copy of the actual trust document for the trust that is named as a beneficiary of the employee under the plan as of the employee’s date of death.”

For sample forms to comply with this requirement, see Appendix B.

The documentation requirement: retroactivity of the new rule

Under the version of the proposed regulations that existed from July 1987 to December 1997, the documentation requirement was that “a copy of the trust instrument” had to be provided to “the plan,” “as of the date of death.” This wording made it sound as though “after” the date of death might be too late. Based on hints from the IRS, there was reason to believe that providing the documentation to the plan shortly after the date of death, before the first required distribution was made, was sufficient. However, not all plan administrators were willing to rely on such “hints.”

Under the new revised documentation requirement, it is now clear that no documentation need be provided to the plan prior to the date of death. The deadline is now the end of the ninth month beginning after the date of death.

Planning mode: For the client who has not yet reached his RBD, and who wants to name a trust as beneficiary of his retirement benefits, filing a copy of the trust with the plan
administrator is not required until after the date of death. Filing a copy of the trust pre-death does not help in any way, if the client actually dies before his RBD. The survivors get no “insurance protection” by filing a copy of the trust pre-death because it appears that, under the new rule, the trustee is required to file a “final” copy of the trust with the plan after the date of death anyway, so filing it in advance does not help.

On the other hand, there would still appear to be some advantage to filing a copy of the trust with the plan administrator along with the beneficiary designation form, namely: the client and planner have the comfort of knowing that if the client does not die before his RBD, the requirement of filing a copy of the trust with the plan administrator by the RBD has been complied with. Accordingly, planners may choose to file the trust with the plan if the client’s RBD is “on the horizon”—say less than five years away.

**Fourth Rule, continued: documentation requirement (at RBD)**

A participant who reaches or has reached his RBD, and wants to name a trust as beneficiary of his plan benefits, and wants to determine his minimum required distributions using the joint life expectancy of himself and the oldest beneficiary of the trust, must provide certain documentation to the plan administrator, before (or on) the RBD (or before the date the trust is named as beneficiary, if that is later than the RBD). This participant has a choice: he can either:

1. Provide to the plan administrator a copy of the trust instrument and [the rest of this sentence presumably applies only if the trust is in fact revocable or amendable] agree that if the trust instrument is amended at any time in the future, the participant will, within a reasonable time, provide to the plan administrator a copy of each such amendment; or

2. Provide to the plan administrator a list of all the beneficiaries of the trust (including contingent and remainderman beneficiaries, with a description of the conditions on their entitlement); certify that, to the best of his knowledge, this list is correct and complete and that the requirements of paragraphs (b)(1), (2) and (3) of D-5A [i.e., trust is valid under state law, trust will be irrevocable by its terms as of the date of P’s death, beneficiaries are identifiable] are satisfied; agree to provide corrected certifications to the extent that an amendment changes any information previously certified; and agree to provide a copy of the trust instrument to the plan administrator upon demand. Prop. Reg. § D-7(a).

Method 1 would appear to be a simpler way of complying than method 2. However, some plans may decide to require method 2, since it relieves the plan administrator of the burden of reading the trust and determining whether it complies with all the technical requirements of the trust rules. Also, some clients may prefer method 2 for privacy reasons.

Note that the person who must fulfill this requirement at the RBD is the participant (not the trustee, as is the case when P dies before the RBD). For sample forms to comply with this requirement, see Appendix B.
Effect on pre-1998 RBD participants

How does this change affect the person who was already past his RBD as of the date the new rules were issued (12/30/97), and who had named a trust as his beneficiary at or after his RBD, but who was out of compliance with the “irrevocable trust” requirement under the 1987 version of the proposed regulations?

Although that requirement no longer exists, this person is not automatically “saved” retroactively by the new rule unless, on or before his RBD (or on or before the date he named a revocable trust as his beneficiary, if later than his RBD), he provided the plan administrator with a copy of his trust and agreed that if the trust instrument were amended, he would, within a reasonable time, send the plan administrator a copy of each such amendment. It hardly seems likely that anyone was so prescient. So the new proposed regulations unfortunately do not provide any “safe harbor” for individuals who were already past their RBD as of December 1997.

The IRS has not issued any guidance for these individuals. The IRS may take the view that, unless P has complied with some version of the proposed regulations, P cannot possibly have a DB if his benefits are payable to a trust, because the IRS may be of the opinion that allowing DB status to trust beneficiaries is a matter of grace on the IRS’s part, so that the only way to get that result is to comply with whatever version of its proposed regulations is in effect at the applicable time. See also “Legal status and effect of proposed regulations,” Chapter 1.

To whom is documentation provided?

The proposed regulations, although they apply to IRAs and 403(b) plans as well as “qualified” plans, are written in language that is designed for qualified plans. It is not clear, in the case of IRAs, who is the “plan administrator” who is to receive the documentation required under the Fourth Rule. IRAs do not have “plan administrators.”

To date the only official pronouncement on this subject is the IRS’s statement in the Preamble to the amended proposed regulations (December 1997) that the documentation must be provided to “the plan administrator or IRA trustee, custodian or issuer” (emphasis added). However, the proposed regulation itself says only “plan administrator”; and the Preamble is not even reproduced in most copies of the proposed regulations. There is no way the average planner (let alone retiree) could find this statement.

Arguably, if P himself had possession of the required documentation (which he presumably would have in all cases—a copy of his own trust), this requirement is complied with. After all, P (and not the IRA custodian) is the one who is required to comply with the minimum distribution rules for his own IRA. Conclusion: In planning mode, give the documentation to the IRA custodian or trustee and get a receipt. In cleanup mode, you must either take the position that P is the “plan administrator” of his own IRA, or capitulate and concede that P had no DB.

Fifth Rule: all trust beneficiaries must be individuals

As explained above (see “IRS ‘trust rules’ permit treating trust beneficiaries as DBs”), the result of compliance with the first four rules is that the trust beneficiaries will be treated as if P
had named them directly as beneficiaries. The next step, therefore, is to make sure that these trust beneficiaries qualify as "designated beneficiaries," i.e., that they are individuals. Prop. Reg. § D-2A, D-4(c), D-5(a) and E-5(a). This requirement is much trickier than it appears. First, some or all remainder beneficiaries count as beneficiaries for this purpose; see "Who Are the Beneficiaries of a Trust?" below.

Another major pitfall in this rule is that, according to the proposed regulations, an "estate" is not an individual and therefore an "estate" cannot be a DB. For comment on this IRS position, see "Naming an estate as beneficiary: before the RBD," Chapter 1. Therefore, if any part of the trust's interest in the benefits will pass to an estate, P has "no DB" (unless the estate can be disregarded; see "Disregarding certain contingent beneficiaries," below).

For problems this rule creates for a client who wants to benefit charity, see "Benefits paid to a trust with charitable beneficiaries," Chapter 7.

Paying estate expenses, taxes, etc. from the trust

Some IRS letter rulings suggest that even indirectly allowing benefits to pass to P's estate (as through a trust provision which allows or directs the use of trust property to pay the deceased participant's debts or probate expenses) may be treated the same as naming the estate as a beneficiary and may result in having "no DB." See, e.g., PLR 9809059 (12/4/97), in which part of an IRA was payable to "Trust K." In ruling that Trust K was entitled to use the "life expectancy method" for the IRA benefits payable to it, the IRS noted that "Trust K does not provide that trust assets shall be used to pay funeral costs," probate expenses or estate taxes (emphasis added). Although the ruling does not comment on the absence of such a provision, it merely recites the fact that the trust contained no such provision, one could conclude that the IRS ruled favorably on Trust K only because it did not contain the (forbidden?) clause.

What about estate taxes on the benefits themselves?

The language of PLR 9809059 suggests that even using trust property to pay estate taxes attributable to the trust property may be forbidden under the proposed regulations, but it is sincerely to be hoped that this is not actually the IRS's position. Since tax apportionment laws would give P's personal representative the right to recover such estate taxes from the trust property even if the trust instrument purports to prohibit such use, such a position on the part of the IRS would amount to saying that, despite the language of the proposed regulations permitting trust beneficiaries to be "designated beneficiaries," in fact such a result can only be obtained if either—

1. The estate is too small to be subject to estate tax; or

2. The deceased participant's will requires all estate taxes on the retirement benefits to be paid out of the probate estate and the probate estate is large enough to pay such taxes.

Furthermore, such an argument by the IRS would mean that even if P has named only one,
individual, beneficiary (no trust involved) P will be deemed to have named two beneficiaries—the individual beneficiary and P’s estate—unless (1) or (2) applies; and therefore P has “no DB.”

What to do

Since the IRS is adamant that an “estate” is not an individual, it might be wise to include, in trusts which are to receive retirement benefits, a clause (such as the following) insulating such benefits from any trust provisions requiring or permitting the trustee to make payments to P’s estate from trust property, and also insulating the benefits from any stray charitable bequests the trust may contain. This form will not help, however, if the retirement benefits are the only asset available to pay debts, expenses and estate taxes.

Sample: Trust Clause Prohibiting Payment of Retirement Benefits to Non-individual Beneficiaries

“Nowithstanding any other provision hereof, the Trustee may not distribute to or for the benefit of my estate, any charity or any other non-individual beneficiary any benefits payable to this trust under any qualified retirement plan, individual retirement account or other retirement arrangement subject to the “minimum distribution rules” of § 401(a)(9) of the Code, or other comparable provisions of law. It is my intent that all such retirement benefits be distributed to or held for only individual beneficiaries, within the meaning of § 401(a)(9) and applicable regulations. Accordingly I direct that such benefits may not be used or applied for payment of my debts, taxes expenses of administration or other claims against my estate; nor for payment of estate, inheritance or similar transfer taxes due on account of my death. This paragraph shall not apply to any charitable bequest which is specifically directed to be funded with retirement benefits by other provisions of this instrument.”

Sixth Rule: no changing beneficiaries after P’s death

Prop. Reg. § E-5(f) provides that “If the plan provides (or allows the employee to specify) that, after the employee’s death, any person or persons have the discretion to change the beneficiaries of the employee, then for purposes of determining the distribution period for both distributions before and after the employee’s death, the employee will be treated as not having designated a beneficiary...” The intent and meaning of this provision are unclear. Might a “spray” power not limited by an ascertainable standard, or any other “power of appointment,” be considered “the discretion to change the beneficiaries of the employee” after his death in violation of Prop. Reg. § E-5(f)?

Judging by recent letter rulings approving trusts which contained powers to appoint principal among the participant’s issue (1999-03050, 1999-18065), the IRS apparently did not intend, by adopting § E-5(f), to prohibit this common estate planning device. Accordingly, it is commonly assumed that a power of appointment (or trustee spray power) that is limited to a narrowly defined group (such as P’s “descendants,” “children” or “issue”) does not violate § E-5(f).
On the other hand, if the IRS intends to distinguish between these common estate planning devices (which are apparently permitted) and some broader category of “discretions” (which would be prohibited by § E-5(f)), the dividing line is not known. The IRS has never, to this author’s knowledge, given any example of a beneficiary designation, plan provision or trust provision which would violate § E-5(f).

So, to err on the side of caution, until the IRS clarifies the boundaries, it would be wise to limit the potential appointees under a power of appointment to a narrow and clearly defined group, unless the power can be disregarded (see “Disregarding certain contingent beneficiaries,” in the next section).

Who Are the Beneficiaries of a Trust?

Introduction

For several purposes under the minimum distribution rules of § 401(a)(9) it is necessary to determine who are the “beneficiaries” of a trust:

1. Are the beneficiaries of the trust “identifiable” (see “Second Rule,” above)?
2. Are all beneficiaries of the trust individuals (see “Fifth Rule,” above)?
3. Which trust beneficiary has the shortest life expectancy?

Despite the importance of the term “beneficiaries of the trust” for all of these questions, the proposed regulations never define that term.

Beneficiaries with respect to the trust’s interest in the benefits

In determining who are the “beneficiaries,” we need be concerned only with beneficiaries who are such “with respect to the trust’s interest in the employee’s benefit.” Prop. Reg. §§ D-5(a), D-6(a).

Example 1: Calvin’s IRA is payable to a trust. At his death the trust assets are divided between a marital trust and a credit shelter trust. However, Calvin’s IRA is required to be paid to the marital trust (either because the plan beneficiary designation form names the marital trust directly as beneficiary, or because the trust requires that all retirement benefits are to be allocated to the marital trust). We need look only at the beneficiaries of the marital trust in applying the various tests and questions. However, if neither the beneficiary designation form nor the trust instrument required (as of the applicable date) that all benefits be paid to one share or the other, then we need to look at all beneficiaries of both shares.

Example 2: Katerina’s 401(k) plan benefits are payable to her living trust as beneficiary. The trust provides for distributions to be made to her husband Lou, various relatives and assorted charities. However, the trust contains a provision prohibiting use of retirement benefits to pay charitable bequests. Accordingly, the charities should not be considered trust beneficiaries “with
respect to the trust’s interest in the employee benefit,” and can be disregarded.

Note that this is not a “separate account” rule (see “Naming more than one beneficiary,” Chapter 1); disregarding beneficiaries who are prohibited from sharing in the retirement benefit does not depend on the existence of “separate accounts” at the plan level or segregated “trust shares” in the usual tax or trust accounting sense. The conclusions in these examples are based on the proposed regulations’ statement that “all beneficiaries of the trust with respect to the trust’s interest in the employee’s benefit” (emphasis added) will be treated as the beneficiaries of the employee. Prop. Reg. § D-6(a). In the rest of this discussion, “beneficiaries of the trust” means “beneficiaries of the trust with respect to the trust’s interest in the employee’s benefit.”

Second, we must conclude that “all” trust beneficiaries (“current” beneficiaries, as well as those who have vested or contingent remainder interests) are considered “beneficiaries of the trust” for purposes of the proposed regulations—unless they can be excluded from consideration under Prop. Reg. § E-5.

What the proposed regulations say: § E-5

If the trust rules are complied with, then all “trust beneficiaries” are treated as having been named directly as beneficiaries by P. If the trust has more than one beneficiary, then: “In the case of payments to a trust having more than one beneficiary, see E-5 of this section for the rules for determining the DB whose life expectancy will be used to determine the distribution period.” For some unknown reason, in both the July 1987 and December 1997 versions of the proposed regulations, this cross reference is included only in Prop. Reg. § D-5(b) (trust named as beneficiary at and after the RBD) but presumably it applies equally to the interpretation of § D-6 (trust as beneficiary, death before the RBD).

Furthermore, for some other unknown reason, the cross-reference provides that § E-5 is to be referred to for “determining the designated beneficiary whose life expectancy will be used to determine the distribution period,” with no mention of whether it can also be used for other needed purposes, such as determining whether all beneficiaries are individuals. Despite this omission, however, § E-5 is apparently supposed to be used for both purposes. See, e.g., PLR 9809059. Here is what § E-5 says: “If a beneficiary’s entitlement to an employee’s benefit is contingent on the death of a prior beneficiary, such contingent beneficiary will not be considered a beneficiary for purposes of determining who is the designated beneficiary with the shortest life expectancy...or whether a beneficiary who is not an individual is a beneficiary.” Prop. Reg. § E-5(e)(1). “Except as provided in [Prop. Reg. § E-5(e)(1)] if a beneficiary’s entitlement to an employee’s benefit is contingent on an event other than the employee’s death...such contingent beneficiary is considered to be a designated beneficiary for purposes of determining which designated beneficiary has the shortest life expectancy” Prop. Reg. § E-5(b) (emphasis added).

Are remaindermen beneficiaries?

Suppose a trust names the decedent’s child as life beneficiary. The trust is to pay all income to child for life, and on child’s death the principal goes to the Red Cross. In this example,
the charity's interest is postponed until the death of the income beneficiary, but is not contingent on his death (unless you postulate that the income beneficiary may never die). Accordingly, the Red Cross, as remainder beneficiary, is counted as a beneficiary of the trust, and therefore this trust "flunks" the rules because not all beneficiaries are individuals. See PLR 9820021 (2/18/98) (a trust which provided income to spouse and remainder to charities; ruled, P had "no DB"); see also, e.g., PLR 9322005 (2/24/93) (marital trust to a spouse for life, remainder to children; spouse and children regarded as beneficiaries).

Thus, if a trust with a vested charitable remainder is named as beneficiary of retirement plan death benefits, the participant "has no DB," and must accordingly, at his RBD, withdraw his benefits over a period not exceeding his own life expectancy; he cannot use the joint life expectancy of himself and the income beneficiary of the trust. Any benefits paid to a trust of this type would have to be paid out within five years after the date of death of a participant who died before his RBD.

Disregarding certain contingent beneficiaries

Remainder beneficiaries can be disregarded if either:

1. The trust is treated as 100% owned by the life beneficiary under §678; see "The 100% Grantor Trust," below; or
2. Prop. Reg. §E-5 permits such remainder beneficiary to be disregarded. The rest of this subsection discusses the "disregard" test of §E-5.

Although holders of vested remainder interests are considered "beneficiaries," Prop. Reg. §E-5 says that some (not all) contingent beneficiaries can be disregarded. At this point we come to the hidden actuarial component of these proposed regulations. §E-5 says a beneficiary can be disregarded if his, her or its right to the benefits is contingent on the death of a "prior" beneficiary (other contingencies which might affect the distribution being disregarded). What this means is that a beneficiary can be disregarded if his, her or its rights are contingent on the premature death of a prior beneficiary, i.e., the death of the prior beneficiary before the end of such prior beneficiary's IRS-defined life expectancy.

So, to test a trust on this point, project what will become of the benefits if all individual beneficiaries live to their full IRS-defined life expectancies. If the benefits must be distributed to individual beneficiaries in that case, the trust passes this test. You can disregard any contingent beneficiaries who will take benefits only if one or more of the individuals die before the end of their life expectancy periods.

Example 1: Hunter leaves his IRA to a trust which provides "income to my wife Anita for life, and on her death the principal shall pass to such of our three children, Peter, Paul and Mary, as are then living, or, if all of them are deceased, shall pass to The Massachusetts Audubon Society." Massachusetts Audubon Society is not an individual. However, since the Society’s interest is contingent on Peter, Paul and Mary dying before their mother, its interest is contingent on the premature deaths of prior beneficiaries and therefore can be disregarded.
**Example 2:** Elana leaves her IRA to a trust for the benefit of her child Joshua, age 6. The trustee is given discretion to use income and principal for Joshua's support and education. The trust is to terminate, with all remaining assets being distributed to Joshua outright, when Joshua reaches age 30. If Joshua dies before age 30, the Cornell Ornithological Laboratory receives the trust property. In determining whether all trust beneficiaries are individuals, Cornell is disregarded, because its interest does not take effect unless the individual beneficiary (Joshua) dies before age 30, *i.e.*, well before the end of his life expectancy.

Examples 1 and 2 are common "vanilla" estate planning examples which "pass" the requirement that all beneficiaries must be individuals, because, in these examples, the contingent charitable remainder beneficiaries can be disregarded under § E-5. Furthermore, whenever a remainder beneficiary can be disregarded under § E-5 because its interest is contingent on the death of a prior beneficiary, other normally "forbidden" clauses (such as a power to appoint to charity, or to older "unidentifiable" beneficiaries) that would apply to the benefits only upon such event can also be disregarded.

The following examples test the limits of E-5. While this author's reading of § E-5 would lead to certain answers, others may disagree with my interpretation, and there can be no certainty in these situations until the IRS clarifies the precise boundaries of rule E-5:

**Example 3:** Consider Example 2 again but change the facts slightly: What if Elana's trust for Joshua is not to be distributed outright to Joshua until age 60 rather than age 30? Or what if the trust requires the trustee to determine Joshua's life expectancy as of Elana's date of death, and then to distribute the principal to Joshua one year prior to the end of that life expectancy period? If all E-5 requires is that the benefits will be paid to an existing individual if he lives to his IRS-defined life expectancy, these trust provisions would "pass" and the charity would be disregarded.

**Example 4:** Pat leaves her IRA to a trust to pay income to her daughter Shannon for life, remainder to Shannon's children, or, if Shannon dies without issue, to the Tai Chi Institute (a charity). At the time of Pat's RBD, however, Shannon does not have any children. The charity's interest is contingent on Shannon's not having children. This is not a contingency which would cause the charity to be disregarded. (The only contingency which can be counted is "death before end of life expectancy.") Accordingly, under my reading of the rule, this trust has a non-individual beneficiary and cannot use the life expectancy method.

**Example 5:** Rhoda leaves her $1 million IRA to a generation skipping trust. The trust will pay all income to her issue living from time to time per stirpes; excluding her children. The trust will terminate and be distributed to her then-living issue 90 years after her death; or, in default of issue, shall be distributed to charity. Rhoda has six grandchildren, the youngest of whom is age 10. This trust will extend beyond the IRS-defined life expectancy of the youngest beneficiary. The charity will inherit the trust at the end of the 90 years, *if* by that time all of Rhoda's existing issue have died without issue. The charity's interest is contingent on a default of issue, but that is not a contingency that enables us to disregard the charity.
Effect of powers of appointment

It appears that if a “countable” remainder interest is subject to a power of appointment upon the death of the life beneficiary, all potential appointees are considered “beneficiaries.” Thus potential appointees should be (i) identifiable (ii) individuals who are (iii) younger than the beneficiary whose life expectancy is the one that the parties want to use to measure distributions.

So “The trustee shall pay income to my spouse for life, and upon my spouse’s death the principal shall be paid to such persons among the class consisting of our issue as my spouse shall appoint by her will” does not create a problem under this rule because the power is limited to a small, clearly-defined group of “identifiable” younger individuals. But “...upon my spouse’s death the principal shall be paid to such members of the class consisting of our issue and any charity as my spouse shall appoint by her will” does create a problem: the benefits could pass under the power to a non-individual beneficiary, so this trust flunks this rule.

(This does not mean that, so long as potential appointees are limited to younger individuals, a power of appointment is automatically “ok”; see “Sixth Rule: no changing beneficiaries after P’s death,” above.)

Finally, if exercise of the power of appointment can affect the benefits only at a point where a contingent beneficiary could be ignored, the power can also be ignored. In other words, if you could disregard a contingent beneficiary, you can disregard a power of appointment that would determine the identity of that contingent beneficiary. See “Disregarding certain contingent beneficiaries,” above.

Example 6: Ned leaves his IRA to a trust which provides “income to my wife Jane for life, and on her death the principal shall pass to any individual or charity Jane designates in her will.” The charity and “unidentifiable” beneficiaries Jane could appoint to are considered beneficiaries of the trust. This trust flunks rules 2 and 5.

Example 7: Dudley leaves his IRA to a trust for the benefit of his child Haven, age 6. The trustee is given discretion to use income and principal for Haven’s support and education. The trust is to terminate, with all remaining assets being distributed to Haven outright, when Haven reaches age 30. If Haven dies before age 30, the trust is distributed to any individual or charity Haven designates in his will. The charity and “unidentifiable” beneficiaries Haven could appoint to are disregarded, because no interest can pass to them unless the individual beneficiary (Haven) dies before age 30, i.e., well before the end of his life expectancy.

When is a trust for the spouse the same as the spouse?

Theoretically, if retirement benefits are payable to a trust, and the spouse (“S”) is “the beneficiary” of that trust, and P dies before age 70½, § 401(a)(9) will apply as if S herself were the DB. Prop. Reg. § D-6(a). Under § 401(a)(9)(B)(iv), the trust would then have the right to defer commencement of distribution of the benefits until the year after the year P would have reached age 70½; and if S also dies before that point is reached, she herself will be considered “the participant” for purposes of applying the five-year rule and its exceptions. See “The Spouse
and § 401(a)(9),” Chapter 3. Also, P’s lifetime distributions would not be subject to the MDIB rule.

Unfortunately, it is not clear what rights S must have under the trust in order to be considered the “beneficiary” of the trust for this purpose. Is it enough that she has the right to all of the income for life, and no principal can be distributed to anyone other than her (the requirements for the marital deduction)?

The proposed regulations suggest that, if S is not the sole beneficiary of the trust, then the trust is not entitled to the benefit of § 401(a)(9)(B)(iv), postponing distributions until P would have reached age 70½. Rather, the trust will be stuck with § 401(a)(9)(B)(iii), distributions commencing within one year after the date of P’s death over the life expectancy of the oldest trust beneficiary. See Prop. Reg. § E-5(a)(1), last sentence, and H-2(b), second to last sentence.

The private letter rulings are not consistent. PLRs 9442032 (7/21/94) and 9623056 (3/12/96) ruled that a trust which provided income to the surviving spouse, remainder to children, would be entitled (under § 401(a)(9)(B)(iv)) to postpone distributions until the deceased spouse would have reached age 70½. Then PLR 9847022 (8/24/98) held exactly the opposite on apparently similar facts, saying § 401(a)(9)(B)(iv) treatment is available only if S is the “sole” beneficiary of the trust. But a still more recent ruling (1999-18065, 2/10/99) held once again that a trust of which S is merely the oldest (but not the sole) beneficiary (and which meets the various other trust requirements) is entitled to the postponement under § 401(a)(9)(B)(iv).

Pending further clarification from the IRS, and resolution of these contradictory holdings, there are still two types of trusts for the benefit of a surviving spouse which would unquestionably be entitled to postpone distributions in the same manner the surviving spouse herself could have done had she been the beneficiary of the benefits. These are a “conduit” trust of which S is the sole life beneficiary (see “MRD Conduit Trust,” below); and a trust all of which is treated as owned by S under § 678 (see “The 100% Grantor Trust,” below).

**Trusts That Are “Safe” under IRS Rules**

Under the proposed regulations, there are three absolutely “safe” trust models to use when creating a trust to be named as beneficiary of retirement benefits.

**The 100% Grantor Trust**

Under § 678 (part of the so-called “grantor trust rules” of the Code), a beneficiary is treated for all purposes of the federal income tax as the “owner” of trust assets if such beneficiary has the sole unrestricted right to withdraw those assets from the trust. If an individual beneficiary is deemed the owner of all of the trust’s assets under § 678, then the retirement benefits must be deemed paid “to” such individual beneficiary for purposes of the minimum distribution rules, and the “all beneficiaries must be individuals” test is met.

The IRS is required to recognize the life beneficiary as the sole DB, because § 678 says that “a person...shall be treated as the owner of any portion of a trust with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself.” See, e.g., PLR 199903050 (10/28/98) (“Trust A”).
This treatment has two significant results: income taxes on the trust’s income will be imposed at the beneficiary’s rate; and the identity of the remainder beneficiary becomes irrelevant. Thus an estate, older individuals or charities can be named as remainder beneficiaries (to succeed to whatever part of the trust is not distributed to or withdrawn by the primary beneficiary during his/her life) without loss of the use of the primary beneficiary’s life expectancy as the measurement for MRDs. Similarly, a power of appointment which affects the trust property only after the death of the primary beneficiary can be disregarded, if the primary beneficiary is deemed the “owner” under § 678.

Example 1: “The trustee shall pay all income of the trust to my spouse for life, plus such amounts of the principal (including all thereof) as my spouse shall request from time to time.” The surviving spouse would be deemed the “owner” of the assets of this trust and therefore payout options would be the same for a retirement plan payable to this trust as if S had been named directly as beneficiary. It doesn’t matter who are the remainder beneficiaries of this trust, or what power to appoint to whom S may have over the principal remaining at her death.

Example 2: “The trustee shall pay to my son such amounts of the income and principal of the trust as my son shall request at any time and from time to time, and such additional amounts as the trustee deems advisable. On my son’s death, the remaining principal shall be paid to his widow.” The son is treated as the owner of the principal and income of the trust under § 678; therefore, the fact that an older remainder beneficiary (a new wife/widow) might be brought in later can be disregarded.

Example 3: “The trustee shall pay to my son such amounts of the income and principal of the trust as my son shall request at any time and from time to time, and such additional amounts as the trustee deems advisable. On my son’s death, the remaining principal shall be paid to such charities as my son shall appoint by his last will.” The son is treated as the owner of the principal and income of the trust under § 678; the fact that he has the power to appoint to charity is disregarded.

Under this model, the trust beneficiary is given the unlimited right to withdraw the benefits (and any “proceeds” thereof) from the trust at any time. Until the beneficiary chooses to exercise this right, the trustee exercises ownership rights and responsibilities on the beneficiary’s behalf, for example, by investing the trust funds, choosing distribution options, and distributing income and/or principal to or for the benefit of the beneficiary.

This type of trust would be uncommon, since anyone wanting to give such broad rights to the beneficiary would presumably choose to leave the benefits outright to the beneficiary rather than in trust. However, there are two situations in which this model could be useful:

(a) A marital deduction “qualified domestic trust” (QDOT) for the benefit of a non-citizen spouse (§ 2056A), where the only purpose of placing a trust between S and the retirement benefits is to qualify for the modified marital deduction available when the surviving spouse is not a U.S. citizen (see Chapter 4).
(b) A trust to provide for a mentally handicapped beneficiary who can exercise the right of withdrawal only through a legal guardian. For this type of beneficiary, this type of trust provides the benefits of a discretionary trust without losing the benefits of the "life expectancy" method based on the life expectancy of the handicapped beneficiary. This can be particularly helpful where the primary beneficiary does not have and is not likely to have issue, and the only likely remainder beneficiaries are the primary beneficiary’s older siblings, the beneficiary’s own estate or charities.

_The MRD Conduit Trust_

A “conduit trust” is not an official term, but is a nickname for a trust which serves as a conduit for minimum required distributions. The trustee is required to withdraw the minimum distributions from the retirement plan over the life expectancy of the trust beneficiary (or of the oldest member of a group of trust beneficiaries) and distribute the distributions out to that beneficiary (or the members of the group).

The trustee does not have the power to hold and retain inside the trust any plan distributions made during the lifetime of the beneficiary (or of the oldest beneficiary). If the (oldest) trust beneficiary lives to his or her full life expectancy, 100% of the benefits will have been distributed out to individuals. With a “conduit trust,” the retirement benefits are deemed paid to the individual beneficiary for purposes of the minimum distribution rules, and the “all beneficiaries must be individuals” test is met; _remainder beneficiaries can be disregarded_, because their entitlement to share in the benefits is contingent on the (premature) death of a prior beneficiary.

**Example 4:** “With respect to any IRA or other retirement plan or arrangement payable to the trust, the trustee shall withdraw from such plan, in each year, the minimum required distribution under § 401(a)(9) for such year computed based on the life expectancy of my oldest grandchild, and immediately distribute such amount in equal shares per capita to my grandchildren living at the time of such distribution. If all my grandchildren die before the trust has been entirely distributed, pay the balance of the principal to the Boston Foundation.” The charitable remainder beneficiary can be disregarded, because it takes only if all the grandchildren die prior to the end of the life expectancy of the oldest grandchild.

**Example 5:** “With respect to any IRA or other retirement plan payable to the trust, the trustee shall withdraw from such plan, in each year, and distribute to my spouse, the greater of the income of such plan for such year, or the minimum required distribution for such plan for such year under § 401(a)(9) (computed based on the life expectancy of my spouse).” If S lives to her life expectancy she is guaranteed to receive all the retirement benefits, so you can disregard any

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1This type of trust may not be appropriate if preservation of the beneficiary’s eligibility for means-tested government benefit programs is a concern. This type of planning is beyond the scope of this book.
remainder beneficiary, and any power of appointment which affects the remainder, under Prop. Reg. § E-5(e)(1).

**Example 6:** “The Trustee shall withdraw from the IRA, and distribute to my daughter, each year, the minimum required distribution for such year, based on my daughter’s life expectancy. After my daughter’s death, if she is survived by a husband, the trustee shall pay income of the trust to my daughter’s surviving husband for life, remainder to my daughter’s issue.” If daughter lives to her full life expectancy she is guaranteed to receive all the retirement benefits, so the potential future older beneficiary can be disregarded.

**Example 7:** “The Trustee shall withdraw from the IRA, and distribute to my daughter, each year, the minimum required distribution for such year, based on my daughter’s life expectancy. After her death, the trustee shall distribute the remaining balance to such charities as my daughter shall appoint by her will.” If daughter lives to her full life expectancy she is guaranteed to receive all the retirement benefits, so the potential appointees under her power of appointment can be disregarded.

The trustee could also be given discretion to withdraw and distribute to the life beneficiary *more* than the minimum in any year without upsetting this approach. The MRD Conduit Trust would be useful in the following situations:

(a) Eli wants to leave his IRA to his wife Laura, but is concerned about her ability to handle a large sum of money that becomes subject to her control all at once. He is confident that she would handle wisely a stream of installment payments from the IRA. So he makes the IRA payable to a trust. The trustee will invest the IRA, and withdraw from the IRA and distribute to Laura each year the annual MRD based on Laura’s life expectancy. (Note: this trust would not qualify for the marital deduction without additional provisions; see “Marital Deduction for Benefits Payable to QTIP Trust,” Chapter 3; and this method would lose the benefits of the spousal rollover.)

(b) Aunt Emily believes that leaving her IRA to her young nephews is a fine way to provide them with the start of a good retirement nest egg, but knows that, if she names them directly as beneficiaries, they will simply cash out the account immediately upon her death. So she leaves the IRA to an MRD Conduit Trust for them. The purpose of the trust is to make sure that the nephews take advantage of the “life expectancy method,” whether they want to or not, and incidentally to provide professional management for the undistributed portion of the IRA. The trustee is instructed to withdraw from the IRA, each year, the MRD (based on the life expectancy of the oldest nephew) and distribute it equally to the surviving nephews.

Under this approach, again, the primary trust beneficiary is in the same position as if he or she had been named directly, individually, as beneficiary of the benefits, but with one difference from the “100% Grantor Trust” model. With the MRD Conduit Trust, it is as if P, instead of leaving it up to the beneficiary to decide when and how to take out the benefits, had specified a
payout mode as well as a beneficiary. In this case, it is as if P had specified that distributions would be paid in instalments over the life expectancy of the DB. If the DB (or life beneficiary of the "MRD Conduit Trust") lives to his or her full life expectancy, he or she will have received 100% of the benefits and the remainder beneficiary will receive nothing. If the DB (or life beneficiary of the "MRD Conduit Trust") happens to die before the end of his or her life expectancy period, the remaining benefits will be paid to the remainder beneficiary of the trust (analogous to a contingent beneficiary).

With an MRD Conduit Trust, as with the 100% Grantor Trust, the identity of the remainder beneficiary becomes irrelevant, because a contingent beneficiary whose rights are contingent on the prior beneficiary’s death before the end of the prior beneficiary’s life expectancy can be disregarded. Prop. Reg. § E-5.

Non-discretionary life trust with remainder to individuals

As noted, the "100% Grantor Trust" and "MRD Conduit Trust" models solve the "trust rules" dilemma in a few limited situations. There are many other situations in which a trust is required, however, for which these two models are not suitable. For example:

(a) Any case in which the purpose of holding the retirement benefits in trust is to keep this asset (or at least the “principal” portion of it) out of the gross estate of the life beneficiary—for example a “credit shelter trust” designed to benefit the surviving spouse for life but not be part of her taxable estate, or a “generation skipping trust” designed to benefit P’s child for life without being included in the child’s estate. Since all of the “100% Grantor Trust” model trust would be included in the life beneficiary’s estate (under § 2041), and all of the “MRD Conduit Trust” property would be included in the life beneficiary’s estate if he lived to his life expectancy (because it would all have been distributed to him at that point), these models are not suitable for these goals.

(b) If the purpose of the trust is to assure that one beneficiary (e.g. a spouse) has the life use of the benefits, but that the principal will be preserved for the benefit of the remainder beneficiary (e.g. children), the first two models are not suitable because nothing may pass to the remainder beneficiary under those models.

(c) There is a need to protect the trust principal from direct access by the beneficiary because the beneficiary is a spendthrift, or is too young, or is subject to creditors’ claims—or any of the myriad reasons clients want to keep large sums of money out of beneficiaries’ hands permanently or temporarily.

In all these cases, a “true” trust is called for—one that is not analogous to naming the beneficiary outright. From the point of view of the minimum distribution regulations, the key difference between this type of trust and the two models previously discussed is that, with this type, beneficiaries who come after the primary or life beneficiary will “count” as beneficiaries of the trust for purposes of determining whether all trust beneficiaries are individuals and who is the
oldest beneficiary. This means that, under this model:

- All remainder beneficiaries (including contingent remainder beneficiaries and potential appointees under powers of appointment) must be individuals—no estates or charities.
- The oldest remainder beneficiary’s life expectancy will determine MRDs even during the lifetime of the primary beneficiary if any remainder beneficiary is older than the life beneficiary.

**Summary of Planning Principles**

1. If a trust is to be named as beneficiary of retirement benefits of a participant who has not yet reached his RBD, the trust must be drafted to comply with the rules explained in this chapter, or else benefits will have to be distributed under the Five Year Rule upon the client’s death (the life expectancy payout method for a designated beneficiary will not be available).

2. If a client dies prior to his RBD, leaving benefits payable to a trust, the trustee must file documentation with the plan administrator by the end of the ninth month following the date of death, or else all benefits will have to be paid out within five years after the date of death.

3. In the case of a client who is approaching his RBD, and who has named or who is going to name a trust as beneficiary of his retirement benefits, a copy of the trust (or other substitute documentation described in this chapter) must be filed with the plan administrator on or before the RBD, or the participant will be forced to use only his own life expectancy to measure required distributions.

4. If a client who has passed his RBD proposes to name a trust as beneficiary of his benefits, a copy of the trust (or other substitute documentation described in this chapter) must be filed with the plan administrator simultaneously with the beneficiary designation, or else the participant will have “no DB.”

5. In general, because of the financial advantages of having a “designated beneficiary,” and because of the stringency and specificity of the IRS’s rules regarding naming a trust as beneficiary if “designated beneficiary” status is to be maintained, no estate planner should name a trust as beneficiary of retirement benefits without either becoming or consulting with someone who has mastered these rules.
Trust Review Checklist

This REVISED version was first released June 1, 1999. This revised version reflects recent IRS letter rulings and also the remarks of Marjorie Hoffman, Esq., of the Treasury (author of the proposed regulations on minimum distributions) at a recent video broadcast seminar put on by ALI-ABA. The changes from the April 1999 version are: a more relaxed attitude towards powers of appointment (based on two recent letter rulings, and the comments of Ms. Hoffman), a slightly simplified structure, and the author’s increased confidence in other conclusions herein. This version has been further updated September 1, 1999, to reflect improvements suggested by Mark Worthington, Esq., of Worcester, Mass.

The purpose of this checklist is to help the attorney who is reviewing or drafting a trust agreement to determine whether the trust complies with the rules of the IRS’s proposed minimum distribution regulations (§ 1.401(a)(9)-1), so that the participant who names such trust as beneficiary of his retirement benefits will be deemed to have a “designated beneficiary.” Section references in this outline refer to that proposed Treasury regulation. You will need to read the proposed regulation to understand some of the questions. You need to understand the “minimum distribution rules” (see Life and Death Planning for Retirement Benefits, by Natalie B. Choate (3rd edition 1999, Ataxplan Publications, 1-800-247-6553; $89.95 plus shipping and handling, plus sales tax if applicable), Chapter 1) to understand this quiz.

Apply these questions to the trust. If the retirement benefits are required by the terms of the trust and/or beneficiary designation to be paid only to one (or more) particular share(s) of the trust, apply these questions only to that (or those) share(s).

The relevant date for applying these questions is (except as otherwise noted) the participant’s required beginning date (“RBD”), or (if he dies before that date) the date of death. If the trust is not named as beneficiary until after the RBD, the test is applied as of the date the trust is named as beneficiary; however, the ability to use the trust beneficiary’s life expectancy to measure required distributions in that case (even if the trust passes this test with flying colors) may be limited by the participant’s prior choices of beneficiary made at and since the RBD.

The explanations include comments for both “planning mode” (you are reviewing or drafting the trust BEFORE the date of death, and BEFORE the RBD, or BEFORE the trust has been named as beneficiary) and “cleanup mode” (the client has already died or passed his RBD, and this trust is named as beneficiary). Some answers may lead you into THE GRAY AREA, where this author cannot guarantee that your trust “passes,” but on the other hand it might be just fine.

Start at the beginning, with Question one. Then follow to where your answer leads you. Do NOT
answer all questions; answer only those which you are directed to answer by your answers to previous questions.

1. Is the trust valid under applicable state law, or will it be valid under applicable state law once it is funded?
   If yes, go to Question 2.
   If no, go to ANSWER A.

Explanation: Prop. Reg. § D-5(b)(1). For either a revocable “living” trust or a testamentary trust, the Question is not whether the trust is ALREADY a “valid” existing trust, but whether it WILL BE a valid trust once the participant dies and the benefits are actually paid to the trust. A trust that would be invalid under state law should be rather rare; examples might include a trust which violates the rule against perpetuities, or a trust which violates public policy (“The trustee shall pay $1000 to my daughter every time she robs a bank”), or a trust which has no beneficiaries.

2. Is the trust irrevocable, or will it, by its terms, become irrevocable upon the participant’s death?
   If yes, go to Question 3.
   If no, go to ANSWER A.

Explanation: Prop. Reg. § D-5(b)(2). Generally, any testamentary trust or “living trust” automatically becomes irrevocable upon the testator’s or donor’s death, and therefore passes this test. Although, in planning mode, it wouldn’t hurt to include in the trust a statement such as “This trust shall be irrevocable upon my death,” this is certainly not necessary. Unfortunately, it is still not clear what the IRS is driving at with this rule; perhaps they are thinking of a situation where someone other than the participant has a power to “revoke” the trust after the participant’s death. For example, a surviving spouse with a community property interest in the retirement benefits might have that power, or the participant might have left his benefits to a trust which is “revocable” by his spouse or someone else, and these trusts would “flunk” this rule.

3. If the participant is past his RBD, did he provide the required documentation to the plan administrator on or before the RBD (or on or before the date the trust was named as his beneficiary, if that occurred after the RBD)?
   If yes, or not applicable, go to Question 4.
   If no, but the “plan” is an IRA, go to THE GRAY AREA.
   Otherwise, go to ANSWER A.


4. If the participant died before his RBD, did (or will) the trustee provide the
required documentation to the plan administrator by the end of the ninth month beginning after the date of death?
  If not applicable (because P reached his RBD still alive), go to Question 6.
  If yes, go to Question 5.
  If no, but the “plan” is an IRA, go to THE GRAY AREA.
  Otherwise, go to ANSWER A.


5. If the participant died before his RBD, was the first distribution paid out from the retirement plan to the trust (or will it be paid out) by the end of the calendar year following the year in which death occurred?
  If yes, go to Question 6.
  If no, go to Bonus Question #1.


6. All individual beneficiaries, part 1: “The estate” as beneficiary of the trust:
Does the trust contain a provision allowing or requiring the trustee to pay trust assets to the participant’s estate to pay the participant’s debts, administration expenses, funeral expenses, estate taxes and/or bequests to non-individual beneficiaries under the participant’s will, and is it possible under the trust that retirement benefits could be used by the trustee for these payments?
  If no, go to Question 7.
  If yes, go to THE GRAY AREA.

Explanation: Prop. Reg. § D-2, D-4(c), D-5(a) and E-5(a).

7. All individual beneficiaries, part 2: Is the trust a “100% grantor trust” with respect to an individual beneficiary under Code § 678?
  If yes, go to Answer B.
  If no, go to Question 8.

Explanation: Under § 678 (part of the so-called “grantor trust rules” of the Internal Revenue Code), a beneficiary is treated for all purposes of the federal income tax as the “owner” of trust assets if such beneficiary has the sole unrestricted right to withdraw those assets from the trust. (For full details and variations, see § 678.) If an individual beneficiary is deemed the owner of all of the trust’s assets under this section, then the retirement benefits are deemed paid to such individual beneficiary for purposes of the minimum distribution rules, and the “all beneficiaries must be individuals” test is met; *remainder beneficiaries can be disregarded.*

Examples:
A. "The trustee shall pay all income of the trust to my spouse for life, plus such amounts of the principal (including all thereof) as my spouse shall request from time to time." The surviving spouse would be deemed the "owner" of the assets of this trust and therefore payout options would be the same for a retirement plan payable to this trust as if the spouse had been named directly as beneficiary. It doesn't matter who are the remainder beneficiaries of this trust, or what power to appoint to whom the spouse may have over the principal remaining at her death.

B. "The trustee shall pay to my son such amounts of the income and principal of the trust (including all thereof) as my son shall request at any time and from time to time, and such additional amounts as the trustee deems advisable. On my son's death, the remaining principal shall be paid to his widow." The son is treated as the owner of the principal and income of the trust under § 678; therefore, the fact that an older remainder beneficiary (a new wife/widow) might be brought in later can be disregarded.

C. "The trustee shall pay to my son such amounts of the income and principal of the trust (including all thereof) as my son shall request at any time and from time to time, and such additional amounts as the trustee deems advisable. On my son's death, the remaining principal shall be paid to such charities or persons as my son shall appoint by his last will." The son is treated as the owner of the principal and income of the trust under § 678; the fact that he has the power to appoint to charity is disregarded.

8. **All individual beneficiaries, part 3:** Is the trust a "conduit trust" as to one or more individual beneficiaries?
   If yes, go to Answer B.
   If no, go to Question 9.

**Explanation:** A "conduit trust" is not an official term, but is a nickname for a trust which serves as a conduit for minimum required distributions. The trustee is required to withdraw the minimum distributions from the retirement plan over the life expectancy of the trust beneficiary (or of the oldest member of a group of trust beneficiaries) and distribute the distributions out to that beneficiary (or the members of the group). The trustee does not have the power to hold and retain inside the trust any plan distributions made during the lifetime of the beneficiary. If the trust beneficiary lives to his or her full life expectancy, 100% of the benefits will have been distributed out to him or her. With a "conduit trust," the retirement benefits are deemed paid to the individual beneficiary for purposes of the minimum distribution rules, and the "all beneficiaries must be individuals" test is met; *remainder beneficiaries can be disregarded*, because their entitlement to share in the benefits is contingent on the (premature) death of a prior beneficiary.

**Examples of conduit trusts:**

A. "With respect to any IRA or other retirement plan or arrangement payable to the trust, the trustee shall withdraw from such plan, in each year, the minimum required distribution under IRC § 401(a)(9) for such year computed based on the life expectancy of my oldest grandchild, and immediately distribute such amount in equal shares per capita to my grandchildren living at the time of such distribution. If all my grandchildren die before the trust has been entirely
distributed, pay the balance of the principal to the Boston Foundation.” The charitable remainder beneficiary can be disregarded, because it takes only if all the grandchildren die prior to the end of the life expectancy of the oldest grandchild.

B. “With respect to any IRA or other retirement plan or arrangement payable to the trust, the trustee shall withdraw from such plan, in each year, and distribute to my spouse, the greater of the income of such plan for such year, or the minimum required distribution for such plan for such year under IRC § 401(a)(9) (computed based on the life expectancy of my spouse).” If the spouse lives to her life expectancy she is guaranteed to receive all the retirement benefits, so you can disregard any remainder beneficiary, and any power of appointment which affects the remainder, under Prop. Reg. § E-5(e)(1).

C. “Trustee shall withdraw from the IRA, and distribute to my daughter, each year, the minimum required distribution for such year, based on my daughter’s life expectancy. After her death, the trustee shall pay income of the trust to her surviving husband for life, remainder to my daughter’s issue.” If daughter lives to her full life expectancy she is guaranteed to receive all the retirement benefits, so the potential future older beneficiary can be disregarded.

D. “Trustee shall withdraw from the IRA, and distribute to my daughter, each year, the minimum required distribution for such year, based on my daughter’s life expectancy. After her death, the trustee shall distribute the remaining balance to such persons or charities as my daughter shall appoint by her will.” If daughter lives to her full life expectancy she is guaranteed to receive all the retirement benefits, so the potential appointees under her power of appointment can be disregarded.

9. All individual beneficiaries, part 4: If all present and potential future individual beneficiaries of the trust who are living on the applicable date (including later-born siblings of such now-living beneficiaries) live until their life expectancy (under IRS tables), will the trust assets necessarily be distributed entirely to individuals?

   If definitely yes, go to Question 10.

   If probably yes depending on the future fertility of the said individuals, go to THE GRAY AREA.

   Otherwise (i.e. “No”), go to Answer A.

Explanation: An essential element is that all trust beneficiaries must be individuals. Prop. Reg. § D-2, D-4(c), D-5(a) and E-5(a). For this purpose the IRS counts both income and remainder beneficiaries (except in the case of a “100% grantor trust” or “conduit trust”—see questions 7 and 8). However, a contingent remainder beneficiary does NOT count if he, she or it will receive a share of the benefits only if the prior (individual) beneficiaries die prematurely (i.e., do not live to their life expectancy). Therefore you can test the trust by looking at all the currently living people who are now (or may in the future be) beneficiaries of the trust, and seeing what happens if they all live to their IRS life expectancy. If the retirement benefits (or proceeds thereof) must pass to individuals under those circumstances, the answer is “definitely yes” and the trust passes this particular test. The IRS disregards contingencies other than premature death; so (e.g.) the fact
that the trustee might use its discretion to distribute all of the property to individuals (or individuals might get all the money if they need it for health or support) is disregarded.

Examples:
A. “Income to my husband for his life, remainder to my issue, or, in default of issue, to charity,” and participant has issue living on the applicable date who are younger than the husband. If those issue and the husband live to their normal life expectancy, the trust will definitely be paid to individuals, so the answer is “yes.”
B. “Income to my son Bobby, plus principal in trustee’s discretion; distribute all principal to Bobby when he reaches age 25, or, if he dies before reaching age 25, distribute the principal to My Favorite Charity.” If Bobby lives to his life expectancy, an individual (Bobby) will get all the trust assets, so the answer is “yes.” The charity can be ignored, because it will get money only if the individual beneficiary dies before his life expectancy.
C. “Income to my wife, plus principal as needed for her health and support [or in the discretion of the trustee]; remainder to charity.” Even if wife (the only individual beneficiary) lives to her life expectancy, she is not guaranteed to get all the trust property, so there is a non-individual beneficiary and the answer is “no.” The fact that the trustee MIGHT distribute all the principal to her (because she needs it for her health or support) (or in the exercise of its discretion) makes no difference.
D. “Income to my issue per stirpes until 21 years after the death of my last descendant who is now living, then distribute to my issue per stirpes, or, in default of issue, to charity.” Because this trust extends beyond the life expectancy of all now-living individuals, you cannot demonstrate that the trust property must be distributed to individuals, even if all the currently-living issue live to life expectancy. On the other hand if there are lots of living issue now, so it seems likely that there will be some more born in the future and eventually the trust will vest in individuals, go to the GRAY AREA.
E. “Income to my son for his life, remainder to his living issue or in default of issue to charity.” If son has living issue on the applicable date, the answer is “yes,” because if son and his issue live to their normal life expectancies, the issue (individuals) will outlive the son and the issue will get the trust property. On the other hand, if son does not have any issue living on the applicable date, then the trust is not guaranteed to be paid to individuals; payment to individuals is contingent on the future fertility of son, so you are in THE GRAY AREA (at best). In planning mode you can fix this by providing younger individual contingent beneficiaries (who are living on the applicable date) instead of a charity in case of default of issue.

10. Is it possible to identify with certainty the oldest person who could ever possibly be a beneficiary of this trust?
   If “definitely yes,” go to Question 11.
   If one or more older beneficiaries could be added later, but any such future-older-added-beneficiary could share in the trust ONLY if a prior, currently-existing, identifiable, individual beneficiary dies before his or her life expectancy, go to Question 11.
   Otherwise (i.e., one or more older beneficiaries could be added later, and you cannot
prove that any such future-older-added beneficiary could share in the trust ONLY if a prior, currently existing, identifiable, individual beneficiary dies before his or her life expectancy), go to ANSWER A.

**Explanation:** Prop. Reg. § D-2, D-5(b)(3). Since minimum required distributions are paid out to a trust based on the life expectancy of the oldest trust beneficiary, you must be able to identify the oldest trust beneficiary with certainty on the applicable date. If the trust is not a “100% grantor trust,” (see Question 7), all potential remainder beneficiaries must be considered in applying this test, with one exception: a remainder beneficiary who will take only if a prior beneficiary dies before his or her life expectancy can be disregarded.

**Examples:**

A. “Income to my husband for life, remainder to my issue surviving my husband and me.” New beneficiaries can come in after participant’s death, during period of husband’s survivorship interest—for example, a child could die and be replaced by his or her own children in the class of “issue”—but such new beneficiaries must necessarily be younger than the existing beneficiaries (unless the trust would recognize the legal adoption of an older individual). So the answer is “definitely yes”; it IS possible to identify with certainty the oldest beneficiary (husband).

B. “Income to my daughter for life, and after her death income to her surviving husband for his life, remainder to my now-living grandchildren.” Unless the daughter’s surviving husband is defined to mean her current husband, the answer is “no”: daughter could marry someone older than herself after the applicable date, so it is not possible to identify the oldest beneficiary of the trust. Furthermore, even if daughter lives to her full life expectancy she is not guaranteed to receive all the trust benefits, so you cannot argue that the potential future older beneficiary can be disregarded under Prop. Reg. § E-5(e)(1).

11. Does any person have a power of appointment over the benefits the exercise of which is not subject to an ascertainable standard?

If definitely no, go to ANSWER B.

If yes, but such power will affect the ownership or enjoyment of the benefits only after the death of a prior beneficiary, AND if such prior beneficiary lives to his or her life expectancy the power will not affect the ownership or enjoyment of the benefits at all, go to ANSWER B.

If yes, but such power is limited to a small, clearly-defined group of “identifiable” younger individuals, go to ANSWER B.

Otherwise, go to THE GRAY AREA.

**Explanation:** Prop. Reg. § E-5(f). Examples:

A. “The trustee shall pay income to my spouse for life, remainder to my issue.”

Definitely no.

B. “The trustee shall pay income and principal to or for the benefit of my minor children as needed for their support, medical expenses, care and education. When I have no living child under the age of 18 years, the trustee shall distribute the remaining income and principal to
my issue then living, by right of representation.” The participant has selected the beneficiaries and dictated the basis on which distributions are to be made to them. So this is a “definite no.”

C. “The trustee shall pay income to my spouse for life. Upon my spouse’s death, the principal shall be paid to such persons among the class consisting of our issue as my spouse shall appoint by her will.” Yes, but such power is limited to a small, clearly-defined group of “identifiable” younger individuals, so go to ANSWER B.

D. “The trustee shall pay income and principal to such of my issue as my trustee chooses in its discretion.” Yes, but such power is limited to a small, clearly-defined group of “identifiable” younger individuals, so go to ANSWER B.

E. “The trustee shall pay income to my spouse for life, and on his death shall distribute the principal to such individuals born after my spouse as my spouse shall appoint by his last will.” Although the power of appointment is limited to individual appointees who are younger than the spouse, the group of potential appointees is not small or narrowly defined. Go to THE GRAY AREA.

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**BONUS QUESTIONS.** Do not answer any of these questions unless you have been specifically directed to answer such question by your answer to another question!

**Bonus Question #1:** Is the surviving spouse the sole beneficiary of the trust?
- If definitely yes, go to Bonus Question #2.
- If definitely no, go to ANSWER A.
- If maybe, go to the GRAY AREA.

**Explanation:** Definitely yes: The surviving spouse is definitely the “sole beneficiary” of the trust if either: (a) she is treated as the sole owner of all of the trust’s income and principal under IRC § 678, which would be the case if she has the unlimited right to withdraw all principal and income of the trust (“100% grantor trust”) (see Question 7); or (b) distributions will be made from the plan to the trust over a period not exceeding the surviving spouse’s life expectancy and all distributions made from the plan during her life will be distributed outright to her from the trust (“conduit trust”) (see Question 8).

Definitely no: If there are other beneficiaries of the trust who may receive distributions from the trust during the surviving spouse’s lifetime, the answer is “definitely no.”

Maybe: If there are no other beneficiaries during the surviving spouse’s lifetime, and the surviving spouse will receive all income of the trust, but is not guaranteed to receive all plan distributions made during her lifetime, the answer is “maybe”; go to the GRAY AREA.

**Bonus Question #2:** Was the first distribution paid out from the retirement plan or IRA to the trust (or will it be paid out) by the end of the calendar year in which the participant would have reached age 70½?
- If yes, go back to (regular) Question 6.
If no, go to ANSWER A.

THE GRAY AREA

These are unresolved questions regarding the IRS’s treatment of retirement benefits payable to trusts. If your trust is in THE GRAY AREA, it cannot be given an automatic “clean bill of health” as is, but that does not necessarily mean you must go to ANSWER A because: in most of these matters the IRS has not spoken clearly; or, if the IRS has spoken clearly, the IRS might change its mind or be held wrong in court. Issues that land you in THE GRAY AREA are:

Questions 3 and 4: Who is plan administrator of an IRA: Documentation must be provided to “the plan administrator.” However, in the case of an IRA, there is no such thing as a “plan administrator”; “plan administrator” is a title that pertains ONLY to qualified plans. Therefore, arguably, if the participant himself had possession of the required documentation (which he presumably would have in all cases—a copy of his own trust), this requirement is complied with. After all, the participant (and not the IRA custodian) is the one who is required to comply with the minimum distribution rules for his own IRA. To date the only official pronouncement on this subject by the IRS is in the Preamble to the Amended Proposed Regulations (issued in December 1997) that the documentation must be provided to the IRA custodian (who generally does NOT calculate MRDs). However, the Preamble is not even reproduced in most copies of the proposed regulations. There is no way the average planner (let alone retiree) could find this statement. So: Planning mode: give the documentation to the IRA custodian or trustee and get a receipt. Cleanup mode: Either take the position that participant is the “plan administrator” and answer yes to Question 3 or 4, or capitulate and go to ANSWER A.

Question 6: Trust paying debts, expenses and taxes of estate: Certain IRS rulings suggest that the IRS will treat a trust under which retirement benefits could be used to pay the deceased participant’s debts, estate taxes and/or probate expenses as a trust which has a non-individual beneficiary, namely, the participant’s “estate.” See, e.g., Ltr. Rul. 9809059 (12/4/97). The author believes that this position of the IRS is wrong; further thoughts on this are expected to be published in the fall of 1999 in Trusts & Estates magazine. However, for now, it is clearly and unequivocally the position of the IRS that “the estate” cannot be a designated beneficiary. Planning mode: It would be highly advisable to amend the trust so it prohibits this use of the retirement benefits. If there are no other assets available to pay these items, consider dividing the plan into two separate plans or accounts, only one of which is allowed to be used to pay these items, so that only the account actually used to pay the debts and expenses will be tainted, and the other can be exempted from this problem; or have the participant take withdrawals during life so the estate will have sufficient non-plan assets to pay these items. Cleanup mode: Either get a ruling on your situation, or prepare for possible IRS challenge, or capitulate and go to ANSWER A.

Question 7: Trust does not clearly vest in currently living individuals even if they live to their life expectancy: If the trust will be paid to individuals only if currently living
individuals produce issue, but there are non-individual beneficiaries who will take in case of default of issue, it is not clear whether the trust passes the “all beneficiaries are individuals” test. The IRS simply has not clarified the boundaries of this rule. However, this author expects that ultimately the IRS will interpret this situation to deny “designated beneficiary” status to such a trust. Planning mode: Revise the trust so that benefits are guaranteed to be distributed to individuals during the life expectancy of such currently living individuals if they live to their normal life expectancy, or get a ruling before proceeding. Cleanup mode: If you are confident that your trust is payable to designated beneficiaries based on a “reasonable interpretation of the statute and proposed regulations,” you could answer “yes” (consider applying for an IRS ruling to back you up); or capitulate and go to ANSWER A.

Question 11: No-one knows the extent to which a “spray” power not limited by an ascertainable standard, or any other “power of appointment,” might be considered “the discretion to change the beneficiaries of the employee” after his death in violation of Prop. Reg. § E-5(f). Based on recent letter rulings approving use of the life expectancy method for trusts which contained a power to appoint principal among the decedent’s issue (1999-03050 and 1999-18065), the IRS apparently did not intend to prohibit this common estate planning device. If the IRS intended to distinguish between said common estate planning devices (which were to be permitted) and some broader category of “discretions” (which are prohibited), the dividing line is not known. It is commonly assumed (based on said private letter rulings and IRS pronouncements at seminars) that a power of appointment (or trustee spray power) that is limited to a narrowly defined group of INDIVIDUALS (such as the participant’s “descendants,” “children” or “issue”) is NOT a problem, provided that the oldest possible appointee can be determined with certainty (so all potential appointees are “identifiable”) and all possible appointees are individuals. Planning mode: Either do not use powers of appointment, or spray powers not limited by an ascertainable standard, at all in trusts that are to receive retirement benefits, or be sure that such powers allow appointment of the benefits only to a small, clearly-defined group of individuals who are younger than the otherwise-oldest trust beneficiary. Cleanup mode: Presumably E-5(f) is intended to interpret the statutory definition of “designated beneficiary” as “any individual designated as a beneficiary by the employee.” § 401(a)(9)(E). It seems a reasonable interpretation of the statute that a narrowly defined group of individuals meets the statutory definition, even if the participant left it up to a beneficiary (holding a power of appointment) or a trustee (holding a spray power) to appoint the property among this group.

Bonus Questions 1 and 2: Two letter rulings, 9442032 (7/27/94) and 9623056 (3/12/96), held that a trust that provided income to the surviving spouse, remainder to children, would be entitled (under § 401(a)(9)(B)(iv)) to postpone distributions until the deceased spouse would have reached age 70½, if that trust was named as beneficiary of retirement benefits. A more recent ruling, 9847022 (8/24/98) held exactly the opposite on apparently similar facts, saying § 401(a)(9)(B)(iv) treatment is available only if the spouse is the “sole” beneficiary of the trust. Then a still more recent ruling (1999-18065, 2/10/99) held once again that a trust of which the spouse is merely the oldest (but not the sole) beneficiary (and which meets the various other trust
requirements) is entitled to the postponement under § 401(a)(9)(B)(iv). Planning mode: If you want to be sure the trust can use the life expectancy method you have two choices: change the trust so the spouse is definitely the sole beneficiary (see Bonus Question 1 explanation); or start distributions (over the oldest trust beneficiary’s life expectancy) within one year after the date of death (so you can answer “yes” to Question 5). Cleanup mode: if you fit within the favorable IRS rulings, consider whether you want to rely on them as a “reasonable interpretation of the statute” and answer yes to Bonus Question 1, or (alternatively) capitulate and go to ANSWER A.

ANSWERS. When you arrive here, you have reached the end of the quiz. Your answer is:

ANSWER A: If you have been directed to “Answer A,” bad news: this trust “flunks” the minimum distribution trust rules of the IRS’s proposed regulations. However, the IRS’s proposed regulations do not have the force of law. Proposed regulations have been characterized as similar to one party’s brief in litigation. Until final regulations have been issued, a taxpayer is entitled to act based on a “reasonable interpretation of the statute.” So if you “flunk” the proposed regulations’ test, but can construct a “reasonable interpretation of the statute” under which you are ok, you should win. If you do not want to or cannot fit into a “reasonable interpretation of the statute,” here are the results of flunking the test:

A-1: If the participant died before his RBD, then all benefits must be distributed by December 31 of the calendar year that contains the fifth anniversary of the date of death. Prop. Reg. § C-2.
A-2: If the participant is still alive and has not yet reached his RBD, you are in good shape: you can fix the trust, and as long as you get it fixed before he dies and before the RBD, you are ok.
A-3: If the participant is already past his RBD, in other words he reached his RBD alive, then, as of the RBD (if this trust was named as beneficiary on the RBD), he did not have a DB. Therefore the participant must withdraw his benefits, beginning at the RBD, over a period not exceeding his own life expectancy (only). Neither the participant (during his lifetime) nor the beneficiary of the benefits (after the participant’s death) is entitled to use the joint life expectancy of the participant and a beneficiary to measure MRDs.
A-4: If the participant is past his RBD, and the trust was not named as beneficiary until after the RBD, see Life and Death Planning for Retirement Benefits, page 43 (effects of changing the beneficiary after the RBD).

ANSWER B: Congratulations! Your trust passes the test. Remember, however, that if P has not yet died or reached his RBD, continued qualification will depend on providing required documentation to the “plan administrator” before the RBD (or by the end of the ninth month after the date of death in case of death before the RBD) (see Questions 3 and 4); and that any amendment of the trust will necessitate another pass through this checklist (as well as providing a copy of the amendment to the plan administrator, if P is past his RBD).