Planning for Distributions from Qualified Retirement Plans

Louis A. Mezzullo
PLANNING FOR DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS

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Richmond, Virginia

(October 24, 1996)

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I. INTRODUCTION

A. Importance.

1. Qualified retirement plan benefits and individual retirement accounts (IRAs) represent a substantial portion of the accumulated wealth of many Americans who seek estate planning advice.

2. The estate planner must be familiar with the tax and nontax considerations associated with the receipt of qualified retirement plan benefits and IRAs by participants, account holders, and their beneficiaries.

3. Generally, the estate planner will be asked to give advice about distributions from qualified retirement plans and IRAs in four situations.

   a. An individual, upon becoming a participant in a qualified retirement plan or upon opening an IRA, will be required to complete a beneficiary designation form naming someone to receive his or her plan benefits or IRA balance if he or she dies before all the benefits or the account balance have been distributed.

b. The participant or account holder should be properly advised when he or she is involved in a divorce to ensure that any benefits paid to the former spouse will be taxed to the former spouse and not to the participant or account holder, because the payments are made pursuant to a qualified domestic relations order.

c. The participant or account holder will seek advice about the appropriate method to receive benefits once he or she has retired or is otherwise required to receive the benefits.

(1) Even if the participant or account holder does not need the plan benefits or IRA for his or her living needs, he or she will be required to begin withdrawing plan benefits or IRA balances by April 1 of the year following the year in which he or she reaches age 70½ (or retires in the case of a participant in a qualified retirement plan who does not own more than five percent of the sponsoring employer). I.R.C. § 401(a)(9)(A).

d. If there are plan benefits or IRA balances remaining to the credit of the individual after his or her death, the deceased individual's personal representative or designated beneficiary may seek advice concerning various options that may be available to reduce taxes or to defer the payment of taxes.

B. Client's Objectives.

1. Perhaps the most important consideration is what the client wants to do with the plan benefits or IRAs.

2. The client will be required to decide:

a. When he or she should begin receiving payments;

b. What method of benefit payment should he or she select; e.g., lump sum, period certain, life annuity, or joint and survivor annuity; and
c. Whom to name as the beneficiary of death benefits.

3. The client’s tax objectives will be to:
   a. Defer the receipt of the benefits in order to postpone paying income tax;
   b. Defer the payment of transfer taxes; and
   c. Avoid penalty taxes.

4. A participant’s desires will be restricted by the provisions in the plan and by the Retirement Equity Act of 1984 (REA). See I.R.C. §§ 401(a)(11) and 417.

C. Plan Provisions.

1. In many cases, particularly in plans sponsored by larger employers, the plan document may restrict the method and timing of receiving plan benefits.

2. The participant may not be entitled to a lump sum distribution under the plan, or, alternatively, may not be entitled to payments in the form of an annuity.

3. Also, forms of annuity payments at retirement may be limited to a joint and survivor annuity or to payments over no more than ten years.

4. The plan may require that payments to a terminated employee begin at the later of the plan’s normal retirement date or when the employee reaches age 62.

D. Spousal Rights.

1. In addition to provisions in the plan, a married participant’s choices may be limited by his or her spouse’s rights under REA. I.R.C. §§ 401(a)(11) and 417.

2. Generally speaking, REA requires that the participant’s spouse be entitled to some or all of the participant’s remaining plan benefits at the participant’s death unless the spouse has consented to the designation of someone else as the beneficiary.
3. In addition, under all types of qualified retirement plans except those profit sharing plans and stock bonus plans that meet certain requirements specified in the Code, the participant must receive his or her benefits in the form of a qualified joint and survivor annuity when he or she reaches his or her retirement date (which is generally whenever the participant commences to receive benefits from the plan), unless the spouse consents to another form of distribution.

   a. Under a qualified joint and survivor annuity, the participant must be entitled to receive his or her plan benefit in the form of a life annuity, and, if the spouse survives the participant, the spouse must be entitled to a life annuity which is not less than 50 percent of (and is not greater than 100 percent of) the amount of the annuity which is payable during the joint lives of the participant and the spouse. I.R.C. § 417(b).

4. According to the Treasury Regulations, a participant about to marry cannot obtain a valid consent from his or her future spouse. Treas. Reg. § 1.401(a)-20, Q&A 28.

   a. Because the spouse may only consent after the marriage to waive his or her right to some or all of the participant’s vested accrued benefit at the participant’s death, a premarital agreement cannot qualify as a valid consent.

   b. While most of the cases support the position taken in the regulations, in an unreported decision, Callahan v. Hutsell, et al., 1993 U.S. App. Lexis 34005 (6th Cir. 1993), remanding 813 F. Supp. 541 (WDKY 1992), the Sixth Circuit Court of Appeals indicated that a premarital agreement that included a spousal consent waiving rights to the participant’s qualified retirement plan benefits could serve as a valid consent if it satisfied the requirements of REA and the plan and if the premarital agreement did not satisfy these requirements, it may be enforceable under state contract law.

5. In addition, a valid consent to a waiver of the qualified joint and survivor annuity can only be
made within 90 days of the date payments to the participant are to commence. I.R.C. § 417(a)(3)(A) and (6)(A).

6. A profit sharing plan or a stock bonus plan that satisfies the following three requirements is not subject to the qualified joint and survivor annuity rules.
   a. The plan must provide that the participant’s entire vested accrued benefit is payable to the spouse upon the participant’s death unless the spouse consents to another designation.
   b. The participant must not elect to receive his or her benefit in the form of an annuity.
   c. The plan must not receive amounts from another plan that was subject to the qualified joint and survivor annuity rules.

7. An IRA or a simplified employee pension plan is not subject to REA at all. Treas. Reg. § 1.401(a)-20, Q&A 3(d).

II. AVOIDING PENALTY TAXES

A. Premature Distributions.
   1. A ten-percent additional income tax is imposed on premature distributions, which are distributions before the participant reaches age 59 ½ unless one of a number of exceptions applies. I.R.C. § 72(t).
   2. The most important exceptions are:
      a. A distribution that is made on account of the death or disability of the participant or account holder; I.R.C. §§ 72(t)(2)(A)(ii) and (iii);
      b. A distribution that is rolled into an IRA or qualified retirement plan; I.R.C. §§ 72(t)(1), 402(c)(1) and 408(d)(3);
      c. A distribution that is one of a series of substantially equal periodic payments over the life expectancy of the employee; I.R.C. § 72(t)(2)(A)(iv);
d. A distribution to an alternate payee pursuant to a qualified domestic relations order (QDRO); I.R.C. § 72(t)(2)(C); and


3. The last two exceptions do not apply to distributions from IRAs and the third exception only applies in the case of distributions from a qualified retirement plan if the participant has separated from service.

B. Excess Retirement Distributions.

1. A 15-percent excise tax is imposed on distributions from qualified retirement plans and IRAs received during a calendar year in excess of the annual threshold amount, which is $155,000 for 1996. I.R.C. §§ 4980A(a) and (c)(1).

2. The annual threshold amount can be increased to $775,000 for 1996 if the distribution would qualify for special averaging or capital gain treatment as a "lump sum distribution." I.R.C. § 4980A(c)(4).

3. Certain types of distributions are not subject to the 15-percent tax, including:

   a. Distributions that are rolled into another IRA or qualified retirement plan;
   b. Distributions after the death of the participant;
   c. Distributions to an alternate payee under a QDRO if included in the alternate payee’s income; and
   d. Distributions of after-tax contributions to qualified retirement plans and IRAs. I.R.C. § 4980A(c)(2).

a. For this purpose, distributions will be treated as paid first from nongrandfathered amounts.

96 Act § 1452(b).

C. Excess Retirement Accumulations.

1. A counterpart to the excess retirement distribution tax is the excess retirement accumulation tax, which is a 15-percent excise tax imposed on an individual's excess retirement accumulation. I.R.C. § 4980A(d).

2. An individual's excess retirement accumulation is the excess, if any, of:

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

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

I.R.C. § 4980A(d)(3).

3. Excess retirement accumulations do not include:

a. Pure death benefits (the face amount of life insurance proceeds payable on account of the death of the participant over the cash value of the life insurance policies);

b. Any amounts payable under a QDRO to an alternate payee in whose income the amount is included; or

c. The amount of the deceased individual's interest in a qualified retirement plan or IRA by reason of the death of another individual, unless the spousal election to defer the excise tax has been made.
I.R.C. § 4980A(d).

4. A surviving spouse who is entitled to at least 99 percent of the value of the decedent’s plan benefits and IRAs may elect not to have the excess retirement accumulation tax applied to the decedent’s benefits and IRAs.

a. If the election is made, the decedent’s plan benefits and IRAs are treated as the spouse’s for purposes of determining the excess retirement distribution tax and excess retirement accumulation tax when payments are made to the spouse or upon the spouse’s death.

I.R.C. § 4980A(d)(5); Senate Finance Comm. Rpt. on TAMRA § 1011A(g)-(k).

5. In some cases, the surviving spouse should not make the election to defer the payment of the excise tax at the death of the participant, particularly where he or she has significant qualified retirement plan benefits and IRAs of his or her own.

a. If the election is not made, the spouse may roll the decedent’s benefit or IRA into his or her own IRA. The spousal IRA would not be included with the spouse’s other plan benefits or IRAs for purposes of determining the excess retirement and accumulation tax with respect to distributions to him or her or accumulations at his or her death.

b. However, the spouse should be careful not to make any contributions of his or her own to the IRA; otherwise, the IRA will be treated as his or her IRA for purposes of determining the 15-percent tax on excess retirement distributions and accumulations.

D. Consequences of the Premature and Excess Distribution Penalties.

1. It may not always be possible to avoid the ten-percent additional income tax on premature distributions if the participant faces a financial hardship and is unable to borrow from the plan and none of the exceptions applies.

a. Because the participant in most cases will be in a lower income tax bracket on account of
the financial hardship, the ten-percent additional income tax plus the regular income tax paid on the distribution will not usually offset the benefit of the prior tax deferrals on the contributions to the qualified retirement plan or IRA and the earnings accumulated in the plan or IRA.

2. Also, it may not be possible to avoid the 15-percent excise tax on excess retirement distributions or accumulations if the participant has experienced high returns on the investments of the funds held for his or her benefit in defined contribution plans or IRAs.

   a. Again, the benefit of the prior tax-free accumulation of income in the plan or IRA will more than offset the 15-percent excise tax if the contributions have been held for a period of time.

   b. The length of time to accomplish such an offset depends upon the rate of return on the investments in the plan or IRA and the participant's marginal income tax bracket during the period of accumulation and at the time the benefits or IRAs are distributed.

E. Minimum Distribution Rules.

1. Under the so-called minimum distribution rules, a 50 percent excise tax is imposed on the amount of a minimum distribution that is not actually distributed. I.R.C. § 4974(a).

   a. This penalty tax must be avoided in all events.

2. Beginning with the participant's required beginning date (RBD), which is April 1 of the calendar year following the calendar year in which the participant attains age 70½, the participant's benefits and IRA balances must be paid in a lump sum or must be paid out in substantially equal periodic payments over:

   a. The life of the participant;

   b. The joint lives of the participant and a designated beneficiary;
c. A period certain not extending beyond the life expectancy of the participant; or

d. A period certain not extending beyond the joint and last survivor expectancy of the participant and a designated beneficiary.


3. Under the 96 Act, the RBD for participants in qualified retirement plans who do not own more than five percent of the sponsoring employer will be April 1 following the later of the calendar year in which the participant reaches age 70½ or the calendar year in which the participant retires.

a. The new definition of the RBD is effective for years beginning after 1996.

b. According to the House Ways and Means Committee Report (as contained on page 64 of the Joint Explanation of the Conferees), a qualified retirement plan may, but is not required to, permit a participant who is currently receiving distributions, but would not be required to under the new definition, to stop receiving distributions until required to under the new definition of the RBD.

96 Act § 1404.

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

a. Under the first exception, which applies if the participant has named a designated beneficiary other than the spouse, the payments may be paid over the life of the designated beneficiary or over a period certain not extending beyond the life expectancy of the designated beneficiary, provided that the payments to the designated beneficiary begin not later than December 31 of the calendar year after the calendar year in which the participant died. I.R.C.
§ 401(a)(9)(B)(iii); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-3(a).

b. Under the second exception, which applies if the designated beneficiary is the spouse of the participant, the payments may be made over the life of the spouse or over a period certain not extending beyond the spouse's life expectancy, provided that the payments begin by the later of December 31 of the calendar year immediately following the calendar year in which the participant died or December 31 of the calendar year in which the participant would have attained age 70½. I.R.C. § 401(a)(9)(B)(iv); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-3(b).

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

III. DEFERRING THE PAYMENT OF BENEFITS

A. Tax Considerations.

1. If the participant currently needs the money in the plan, he or she should consider qualifying the distribution as a lump sum distribution so that he or she can take advantage of five-year averaging if he or she has reached age 59½, and ten-year averaging and capital gain treatment if he or she reached age 50 before 1986. I.R.C. § 402(d).

a. Under five or ten-year averaging, the lump sum distribution will be taxed at a lower rate than if included in the recipient's other income.

b. Averaging and capital gain treatment do not apply to distributions from an IRA. I.R.C. § 408(d)(1).

c. The 96 Act repeals five-year averaging for taxable years beginning after December 31, 1999, but retains the transition rule for ten-year averaging (but not five-year averaging) and capital gain treatment for participants.
who reached age 50 before 1986. 96 Act § 1401(a).

(1) The increased threshold (five times the annual threshold) for lump sum distributions for purposes of determining the amount subject to the 15 percent excise tax on excess retirement distributions is retained. 96 Act § 1401(b)(12).

2. If the participant does not need the money in the qualified retirement plan or IRA, he or she should defer the receipt of plan benefits or IRAs until he or she is required to receive such benefits under the minimum distribution rules.

a. In many cases, a retiring participant may direct that his or her plan benefit be transferred directly to an IRA so that he or she may control the investment of the funds.

(1) However, in some cases leaving the funds in the plan may achieve a higher rate of return and may insulate the funds from the participant's creditors.

(a) Funds held in an ERISA qualified plan are currently excludible from a participant's bankruptcy estate under Patterson v. Shumate, 112 SCt 2242 (1992).

(b) Funds in an IRA will only be excludible from the account holder's bankruptcy estate if a state law shields IRAs from creditors.

b. Deferral has two benefits.

(1) The amount that would have been paid in tax on a current distribution will remain invested for the benefit of the participant; and

(2) The earnings on the plan benefit or IRA (including the amount that would have been paid as income tax) will continue to accumulate income tax free.
c. Although deferral may cause some of the benefits to become subject to the 15 percent tax on excess retirement distributions and accumulations or to become subject to a higher income tax rate if rates are again increased by Congress, the tax-free accumulation will offset this cost after a period of years, depending upon the rate of return on the investments and the participant’s marginal income tax bracket.

d. In order to achieve the maximum deferral, the participant or account holder should wait until he or she reaches age 70\% to begin receiving distributions.

(1) If the value of the participant’s plan benefits and IRAs is substantial, the first distribution should be taken before the end of the year in which the participant reaches age 70\%.

(a) Although the law permits the participant to wait until April 1 of the following year to take the first distribution, if the participant waits until his or her RBD, he or she must receive another distribution before the end of same year to avoid the 50-percent excise tax.

(b) If the sum of the two distributions exceeds the annual threshold amount, the participant will be subject to the 15-percent penalty tax on excess retirement distributions.

(c) In addition, the receipt of two distributions in one year may push some of the participant’s income into a higher bracket.

B. Selecting the Method of Payment.

1. If the participant is happily married and has sufficient assets to fund a credit shelter trust (currently $600,000 can be transferred by gift or at death free of federal transfer tax without using the marital deduction), the participant should name his or her spouse as the primary beneficiary and
elect to receive his or her plan benefits and IRAs over a period certain equal to the joint and last survivor expectancy of the participant and his or her spouse.

a. Although naming someone other than the spouse may increase the initial period if the other designated beneficiary is younger than the spouse, it will also limit the options available if the participant dies before the spouse.

b. In addition, a designated beneficiary other than the participant’s spouse will be treated as no more than ten years younger than the participant while the participant is alive for purposes of determining the amount that has to be paid each year to avoid the 50 percent excise tax. I.R.C. § 401(a)(9)(G); Prop. Treas. Reg. § 1.401(a)(9)-2.

c. In some cases, it may be advisable to name a child or grandchild as the designated beneficiary if the spouse has sufficient money of his or her own or is in bad health.

(1) This would ensure that at the death of the participant the benefit could be paid out over the longer life expectancy of the child or the grandchild.

(2) However, the benefit would not qualify for the marital deduction and to the extent that the value of the benefit or IRA exceeds the amount offset by the unified credit, estate tax would be payable on the benefit or IRA.

2. The minimum distribution is determined annually by dividing the remaining life expectancy (or joint life expectancies if that is the form of payment selected) into the value of the participant’s plan benefits and IRAs as of the valuation date (usually December 31) in the year preceding the year in which the distribution has to be made. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A F-1(a).

a. Consequently, the longer the payout period the smaller the minimum distribution will be.
b. Life expectancies are determined at the first to occur of the death of the participant or the participant's RBD.

c. In the case of the participant and the participant's spouse, life expectancies may be recalculated each year. I.R.C. § 401(a)(9)(D).

(1) Note that the life expectancy of an individual who survives one year is not reduced by one year if recalculation is elected, since that individual will now be expected to live to an older age.

(a) For example, because an individual age 70 has a life expectancy of 16 years, while an individual age 71 has a life expectancy of 15.3 years, the life expectancy of an individual who survives from age 70 to age 71 is only reduced by seven-tenths of a year. Treas. Reg. § 1.72-9, Table V.

(2) By recalculating the life expectancy of an individual each year, the individual will continue to have a life expectancy under the mortality table contained in the Treasury Regulations until the individual reaches age 115. Treas. Reg. § 1.72-9, Table V.

d. The life expectancy of a designated beneficiary, other than the spouse, may not be recalculated. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(b).

(1) In this case, the original life expectancy, based on the age of the beneficiary at the first to occur of the death of the participant or the year preceding the participant's RBD, will be reduced by one each year until it reaches zero. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(c) Ex. 1.

(2) If the beneficiary dies before then, the remaining life expectancy will continue to be used for determining the minimum distribution to the individual entitled
to the remaining benefit. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(c) Ex. 3.

e. Under the proposed regulations dealing with the minimum distribution rules, if an individual’s life expectancy is being recalculated each year and the individual dies, the individual’s life expectancy in the following year will be zero. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(a).

(1) Consequently, if the life expectancies of both the participant and the participant’s spouse are being recalculated, the balance of any plan benefits and IRAs must be distributed to the individual entitled to receive them before December 31 of the year following the year in which the survivor of the participant and the participant’s spouse dies.

(2) On the other hand, if the participant’s life expectancy was being recalculated but not the life expectancy of the spouse, the payments could continue to be made over any remaining life expectancy of the spouse regardless of how soon the survivor of the participant and the spouse died.

(3) For example, assume a participant age 70\% has a spouse age 59. The participant elects to have the benefits paid out over a period certain equal to the joint and last survivor expectancy of the participant and her spouse. She elects to have her life expectancy recalculated each year, but not the life expectancy of her spouse (which would be 25 years). The initial joint and last survivor expectancy would be approximately 27 years. Assume that the spouse dies after three years and the participant dies two years later, or five years after the payments commenced. The balance of the participant’s benefits and IRAs may be paid out over the remaining 20 years of the original 25-year life expectancy of the spouse to the alternate beneficiary.
entitled to receive the plan benefits or IRAs upon the death of the survivor.

3. Having the participant's life expectancy recalculated each year will guarantee that distributions will continue as long as the participant is alive.
   a. If the spouse's life expectancy was not being recalculated and the spouse dies before the participant, the remaining life expectancy of the spouse will continue to be used for determining the minimum distribution to the participant.
   b. If the participant is in poor health, the participant's life expectancy should not be recalculated.

4. If the spouse is the designated beneficiary and the participant dies first, the spouse will have two options.
   a. First, he or she can continue to receive the plan benefits over his or her remaining life expectancy.
      (1) The participant's life expectancy will not be taken into account since it was being recalculated.
   b. The better choice, if permitted under the plan, would be to have the remaining balance, except for the minimum distribution for the year in which the participant died, transferred to an IRA established for the benefit of the spouse. I.R.C. § 402(c)(9).
      (1) If the spouse is the beneficiary of the decedent's IRA, the spouse may treat the IRA as his or her own IRA. I.R.C. § 408(d)(3); Prop. Treas. Reg. § 1.408-8, Q&A 4(b).
      (2) In either case he or she would then be permitted to have the IRA paid out over a period certain equal to the joint and last survivor expectancy of the spouse and a new designated beneficiary, such as a child or a grandchild. I.R.C. §§ 408(a)(6) and 401(a)(9)(A).
(a) The spouse could elect to have his or her life expectancy recalculated so that the payments would continue to him or her no matter how long he or she lived. I.R.C. § 401(a)(9)(D).

(b) Regardless of the age of the new designated beneficiary, while the spouse is alive, the designated beneficiary would be treated as no more than ten years younger than the spouse under the minimum distribution incidental death benefit rule. I.R.C. § 401(a)(9)(G); Prop. Treas. Reg. § 1.401(a)(9)-2.

(c) Once the spouse dies, the balance in the IRA could be paid over the designated beneficiary's remaining life expectancy. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A E-8(c) Ex. 2.

(d) For example, assume that at the time the participant died the spouse was age 72 and the spouse named a grandchild, age 26, as the designated beneficiary, and that the spouse dies five years after the participant died. Although the grandchild's life expectancy is 56 years, the grandchild would be treated as age 62 for purposes of determining the minimum distribution to the spouse in the first year and one year older for each subsequent year during the spouse's lifetime. If the spouse dies five years later, however, the balance in the IRA can be paid out over the grandchild's unrecalculated remaining life expectancy, which would be 51 years, since five years have elapsed since the payments commenced to the spouse.

c. If the spouse is older than the deceased participant, and the participant dies before his or her RBD, the spouse may wait until the deceased participant would have reached age
70½, and then have the deceased participant's plan benefit or IRA rolled over to his or her own IRA.

(1) This will allow the spouse to defer the payment of the benefit for as long as possible under the minimum distribution rules.

(2) It will also allow the spouse to have a designated beneficiary both before and after payments are required to be made.

(a) If the spouse does not have the deceased participant's benefit rolled into his or her own IRA, he or she may name a designated beneficiary to receive benefits if the spouse dies before the participant would have reached age 70½, but the spouse may not have a designated beneficiary once payments must commence, and will only be able to use his or her own life expectancy for determining the required minimum distribution.

(b) However, once the spouse has the deceased participant's benefits rolled into his or her own IRA, the spouse may now name a designated beneficiary to receive any remaining benefits after his or her death, regardless of whether payments are required to be made to the spouse, and the designated beneficiary's life expectancy may now be used for purposes of determining the amount of the required minimum distribution to the spouse, subject to the minimum distribution incidental death benefit rule.

IV. NAMING A QTIP TRUST AS BENEFICIARY

A. Reason for Naming a QTIP Trust.

1. Unless one of the transition rules applies because the participant terminated employment with the sponsoring employer before 1983, in the case of the unlimited exclusion, or before 1985, in the case of
the $100,000 exclusion, plan benefits and IRAs will be subject to federal estate tax. TEFRA 1982 §§ 245(a) and (c); DEFRA 1984 § 525(a); TRA 1986 § 1852(e)(3).

a. If the participant separated from service before 1983 and has not changed the beneficiary designation or form of benefit with respect to the plan after 1982, the plan benefit or IRA will be excluded from the federal gross estate as long as favorable averaging is not elected and the plan benefit or IRA is not paid to the estate.

b. If the participant terminated employment after 1982 but before 1985, $100,000 of the participant’s plan benefit or IRA will be excluded from the federal gross estate as long as favorable averaging is not elected and the benefit or IRA is not payable to the estate.

2. If the participant wants to qualify the plan benefits or IRAs for the marital deduction in order to defer the federal estate tax on the benefits or IRAs until the death of the spouse, but does not want to give the spouse control over the plan benefits or IRAs, the participant may name a trust designed to qualify for the marital deduction as the designated beneficiary. I.R.C. §§ 2056(b)(5) or (7).

3. Because the goal of the participant is to eliminate the spouse’s control over the plan benefits and IRAs, a qualified terminable interest property (QTIP) trust will be the type of marital deduction trust used for this purpose.

a. Only the QTIP trust assures the participant of ultimate control over the disposition of any remaining assets in the trust at the death of the spouse.

b. An estate trust, which qualifies for the marital deduction, requires that any remaining assets in the trust be payable to the spouse’s estate.

c. A life income/general power of appointment trust requires that the surviving spouse have the right either to withdraw the assets from the trust during his or her lifetime or to
designate where the assets in the trust will go at his or her death.

d. A charitable remainder trust in which the spouse is the only noncharitable beneficiary will qualify for both the charitable and marital deductions. However, at the death of the surviving spouse, the assets in the trust will go to the charitable organization.

4. Under REA, the participant’s spouse will be required to consent to the designation of the trust as the primary beneficiary of the participant’s plan benefits. I.R.C. §§ 401(a)(11) and 417.

a. In the case of an IRA, spousal consent is not required.

b. If the participant’s benefits are in a plan not subject to the qualified joint and survivor annuity rules, such as a profit sharing plan, the participant may have the benefit transferred to an IRA to avoid obtaining the spouse’s consent to naming the QTIP trust as the beneficiary.

B. Complying with the Minimum Distribution Rules.

1. If the surviving spouse’s life expectancy is to be used for purposes of determining the required minimum distribution once the participant reaches his or her RBD, he or she must be treated as the participant’s designated beneficiary. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A B-4.

2. In addition, if the participant dies before the RBD, and the participant has not named a designated beneficiary, any plan benefits and IRAs must be distributed by the end of the fifth year following the year of the participant’s death. I.R.C. § 401(a)(9)(B)(ii); Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A C-2.

3. In order for the surviving spouse who is the beneficiary of a QTIP trust to be treated as the participant’s designated beneficiary, the trust must satisfy four requirements upon the later to occur of the date the trust is named as the designated beneficiary or the participant’s RBD.
a. The trust must be a valid trust or would be a valid trust under state law if it had a corpus.

b. A copy of the trust document must be provided to the plan administrator.

c. The beneficiary of the trust entitled to the plan benefits or IRAs must be identifiable.

d. The trust must be irrevocable.

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

4. The requirement that the beneficiary entitled to the plan benefits or IRAs be determinable is necessary because the age of the beneficiary is required to calculate the minimum distribution.

5. The requirements that the trust be valid and that the trust document be furnished to the plan administrator, while serving no useful purpose, are not difficult to satisfy.

6. According to most commentators, the trust must be irrevocable at the first to occur of the participant's RBD or the participant's death.

a. Under this interpretation, if the participant was alive at his or her RBD, a testamentary trust or a revocable living trust could not be named as the beneficiary.

b. This interpretation treats a beneficiary as being "named" when the life expectancy of the beneficiary becomes relevant for purposes of computing the required minimum distribution, rather than when the participant can no longer change the beneficiary.

c. If this is the proper interpretation, it serves no practical purpose since the participant is always free to change the beneficiary, even after the RBD, unless the beneficiary designation itself is irrevocable.

d. The conservative approach would be to use an irrevocable trust as the beneficiary until final regulations are issued that eliminate this requirement.
An alternative approach might be to make an otherwise revocable trust irrevocable on the participant’s RBD with respect to any plan benefits or IRAs payable to the trust.

C. Qualifying for Marital Deduction.

1. If the trust is designed to be a QTIP trust, the income from the trust must be distributed to the surviving spouse at least annually. I.R.C. § 2056(b)(7)(B)(ii)(I).

   a. The regulations interpreting this requirement in connection with the life income/general power of appointment trust require that either the assets in the trust be income producing or the surviving spouse have the right to demand that the trustee convert unproductive property to productive property or distribute other assets equal in value to the income that would have been produced by the unproductive property if it were productive property. Treas. Reg. § 20.2056(b)-5(f)(4) and (5).

   (1) The final QTIP regulations adopt these rules for purposes of determining whether the spouse is entitled to all the income. Treas. Reg. § 20.2056(b)-7(d)(2).

   b. If the income generated by the decedent’s plan benefits or IRAs is not currently distributed to the QTIP trust and then redistributed to the surviving spouse, the Internal Revenue Service could take the position that the income requirement has not been satisfied.

   c. However, if the trustee of the QTIP trust has the right to withdraw the plan benefit or IRA at any time, as is the typical case, and the surviving spouse has the right to require the trustee to make unproductive property productive, there should be no requirement that any amount be paid out to the QTIP trust from the plan or IRA until required under the minimum distribution rules.

   (1) Note that because the constructive receipt doctrine does not apply to qualified retirement plan benefits and IRAs, the trust will not be taxable on
amounts subject to the trustee’s right to withdraw that are not actually withdrawn.

2. In two situations the minimum distribution rules will not require all the income generated by the plan benefit or IRA to be distributed.

   a. If the participant dies before the participant reaches age 70½ and the surviving spouse is the designated beneficiary, payments do not have to commence to the surviving spouse until the participant would have reached age 70½. I.R.C. § 401(a)(9)(B)(iv).

   b. Once the payments begin, the required distribution in the first few years may not equal the income generated by the plan benefit or IRA.

      (1) For example, if the surviving spouse is age 59 when the participant would have reached age 70½, the spouse’s life expectancy will be 25 years.

      (2) Consequently, the first distribution will represent four percent of the value of the plan benefits and IRAs, which may be considerably below the income they generated.

3. Unfortunately, the Internal Revenue Service in one published ruling and a number of private letter rulings has led commentators to conclude that the plan benefit or IRA itself must satisfy the requirements of a QTIP trust and the executor of the deceased participant’s estate must make the QTIP election with respect to the plan benefit or IRA. Rev. Rul. 89-89, 1989-2 C.B. 231; Letter Rulings 9416016, 9321059, 9245033, and 9220007.

   a. In order for the plan benefit or IRA to satisfy the QTIP requirements, the form of payment of the plan benefit or IRA selected by the participant before his or her death must require that at least the income generated by the plan benefit or IRA be payable to the QTIP trust.

   b. Furthermore, under the terms of the QTIP trust, income distributions from the plan or IRA must also be treated as income for trust
accounting purposes so that it will be redistributed to the spouse.

c. Satisfying the Internal Revenue Service’s position may require an earlier and larger distribution from the plan or IRA than would have been required under the minimum distribution rules, thereby accelerating the payment of income tax on the benefit or IRA.

4. The Internal Revenue Service’s position that a QTIP election must be made to qualify a plan benefit or IRA for the marital deduction may arise out of a concern that the plan benefit or IRA remaining at the surviving spouse’s death would not be includible in the surviving spouse’s estate if the election were not made.

a. If a QTIP election is made with respect to the plan benefit or IRA, any remaining plan benefits or IRA at the spouse’s death will be includible in the spouse’s federal gross estate under Code § 2044.

b. However, the same result could be achieved by requiring that any remaining plan benefit or IRA continue to be paid to the trust created for the benefit of the spouse after he or she dies, so that the QTIP election made with respect to that trust will automatically cause the plan benefit or IRA to be includible in the surviving spouse’s gross estate under Code § 2044.

c. Nonetheless, the conservative approach is to abide by the Internal Revenue Service’s current ruling position by requiring that the greater of the income generated by the plan benefit or IRA or the amount required under the minimum distribution rules be paid to the QTIP trust and that the QTIP trust contain a provision that will treat the distribution of income from the plan benefit or IRA as trust accounting income.

5. As a result of the Internal Revenue Service’s position, the conservative approach when it is desirable to name a QTIP trust as the beneficiary of a qualified retirement plan benefit or IRA is as follows:
a. The form of payment designation for the qualified retirement plan benefit or IRA should provide that the QTIP trust be paid each year the greater of (x) the income generated by the assets representing the accrued benefit in the qualified retirement plan or in the IRA or (y) the required minimum distribution determined under I.R.C. § 401(a)(9).

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

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

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

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

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

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

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

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

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

(1) However, from an income tax standpoint, it may be preferable to distribute the principal to the spouse, who is likely to be in a lower income tax bracket than the trust, which reaches the 39.6 percent bracket when it has $7,900 of taxable income in 1996, while the spouse does not reach the 39.6 percent bracket until he or she has $263,750 of taxable income in 1996 (or $131,875 for a married individual filing a separate return).

V. OTHER ESTATE TAX CONSIDERATIONS

A. Naming the Credit Shelter Trust as Beneficiary.

1. If the participant does not have sufficient assets outside of qualified retirement plan benefits and IRAs to take advantage of the unified credit exemption equivalent (currently $600,000), he or she may consider one of two ways of using the plan benefits or IRAs for this purpose.
2. First, the participant could specifically designate a credit shelter trust as the beneficiary of a portion of the participant’s plan benefits or IRAs.
   a. If the spouse were the named income beneficiary of the credit shelter trust, the life expectancy of the spouse could still be used to determine the required distributions to the participant during his or her lifetime. Prop. Treas. Reg. § 1.401(a)(9)-1, Q&A D-5.
   b. Once the participant died, the payments would continue to the credit shelter trust over the remaining life expectancy of the participant’s spouse (assuming that the participant’s life expectancy was being recalculated and the spouse’s was not).
   c. The spouse would not have the option of rolling the remaining plan benefits or IRAs that were payable to the credit shelter trust into his or her own IRA.

3. A second option would be to designate the spouse as the primary beneficiary and the credit shelter trust as the secondary beneficiary.
   a. If the participant dies before the spouse, the spouse may disclaim the amount of plan benefits and IRAs necessary to use the participant’s unified credit. GCM 39858 sanctioned the use of a qualified disclaimer with respect to qualified retirement plan benefits.
   b. In order to satisfy the qualified disclaimer rules under the Code, the designation of the spouse should remain revocable while the participant is alive.

(1) If the participant irrevocably names the spouse as the beneficiary of his or her plan benefits and IRAs, the nine-month period within which a qualified disclaimer must be made will commence upon the date that the irrevocable beneficiary designation is made rather than at the death of the participant.

I.R.C. § 2518(b).
4. Note that it is always better for the participant to use other assets to fund the credit shelter trust if at all possible, since the plan benefits and IRAs will be subject to income tax when received by the trust, thereby reducing the amount passing estate tax free to the participant's children or other beneficiaries when the spouse dies.

   a. Had the plan benefits and IRAs been paid to the spouse or a trust designed to qualify for the marital deduction, the income tax paid on the benefits would have reduced the amount that will be subject to estate tax when the spouse dies.

B. Charitable Bequests.

   1. If the participant is giving a significant bequest to a charitable organization, he or she may want to use a plan benefit or IRA for this purpose.

   2. Not only will the plan benefit or IRA qualify for the estate tax charitable deduction, but income tax on the plan benefit or IRA will also be avoided.

   3. Although the 15-percent excise tax on excess retirement accumulations will still apply to a plan benefit or IRA that is payable to a charitable organization, the estate tax will not be increased if the charitable organization is required to pay the excise tax out of the amount payable to the charitable organization from the plan benefit or IRA.

      a. Because the excise tax is deductible for estate tax purposes, the deduction for the excise tax will offset the loss of the charitable deduction.

      b. Some commentators have suggested that requiring the charity to pay the excise tax out of the amount payable to the charitable organization from the plan benefit or IRA may cause the estate to recognize taxable income because the charity is satisfying the estate's obligation. However, if state law imposes the obligation to pay the excise tax on the recipient of the plan benefit or IRA absent a direction to the contrary by the decedent, the payment of the excise tax by the charitable
organization should not result in taxable income to the estate.

4. An executor should not use qualified retirement plan benefits and IRAs to satisfy a specific pecuniary bequest to a charitable organization since the satisfaction of the bequest will cause the estate to recognize current taxable income equal to the value of the plan benefits or IRAs used for this purpose.

C. Payment of Estate Taxes.

1. The advisor should be certain that the client has considered the source of payment of federal and state estate and death taxes attributable to plan benefits and IRAs and the excise tax on excess retirement accumulations.

2. If the residuary beneficiaries of the client's estate are also the beneficiaries of the plan benefits and IRAs, a clause in the client's will requiring the estate to pay all such taxes will accomplish the client's objectives.
   a. In effect, the residuary beneficiaries will be paying a pro rata portion of these taxes.

3. On the other hand, if the plan benefits and IRAs are being paid to beneficiaries who are not also residuary beneficiaries, in most cases the client's objectives will be accomplished by having the beneficiaries entitled to the plan benefits or IRAs responsible for paying the taxes on the benefits or IRAs.

4. Because the beneficiary will be subject to income tax on any amounts withdrawn to pay the estate tax, the amount withdrawn will have to be grossed up if the beneficiary wants to use the plan benefits or IRAs to satisfy all his or her tax liabilities arising from being named the beneficiary.

5. Although the plan benefit may not be currently payable under the terms of the plan, the beneficiary entitled to the plan benefit may still be legally responsible to pay the estate tax.
   a. In such event, the beneficiary would have to use other resources to pay the tax.
b. If there were no other resources and there were no other assets in the estate, it is unclear how the tax would be currently paid.

c. Under Code § 6324(a)(2), the federal government cannot place a tax lien on a benefit held in a trust that meets the requirements of Code § 401(a) (dealing with qualified retirement plans).

d. Perhaps an extension to pay the tax could be granted for reasonable cause under Code § 6161.
EXHIBIT A

ILLUSTRATION OF TAX CONSEQUENCES

Mrs. Smith, a widow, has accumulated $2 million in a pension plan. She dies in 1996 at age 65, survived by all her children and a grandchild. She was a resident of a state that only has a pick-up type estate tax (that is, the estate tax is equal to the federal estate tax credit for estate and inheritance taxes paid to the state). She has designated a trust that is held exclusively for the benefit of her grandchild as the recipient of the plan benefit, which is to be paid in a lump sum. The grandchild’s interest in the trust is vested and will be included in the grandchild’s federal gross estate.

Mrs. Smith had a grandfathered amount of $1 million (the value of her accrued benefit as of August 1, 1986) and she made the grandfather election on Form 5329. The annual excess retirement distribution limit of $155,000 x 8.8741 (the annuity factor at age 65 using an interest rate assumption of 6.8 percent) results in a present value of an annuity of $155,000 for her life (determined as if she had not died) equal to $1,375,486. Since this amount is greater than her grandfathered amount of $1 million, it will be used for purposes of determining the amount of excess retirement accumulations. (Mrs. Smith could have withdrawn her grandfathered amount before death and her estate would have been entitled to reduce her remaining plan benefit by the value of the hypothetical annuity.) Note her accrued benefit grew to $2 million from August 1, 1986 until 1996 because of continued benefit accruals.

Mrs. Smith’s federal gross estate is $6 million before taking into account the excise tax, and therefore the marginal federal estate tax rate is 55 percent. The generation-skipping transfer (GST) tax rate is also 55 percent. The trust’s marginal combined federal and state income tax rate is 43 percent (taxable income of a trust in excess of $7900 is taxed at 39.6%). Mrs. Smith had used her GST exemption before her death. Assume that Mrs. Smith’s will contains a tax apportionment clause that reduces a bequest by any estate taxes attributable to the bequest as well as the 15-percent penalty tax attributable to any qualified retirement plan or IRA benefits.

Calculation of Applicable Taxes

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of benefit passing to Grandchild’s Trust</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Amount subject to excise tax</td>
<td>624,514</td>
</tr>
<tr>
<td>($2,000,000 - $1,375,486, the amount not subject to the excise tax)</td>
<td>624,514</td>
</tr>
</tbody>
</table>
Excise tax rate  

Excise tax on excess retirement accumulations $93,677  
Balance subject to estate tax $1,906,323  
(The excise tax is deductible for estate tax purposes)  

Estate tax rate  
Combined Federal and State Estate tax $1,048,477.65  
Combined estate tax and excise tax $1,142,154.65  

Amount passing to Grandchild’s Trust after estate and excise taxes ($2,000,000 - $1,142,154.65) $857,845.35  

Because the GST Tax in the case of a direct skip is tax exclusive (i.e., it is determined by applying the 55% GST Tax Rate to the amount passing after the GST Tax), the GST Tax can be determined by applying the following formula:

\[
\text{Amount passing to the recipient before the GST tax} - \frac{\text{Amount passing to the recipient before the GST tax}}{1 + \text{GST tax rate}} = \text{GST tax}
\]

857,845.35 divided by 1.55 (1+ GST tax rate) = $304,396.74  

Amount subject to income tax ($2,000,000 less the IRD deduction of $1,133,715.63, which is the sum of the GST tax ($304,396.74) and the federal estate tax ($829,318.89)). Note that the IRD deduction is limited to the federal estate tax; consequently, the total federal and state estate tax of $1,048,477.65 attributable to the $2,000,000 of IRD must be reduced by the state death tax credit attributable to the same amount, which is $219,158.76. Note also that the excise tax is not deductible for purposes of computing the federal income tax.  

Combined Federal and State income tax rate 43%
<table>
<thead>
<tr>
<th><strong>Summary of Taxes</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Original Amount</strong></td>
<td>$2,000,000</td>
</tr>
<tr>
<td><strong>Excise Tax</strong></td>
<td>($93,677)</td>
</tr>
<tr>
<td><strong>Combined Federal and State Estate Tax</strong></td>
<td>($1,048,477.65)</td>
</tr>
<tr>
<td><strong>GST Tax</strong></td>
<td>($304,396.74)</td>
</tr>
<tr>
<td><strong>Combined Federal and State Income Tax</strong></td>
<td>($372,502.28)</td>
</tr>
<tr>
<td><strong>Total Taxes</strong></td>
<td>($1,819,053.67)</td>
</tr>
<tr>
<td><strong>Amount Left</strong></td>
<td>$180,946.33</td>
</tr>
</tbody>
</table>

(About 9 percent of the total)
EXHIBIT B
EXAMPLE OF DEFERRAL

Mary’s accrued benefit on December 31, 1995 was $1,500,000. When she reaches age 70½ in 2000 (her date of birth was May 29, 1930), she elects to receive her first required distribution on December 31, 2000 and to have her plan benefit paid over the joint and last survivor expectancy of her and John, with her life expectancy being recalculated each year but not John’s. John’s date of birth was January 15, 1933. The value of her accrued benefit on December 31, 1999, assuming no additional contributions on her behalf and an eight percent growth factor, is $2,040,733. The amount of the required distribution that Mary receives on December 31, 2000 is $92,761 ($2,040,733 ÷ 22.0, because their joint and survivor expectancy is 22.0 years based on their attained ages, 70 and 67, in 2000). Mary dies on June 15, 2004, after receiving four required distributions, for a total of $422,780. Assume that under the proposed regulations the required distribution Mary would have been required to take in 2004, $130,156, must be paid to John before the end of 2004. He has the balance, $2,357,897, transferred to his own individual retirement account and names their daughter, Anne, who is age 44 in 2005, as his designated beneficiary. John elects to have his life expectancy recalculated, and, of course, cannot elect to have Anne’s recalculated, even if this were desirable. The first required distribution to John, which he receives on December 31, 2005, is $96,635 ($2,357,897 ÷ 24.4). This is based on John’s age of 72 and on treating Anne as age 62, because Anne is treated as ten years younger than John under the minimum distribution incidental death benefit rule. Assume John dies on September 15, 2010, after receiving five required distributions, for a total of $563,912. He did not receive the 2010 required distribution before he died. The account balance as of December 31, 2009 was $2,810,408. Assume the required distribution John would have been required to take in 2010, $139,821, must be paid to Anne before the end of 2010. This leaves a balance on December 31, 2010 of $2,895,419. The required distribution that must be paid to Anne before the end of 2011 is $88,545, based on Anne’s remaining life expectancy of 32.7, determined by subtracting six from her life expectancy of 38.7 in 2005, when distributions began over the joint lives of John (recalculated) and Anne. The aggregate amount of the remaining payments over the period of Anne’s life expectancy is $14,267,746, again assuming an eight percent growth rate. If Anne dies before the end of the period, these payments will continue to Anne’s beneficiary for the balance of the period, since her life expectancy is not being recalculated (and in fact cannot be recalculated). The aggregate amount of all payments before income taxes to Mary, John and Anne over the 45-year period (2000 through 2044) is $15,612,960. This assumes that any estate taxes and
excise taxes on excess retirement accumulations are paid out of other sources.
EXHIBIT C

FORMS

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

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

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

The final beneficiary form deals with a bequest to a charitable organization. The forms are not meant to exhaust all the possible beneficiary designations a participant may wish to consider. Note these forms may not be appropriate once the participant has reached his or her required beginning date. At that point the participant will be required to name a designated beneficiary for purposes of determining the payout period and to elect not to have either his or her life expectancy or his or her spouse’s life expectancy recalculated. If the participant dies after the RBD, the payments to the designated beneficiary after the participant’s death must continue at least as rapidly as under the method in effect before the participant’s death. However, a surviving spouse may roll the plan benefit or IRA into his or her own IRA or treat a decedent’s IRA as his or her own IRA.

The first two sample trust language forms are designed to qualify the plan benefit or IRA for the marital deduction. The third trust language form is designed to satisfy the irrevocability requirement under the minimum distribution rules so that the oldest beneficiary of the trust will be treated as the designated beneficiary.

As with any sample forms, there is no guarantee that these forms are appropriate in any particular case or that they satisfy federal or state law.
FORM I: BENEFICIARY DESIGNATION FOR QUALIFIED RETIREMENT PLAN BENEFIT OR INDIVIDUAL RETIREMENT ACCOUNT NAMING SURVIVING SPOUSE AS PRIMARY BENEFICIARY AND TRUST AS SECONDARY BENEFICIARY

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

NOTE: If a trustee is also a beneficiary, the participant may want to restrict the right of the trustee to designate a beneficiary of the trust to receive any remaining benefits directly and to withdraw the remaining benefits. This same comment applies to Forms II-IV and VII.

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

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

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

NOTE: The current ruling position of the Internal Revenue Service is that the form of payment itself must qualify for the marital deduction. However, the plan benefit or IRA should qualify for the marital deduction as long as the spouse has the right to require any unproductive property be converted into productive property and the trustee has the right to accelerate payments from the plan or IRA. See Treas. Treas. Reg. § 20.2056(b)-5(f)(4).
My [benefit or IRA] shall be distributed to the trust created by me as of __________, in installments equal to the amount required to be distributed under the minimum distribution rules under I.R.C. § 401(a)(9) and the regulations thereunder, or any subsequent statute requiring minimum distributions from such [plans or IRAs]. My trustee shall have the right at any time to withdraw all or any part of the remaining [benefit or IRA] or to designate a beneficiary of the trust to receive any remaining payments directly and to have the right to withdraw at any time all or any part of the remaining [benefit or IRA].
FORM V: DESIGNATION OF A CHARITABLE BENEFICIARY
TO RECEIVE BENEFITS UNDER A QUALIFIED RETIREMENT PLAN OR IRA

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

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

My [husband or wife] shall have the right to direct my trustee of the marital trust to make any unproductive property productive or to convert any unproductive property into income-producing property within a reasonable time. In lieu of making the property productive or converting the unproductive property, my trustee may distribute quarterly to my [husband or wife] other assets from the marital trust the value of which is equal to the income that would have been produced during the calendar quarter if the property had been made productive or converted into income-producing property. Unproductive property shall include any benefit held in a qualified retirement plan as defined in I.R.C. § 401(a), any qualified retirement annuity as defined in I.R.C. § 403(a) or 403(b), and any individual retirement account as defined in I.R.C. § 408(a), but only if and to the extent that income generated or deemed to be generated by the plan benefit, annuity, or account is not distributed to the trust at least annually.
I direct my trustee to treat distributions from any qualified retirement plan as defined in I.R.C. § 401(a), any qualified retirement annuity as defined in I.R.C. § 403(a) or 403(b), or any individual retirement account as defined in I.R.C. § 408(a) as income of the trust to the extent that the distribution represents income generated or deemed to be generated by such plan or individual retirement account, notwithstanding the treatment of such portion of the distribution under any law concerning the determination of income and principal for trust accounting purposes and my trustee shall not charge to such income any expense properly chargeable to the nonincome portion of the distribution. In addition, my trustee shall have the right in his or her or its sole discretion to withdraw any part or all of the remaining qualified plan benefit or individual retirement account or to direct that the plan benefit or individual retirement account be paid directly to the beneficiary of the trust who is entitled to the income of the trust and to give such beneficiary the right to withdraw at any time all or any part of the benefit or individual retirement account.

NOTE: The spouse should not be the trustee since the spouse would then be treated as having a general power of appointment for transfer tax purposes.
FORM VIII: PROVISION IN TRUST AGREEMENT
TO SATISFY IRREVOCABILITY REQUIREMENT UNDER
MINIMUM DISTRIBUTION RULES

On April 1, ____ (the year following the year in which the
grantor will reach age 70%), this trust shall become irrevocable
with respect to any distribution that may be payable to the trust
from any qualified retirement plan as defined in I.R.C. § 401(a),
any qualified retirement annuity as defined in I.R.C. § 403(a) or
403(b), or any individual retirement account as defined in I.R.C.
§ 408(a); provided, however, that this provision will not cause the
beneficiary designations under any of the aforesaid plans or
individual retirement accounts to become irrevocable.