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Trusts as Beneficiaries of Retirement Benefits

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There are many reasons for leaving assets in trust rather than outright. These include protection from creditors, protection from spouses, asset management, control over distributions, Medicaid, and keeping the assets out of the beneficiaries' estates for estate tax purposes. These reasons apply to qualified plan and IRA benefits (collectively referred to as retirement benefits) in the same way as other assets. This article explores the tradeoffs and special considerations involved in leaving retirement benefits in trust rather than outright.

REQUIRED DISTRIBUTIONS

A designated beneficiary of retirement benefits must generally take the minimum required distributions ("MRDs") over his or her life expectancy.[1] Alternatively, a beneficiary who is also the surviving spouse can roll the benefits over to his or her own IRA,[2] or remain as beneficiary and postpone taking distributions until the calendar year when the deceased spouse would have reached age 70½.[3]

If a trust is the beneficiary, assuming all of the trust beneficiaries are individuals, the trust beneficiary with the shortest life expectancy (i.e., the oldest beneficiary) is treated as the designated beneficiary on whose life expectancy the MRDs are based.[4]

WHO IS A BENEFICIARY

In order to determine the oldest beneficiary of a trust, it is first necessary to identify the trust beneficiaries.

The regulations explain that a contingent beneficiary is generally considered a beneficiary for this purpose.[5] A "mere successor beneficiary" is not considered a beneficiary. However, a person who has any right (including a contingent right) beyond being a mere successor beneficiary is considered a beneficiary. Thus, for example, if one person has a right to all income for life, and a second person has a right to the principal (including the principal distributed during the first beneficiary's lifetime), both are considered beneficiaries.[6]

Remainder beneficiaries. The regulations give an example illustrating that remainder beneficiaries are taken into account.[7] Similarly, before the final regulations were issued, the Internal Revenue Service took trust remainder beneficiaries into account in Rev. Rul. 2000-2.[8]

Remote contingent beneficiaries. Remote contingent beneficiaries were considered beneficiaries for this purpose in PLR 200228025, but not in previous rulings.[9] In PLR 200228025, the IRA owner left the IRA to separate trusts for the benefit of her two minor grandchildren. If both grandchildren died before age 30, the balance of the trust was payable to contingent beneficiaries, the oldest of whom was age 67. Even though the 67-year-old's interest was extremely remote, the Service considered her to be a beneficiary, and thus the measuring life for purposes of determining the MRDs.

Private letter rulings have no precedential effect.[10] One commentator argues that a remote contingent beneficiary should be disregarded if there is less than a 5% probability that the trust would pay out to him or her.[11] However, until this issue is resolved, the conservative approach is to avoid any contingent beneficiaries who are older than the desired designated beneficiary.

Presumably the Service will disregard takers by operation of law. If takers by operation of law were considered beneficiaries, it would be virtually impossible for any trust to qualify. In this regard, Regs. §1.401(a)(9)-4 A-1 states that "the fact that an employee's interest under the plan passes to a certain individual under a will or otherwise under applicable state law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan."

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[1] §401(a)(9)(B)(iii); Regs. §1.401(a)(9)-3 A-1(a) and -5 A-5. All section references are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder.

[2] §402(c)(9).

[3] §401(a)(9)(B)(iv)(I); Regs. §1.401(a)(9)-3 A-3(b)(2).

[4] Regs. §§1.401(a)(9)-4 A-5 and -5 A-7.

[5] Regs. §1.401(a)(9)-5 A-7(b).

[6] Regs. §1.401(a)(9)-5 A-7(c).

[7] Regs. §1.401(a)(9)-5 A-7(c)(3) *Ex. 1*.

[8] 2000-1 C.B. 305.

[9] E.g., PLR 200040035.

[10] Regs. §601.201(*l*)(1)

[11] Martin Silfen, quoted in David W. Polstra, "Accumulation Trusts as Beneficiaries of IRAs—A Fateful Twist for the Unwary," *CCH J. of Retirement Planning*, Mar. 2003, at 35, 39.

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Permissible appointees. Suppose a beneficiary has a power of appointment. Are the permissible appointees considered beneficiaries?

In at least some jurisdictions, where the trustees have complete discretion to distribute the principal, they can distribute the principal to another trust.[12] Suppose a beneficiary of the first trust has a power of appointment over the second trust. Are the permissible appointees of the second trust considered beneficiaries?

In the example in the regulations, no one had the power to appoint the principal of the trust to anyone other than the income beneficiary, and the remainder beneficiaries were all younger than the income beneficiary. In that case, the income beneficiary was treated as the oldest beneficiary of the trust.[13]

Similarly, the Service has approved trusts in which the powers of appointment cannot be exercised in favor of anyone older than the desired designated beneficiary, and the trustees were not permitted to distribute the trust assets to another trust in which anyone older than the desired designated beneficiary could be a beneficiary or a permissible appointee.[14] Accordingly, unless and until the issue is resolved more favorably, the conservative approach is to incorporate the restrictions of PLRs 200235038 through 200235041 and not have any permissible appointees (or trusts with permissible appointees) who are older than the desired designated beneficiary, or who are not individuals.

An even more conservative approach is to protect against the possibility that the trust assts might pass to an older person by operation of law. This can be done in several ways. One way is for the trust assets to vest in the last living beneficiary. Another way is to require the last living beneficiary to exercise a testamentary power of appointment in favor of persons younger than the desired designated beneficiary.[15] Still another way is to give the trustees the power to expand the class of beneficiaries upon the death of the last living beneficiary, so long as the additional beneficiaries are all younger than the desired designated beneficiary.

Conduit trusts. The conduit trust is an exception to the general rule that all beneficiaries of a trust are considered. In a conduit trust, the trustees are required to distribute the MRDs (as well as any distributions in excess of the MRDs) to the beneficiaries of the trust on a current basis so that no amounts distributed from the qualified plan or IRA during the current beneficiaries' lifetimes are accumulated for the benefit of subsequent beneficiaries. In that case, the subsequent beneficiaries are disregarded.[16] The conduit trust is discussed in greater detail in the context of the various types of trusts.

QTIP TRUST

By naming a QTIP trust as the beneficiary, an IRA owner can control the ultimate disposition of the principal while still obtaining the marital deduction for the IRA benefits. Assuming the spouse is the oldest beneficiary of the trust, distributions can be stretched out over the spouse's life expectancy. Deferral of estate tax by use of the marital deduction may be especially desirable now that the highest estate tax rate is scheduled to decrease from 49% in 2003 to 48% in 2004, 47% in 2005, 46% in 2006 and 45% in 2009,[17] and the estate tax exempt amount is scheduled to increase from $1 million in 2003 to $1.5 million in 2004-05, $2 million in 2006-08 and $3.5 million in 2009. There is no estate tax in 2010. However, the estate tax returns in 2011, with a $1 million exempt amount and a 55% top rate.[18] In addition, about one-third of the states have decoupled from the Federal estate tax changes under EGTRRA. In these states, the estate tax rates may increase.[19]

The tradeoff for naming a QTIP trust as beneficiary is generally a substantial loss of income tax deferral. If the spouse is the plan beneficiary, he or she can roll the benefits over into his or her own IRA,[20] possibly convert to a Roth IRA,[21] name new beneficiaries, and obtain a longer stretchout period both during the spouse's lifetime and after the spouse's death. Thus, if the participant or IRA owner is willing to permit the spouse to control the retirement benefits, he or she should consider naming the spouse as the beneficiary, even if the balance of the marital share passes in the form of a QTIP trust.

The ability to convert to a Roth IRA is particularly valuable, especially if the IRA owner has sufficient

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[12] N.Y. EPTL §10-6.6; Alaska Statutes §13.36.157; *Matter of Spencer,* 232 N.W.2d 491 (Iowa 1975); *Phipps v. Palm Beach Trust Co.,* 142 Fla. 782, 196 So. 299 (1940); *see Matter of Wold,* 310 N.J. Super. 382 (Ch. Div. Middlesex Co. 1998); *National State Bank of Newark v. Morrison,* 9 N.J. Super. 552 (Ch. Div. 1950); *Guild v. Mayor,* 87 N.J. Eq. 38 (1916).

[13] Regs. §1.401(a)(9)-5 A-7(c)(3) *Ex. 1.*

[14] PLRs 200235038 through 200235041.

[15] A power of appointment that the power holder is required to exercise is an imperative power of appointment. *See, e.g.,* N.Y. EPTL §10-6.4(b). If the power holder does not exercise it, the power devolves on the court. *See, e.g.,* N.Y. EPTL §10-6.8(a)(2). This is analogous to the doctrine of cy pres in the charitable context.

[16] Regs. §1.401(a)(9)-5 A-7(c)(3) *Ex. 2.*

[17] §2001(c)(2)(B).

[18] §2010(c).

[19] Bruce D. Steiner, "Coping With the Decoupling of State Estate Taxes After EGTRRA," 30 *Estate Planning* 167 (April 2003).

[20] §402(c)(9).

[21] §408A(c)(3)(B).

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nonretirement assets with which to pay the income tax on the conversion. A surviving spouse may be able to convert to a Roth IRA even if neither spouse could convert while both spouses were alive.

The Service looks at the IRA itself as the asset which must qualify for the marital deduction. Thus, if the IRA is payable to a QTIP trust, the spouse must be entitled to all of the income of both the QTIP trust and the IRA on a current basis.[22]

If the spouse is relatively young, the internal income of the IRA may exceed the minimum required distributions (MRD). For example, if the IRA is $1 million, and the MRD is $30,000, but the internal income of the IRA is $40,000, then the trustees of the QTIP will generally withdraw $40,000 from the IRA and distribute the entire $40,000 to the spouse.

Rev. Rul 2000-2 points out that a QTIP trust need not require that all of the income be paid to the spouse. It is sufficient if the spouse has the right to require the trustees to distribute the income.[23] Thus, in the above example, if instead of requiring that all of the income of the QTIP trust be distributed to the spouse, the Will instead gave the spouse the power to compel the distribution of all of the income, then (if the spouse did not exercise that power), the trustees need only withdraw the $30,000 MRD from the IRA. However, this alternative may not have much practical significance, since the QTIP trust is not likely to be the beneficiary except in cases where control over the principal is an important objective for the IRA owner, and in those cases the spouse is likely to demand all of the income.

Where the MRD exceeds the internal income of the IRA, the QTIP trust can retain the difference as principal. For example, if the MRD is $50,000 and the internal income of the IRA is $40,000, the trustees of the QTIP trust must withdraw $50,000 from the IRA and distribute $40,000 to the spouse, while retaining the remaining $10,000 in the trust.

One can argue that it should be sufficient if the QTIP trust as a whole qualifies for the marital deduction. In other words, in the first example, instead of having to withdraw $40,000 from the IRA, arguably it should be sufficient if the trustees withdraw the $30,000 MRD from the IRA and distribute it to the spouse, so long as the trustees distribute $10,000 of principal to the spouse out of other assets of the trust. This is consistent with Regs. §§20.2056(b)-5(f)(5) and -7(d)(2), which allow the spouse's beneficial enjoyment to be satisfied with respect to non-income producing assets if the spouse can require payments out of other assets of the trust. However, it is inconsistent with both Rev. Rul. 2000-2 and its predecessor, Rev. Rul. 89-89.[24]

CONDUIT QTIP TRUST

The conduit QTIP trust is a variation of the QTIP trust. In a conduit QTIP trust, all of the MRDs (as well as any distributions in excess of the MRDs) must be paid to the spouse, even if they exceed the income.

Since none of the MRDs during the spouse's lifetime can ever be accumulated for the ultimate benefit of anyone but the spouse, the spouse is treated as the sole beneficiary of the IRA.[25] This offers two income tax advantages. No MRDs are required until the year in which the IRA owner would have reached age 70½.[26] Once the spouse is required to begin taking distributions, his or her life expectancy can be recalculated each year, thus resulting in smaller MRDs.[27]

Notwithstanding the income tax benefits of the conduit QTIP trust over the standard QTIP trust, the conduit QTIP trust may not have much practical significance. In the conduit QTIP trust, where the MRDs exceed the internal income of the IRA, the portion of the MRDs that represent principal must be paid to the spouse, thus reducing the amount of principal subject to the IRA owner's control.

CREDIT SHELTER TRUST

Sometimes a married participant's nonretirement assets are less than the estate tax exempt amount. In other words, he or she does not have enough nonretirement assets to fully fund the credit shelter trust. He or she must choose between the income tax benefits of naming the spouse as beneficiary and the potential estate tax benefits of fully funding the credit shelter trust or otherwise taking advantage of the entire estate tax exempt amount.

From an income tax standpoint, it is generally advantageous to leave the retirement benefits to the spouse. As previously noted, the spouse can roll them over to his or her own IRA,[28] name new beneficiaries, possibly convert to a Roth IRA,[29] and obtain a longer stretchout period. Alternatively, the spouse can remain as beneficiary, and wait until the year in which the

[22] Regs. §§20.2056(b)-5(f)(8) and -7(d)(2).

[23] Rev. Rul. 2000-2, 2000-3 I.R.B. 305.

[24] 1989-2 C.B. 231.

[25] Regs. §1.401(a)(9)-5 A-7 *Ex.* 2.

[26] §401(a)(9)(B)(iii); Regs. §1.401(a)(9)-3 A-3(b).

[27] Regs. §1.401(a)(9)-5 A-5(c)(2).

[28] §402(c)(9).

[29] §408A(c)(3)(B).

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participant would have reached age 70½ before having to begin taking distributions.[30]

However, from an estate tax standpoint, depending upon the size of the surviving spouse's estate and the exempt amount at the time of the spouse's death, it may be advantageous to fully fund the credit shelter trust, or otherwise take advantage of the entire estate tax exempt amount, so as to shelter the largest possible amount from being included in the surviving spouse's estate.

This situation will become more common as the estate tax exempt amount increases. The estate tax exempt amount is scheduled to increase to $1.5 million in 2004, $2 million in 2006, and $3.5 million in 2009. There is no estate tax in 2010. However, the estate tax returns in 2011, with a $1 million exempt amount.[31]

A participant can mandate the use of retirement benefits to the extent necessary to fully fund the credit shelter trust or estate tax exempt amount. The simplest way to do this is to leave the retirement benefits to the estate. However, an estate is not a designated beneficiary.[32] This means that, as a general rule, the benefits would have to be paid out over the participant's life expectancy as of just before his or her death if the participant had already reached his or her RBD,[33] or over five years if not.[34] One possible exception is that, if the marital share of the estate passes to the spouse outright rather than in a QTIP trust, the spouse may be able to roll over the portion of the retirement benefits necessary to satisfy the spouse's share, or perhaps the retirement benefits actually distributed to the spouse if the spouse is the executor,[35] although to accomplish this it may be necessary to obtain a private letter ruling.

Another way to fund the estate tax exempt amount is to create a separate trust, name that trust as the beneficiary of the retirement benefits, and then put the marital/credit shelter formula in that trust. From a drafting standpoint, this simplifies the beneficiary designation form, and may thus facilitate dealing with the plan administrator or IRA custodian. However, it requires drafting a separate trust, and coordinating the terms of the trust with the participant's Will.

Creating a separate trust with a marital/credit shelter formula also raises other issues. First, if the IRA benefits payable to the trust are subject to the estate's debts, administration expenses and estate taxes (presumably other than merely by operation of law), there is a question as to whether the estate is in effect the beneficiary of a portion of the benefits, so that there would be no designated beneficiary.[36] Second, even if the marital share passes outright, the rollover may not be available except to the extent that the marital share could not be satisfied with other assets, or at least to the extent that no one other than the spouse had any discretion to fund the marital share with other assets.[37] To accomplish such a rollover it may be necessary to obtain a private letter ruling. Third, there is an issue as to whether, if there is a pecuniary marital or a pecuniary credit shelter bequest, the use of retirement benefits to fund the pecuniary marital or pecuniary credit shelter bequest accelerates the income in respect of a decedent.[38] The last issue can be avoided by using a fractional share marital/credit shelter formula. However, a fractional share can be difficult to administer.

Another approach is to put the marital/credit shelter formula in the beneficiary designation form rather than in the Will or a separate trust agreement. The beneficiary designation would essentially provide that to the extent other assets are not sufficient to fully fund the credit shelter or exempt amount, the necessary portion of the retirement benefits would be payable to the credit shelter trust or other beneficiaries other than the spouse or the marital trust. This avoids all of the potential problems involved in leaving the retirement benefits to the estate or to a separate trust. Even if the use of retirement benefits to fund a pecuniary bequest accelerates the income in respect of a decedent, by placing the formula in the beneficiary description form, there is no pecuniary bequest, though to be safe one could use a fractional share formula in the beneficiary designation. Since the fractional share applies only to the particular retirement benefit, it should not cause the administrative complexities generally associated with a fractional share formula. However, it necessitates a complicated beneficiary designation, which may not be acceptable to the plan administrator or IRA custodian.

Often the most practical approach is to name the spouse as the primary beneficiary, and the credit shelter trust, or other beneficiaries, as the contingent beneficiaries. This approach allows the choice between

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[30] §401(a)(9)(B)(iii); Regs. §1.401(a)(9)-3 A-3(b).

[31] §2010(c).

[32] Regs. §1.401(a)(9)-4 A-3.

[33] Regs. §1.401(a)(9)-5 A-5(a)(2).

[34] §401(a)(9)(B)(ii); Regs. §1.401(a)(9)-3 A-4(a)(2).

[35] E.g., PLRs 200151054, 200106047, 200032045; Bruce D. Steiner, "Postmortem Strategies to Shift Retirement Plan Assets to the Spouse," 24 *Estate Planning* 369 (1997).

[36] Marcia Chadwick Holt, "The 2001 Proposed Distribution Regulations," 36 *U. Miami Inst. on Estate Planning* ¶302.2B at 3-15 (2002); Natalie B. Choate, "Making Retirement Benefits Payable to Trusts," 34 *U. Miami Inst. on Estate Planning* ¶302 at 3-19 (2000); *see* PLR 9809059.

[37] PLRs 9633043, 9633042 and 9623056.

[38] §691(a)(2); Regs. §1.661(a)-2(f)(1); *Kenan v. Comr.*, 114 F.2d 217 (2d Cir. 1940); Marcia Chadwick Holt, "Retirement Planning: A Practical Guide to Making the Tough Choices," 29 *U. Miami Inst. on Estate Planning* ¶406.4 at 4-32 (1995).

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the income tax benefits of the spousal rollover and the potential estate tax benefits of fully funding the credit shelter trust or taking full advantage of the estate tax exempt amount to be postponed until the participant's death. However, the decision becomes the surviving spouse's, rather than the participant's. The spouse may choose not to disclaim even though his or her advisors recommend a disclaimer. Alternatively, the spouse's advisors may not be aware of the possibility of a disclaimer. The time period for a disclaimer (nine months from the participant's death, or nine months after the spouse reaches age 21, if later)[39] may elapse. The spouse may take the benefits before disclaiming, thus destroying his or her ability to disclaim them.[40] Finally, a disclaimer trust is less flexible than a mandatory credit shelter trust, since the spouse cannot have a power of appointment over a disclaimer trust, nor can the spouse participate in discretionary distributions to other beneficiaries (except as limited by an ascertainable standard).[41] Nevertheless, the benefits of being able to postpone the decision until the participant's death, thus preserving the opportunity for the spousal rollover, as well as the simplified drafting of the beneficiary designation, make this a desirable choice in many cases. In addition, this approach avoids all of the problems involved in leaving the retirement benefits to the estate or to a separate trust with a marital/credit shelter formula. Notwithstanding the benefits of this approach, some plan administrators or IRA custodians may not be comfortable with disclaimers.

Finally, several recent private letter rulings suggest that in a common law state (i.e., a noncommunity property state) it may be possible to utilize the same nonretirement assets to fund the credit shelter trust regardless of which spouse dies, if one spouse creates a revocable trust and gives the other spouse a general testamentary power of appointment over the trust assets if the other spouse dies first, or if both spouses create a joint revocable trust for their nonretirement assets.[42] If this works, the nonretirement assets will pass to the credit shelter trust regardless of which spouse dies first. Some commentators agree with this result.[43] Others disagree.[44] If this technique does not work, then the surviving spouse may be deemed to have made a taxable gift of his or her share of the revocable trust, or a portion of what was intended to be the credit shelter trust may be included in the surviving spouse's estate. For example, if each spouse has $1.5 million, and they each contribute their assets to a joint revocable trust, there is a risk that $2.25 million will be included in the surviving spouse's estate, assuming a $1.5 million exempt amount and no changes in the value of the assets, even though only $1.5 million would be included in the surviving spouse's estate if the couple had simply divided their assets and signed Wills containing marital deduction and credit shelter formula provisions. However, the risk is not the same in the case of retirement assets. For example, if a couple has $1 million of nonretirement assets which they contribute to a joint revocable trust, and one spouse has a $1 million IRA of which the other spouse is the beneficiary, and this technique does not work, the surviving spouse's estate will be $1.5 million (one-half of the nonretirement assets plus the IRA). However, if the couple divided their assets equally, the surviving spouse's estate would likewise be $1.5 million.

CHILDREN'S TRUSTS

Perhaps the most common situation in which the use of a trust is indicated for retirement benefits is when the participant intends to benefit a child. As in the case of other assets, retirement benefits passing to a child in trust rather than outright can be kept out of the child's estate for estate tax purposes, and can be protected against the child's creditors (including spouses). The tradeoffs involving spousal rollovers or Roth conversions do not apply in the case of a child, since no beneficiary other than a spouse can roll the benefits over into his or her own IRA,[45] and hence no beneficiary other than a spouse can convert to a Roth IRA.

One frequently raised tradeoff is the higher income tax rates that are generally applicable to trusts.[46] However, a child's trust can provide the trustees with the flexibility to decide whether to distribute the income (including the retirement benefits for this purpose) to the child or to the child's issue, or to accumulate them in the trust, based upon all of the facts and circumstances existing from time to time, includ-

[39] §2518(b)(2); Regs. §25.2518-2(c)(1).

[40] §2518(b)(3); Regs. §25.2518-2(d).

[41] §2518(b)(4); Regs. §25.2518-2(e)(2).

[42] PLRs 200210051, 200101021; *see also* TAM 9308002.

[43] Paul M. Fletcher, "Drafting Revocable Trusts to Facilitate a Stepped-Up Basis," 22 *Estate Planning* 100 (1995); Paul M. Fletcher, "A Practitioner's View of Tax Basis Revocable Trusts," *Trusts & Estates*, Jan. 1995, at 31; Richard A. Williams, "The Benefits and Pitfalls of Joint Revocable Trusts," *Trusts & Estates*, Nov. 1992, at 41.

[44] Michael Mulligan, "Income, Estate and Gift Tax Effects of Spousal Joint Trusts," 22 *Estate Planning* 195 (1995); Nancy E. Shurtz, "An Academic's View of Tax Basis Revocable Trusts," *Trusts & Estates*, Jan. 1995, at 43; Roy M. Adams and Thomas W. Abendroth, "The Joint Trust: Are You Saving Anything Other Than Paper," *Trusts & Estates*, Aug. 1992, at 39.

[45] §408(d)(3)(c).

[46] §1(e).

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ing the applicable income tax rates. In addition, it is often possible for trusts to avoid being subject to state income taxation.[47] Thus, to the extent income taxation is a factor, it weighs in favor of leaving retirement benefits to children in trust rather than outright.

A Roth IRA is a particularly valuable asset to which to allocate GST exemption, since the income and gains within the Roth IRA are income tax free. This is another reason for a Roth IRA owner to leave the Roth IRA benefits in trust rather than outright, particularly if he or she has available GST exemption. Since distributions from a Roth IRA are generally free of income tax the trust tax rates do not represent a tradeoff in the case of a Roth IRA.

To the extent the trust is not covered by the participant's or IRA owner's GST exemption and is therefore subject to GST tax, another possible tradeoff is that the GST tax is at the highest transfer tax rate, whereas assets passing to the beneficiary outright are subject to estate or gift tax (in the beneficiary's estate or if the beneficiary makes a gift) at graduated rates, and then only after the beneficiary uses his or her exempt amount. This tradeoff will become more important as the exempt amount increases. On the other hand, (i) in states that have decoupled, the estate tax rate may be higher than the GST tax rate, (ii) if the child appoints trust assets to or in trust for his or her grandchildren, the assets can pass down two generations at the cost of only one GST tax, whereas transfers of the child's own assets to or in trust for the child's grandchildren are subject to transfer taxes twice, (iii) the child can hedge against dying at a time when he or she has issue but does not have a taxable estate by buying life insurance, and (iv) it is always possible to distribute the trust assets to the child if desired. It may also be possible to give the child a general power of appointment over a portion of the trust by formula,[48] although it may not be desirable to do so.[49] It may also be possible to give the trustees the power to give the child a general power of appointment; however, giving the trustees this power may itself constitute a general power of appointment as a power exercisable with the consent of an independent trustee.[50] Of course, if the trust is the beneficiary of retirement benefits, giving the child (or giving the trustees the power to give the child) a general power of appointment is inconsistent with PLRs 200235038 through 200235041, and may result in the trust not having a designated beneficiary.

If each child is a contingent beneficiary of each of the other children's trusts, then each child's trust may be limited to a stretchout over the oldest child's life expectancy.[51] If the children are close in age, this is a relatively minor tradeoff. If not, then the younger children's trusts can be designed so that the older children are not contingent beneficiaries, at the cost of some loss of flexibility.

Another possibility is a conduit trust, in which all of the distributions from the IRA are in turn distributed to the child, so that each child will be treated as the sole beneficiary of his or her trust. However, if the child reaches his or her life expectancy, all of the trust assets will have been distributed to the child, thus defeating the transfer tax and asset protection benefits of the trust.

GRANDCHILDREN'S TRUSTS

The considerations involved in leaving retirement benefits in trust for grandchildren are similar to those in the case of children, except that to the extent the benefits exceed the IRA owner's available GST exemption, GST tax is payable upon the IRA owner's death.

However, by leaving IRA benefits in trust for grandchildren (or outright to grandchildren), they can be stretched out over a longer period of time.

Assuming that contingent beneficiaries are taken into account in determining the oldest beneficiary of a trust, the children should not be contingent beneficiaries of the grandchildren's trusts if it is desired to stretch the benefits out over a grandchild's life expectancy.

PAYING THE ESTATE TAX

In order to obtain the full benefit of the stretchout, a source of funds other than the retirement benefits must be available to pay the estate tax or the retirement benefits. This is particularly important where trusts are the beneficiaries, since trusts are less likely to have other assets with which to pay the estate tax.

Assuming a 50% estate tax rate, and disregarding the exempt amount, so long as the retirement benefits constitute less than one-half of the net estate, the nonretirement assets will be sufficient to pay the estate

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[47] *Mercantile Safe Deposit & Trust Co. v. Murphy,* 242 N.Y.S.2d 26 (3d Dept. 1963), *aff'd* 255 N.Y.S.2d 96 (1964); N.Y. Regs. §105.23; *Pennoyer v. Director,* 5 N.J. Tax 386 (1983), *Potter v. Director,* 5 N.J. Tax 399 (1983); Max Gutierrez, Jr., "The State Income Taxation of Multi-Jurisdictional Trusts," 36 *U. Miami Inst. on Estate Planning* §13 (2002).

[48] PLR 9527024.

[49] Richard B. Covey, "Question and Answer Session I of the Thirty-Second Annual Institute on Estate Planning," 32 *U. Miami Inst. on Estate Planning* ¶215 at 2-25 – 2-26 (1998).

[50] Dave L. Cornfeld, "Question and Answer Session I of the Thirty-Second Annual Institute on Estate Planning," 32 *U. Miami Inst. on Estate Planning* ¶215 at 2-26 (1998).

[51] PLRs 200235038 through 200235041.

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taxes on the entire estate. However, if the retirement benefits constitute more than one-half of the net estate, the nonretirement assets may not be sufficient to pay the estate taxes or the entire estate. This problem can be exacerbated by converting to a Roth IRA and using nonretirement assets to pay the income tax on the conversion.

If the participant or IRA owner is living, he or she should consider making lifetime gifts to or in trust for his or her beneficiaries, so as to reduce the estate taxes and increase the amount of assets not subject to estate tax.

After the participant's or IRA owner's death, the beneficiaries of the retirement benefits will have to provide the funds to pay the estate tax to the extent the nonretirement assets are not sufficient, or to the extent the taxes are charged against the recipients of the retirement benefits.

If a trust is a beneficiary of retirement benefits, it may be able to receive funds by means of a distribution from another trust, such as an insurance trust.[52] If such a distribution is contemplated, care must be taken to avoid violating the rule against perpetuities, as well as to avoid any adverse GST tax consequences. Assuming it will not significantly reduce the available perpetuities period or result in any adverse GST tax consequences, a simple approach is to have the retirement benefits payable to an insurance trust, so that the insurance proceeds can be used to pay the estate tax.

Another possibility is for the trust to borrow money from the beneficiaries of the trusts. While though the interest will not be deductible for income tax purposes, the retirement benefits enjoy favorable income tax treatment. The trusts can then repay the loan as the retirement benefits are received.

Alternatively, the estate can borrow the money to pay the estate taxes, to be repaid as the trusts receive the retirement benefits and reimburse the estate for the estate taxes. It is not clear whether the estate can deduct the interest for estate tax purposes.

CONCLUSION

While the rules governing trusts as beneficiaries of retirement benefits are difficult and uncertain, leaving retirement benefits in trust rather than outright often provides estate planning, transfer tax and asset protection benefits.

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[52] NY EPTL §10-6.6; Alaska Statutes §13.36.157; *Matter of Spencer,* 232 N.W.2d 491 (Iowa 1975); *Phipps v. Palm Beach Trust Co.,* 142 Fla. 782, 196 So. 299 (1940); *see Matter of Wold,* 310 N.J. Super. 382 (Ch. Div. Middlesex Co. 1998); *National State Bank of Newark v. Morrison,* 9 N.J. Super. 552 (Ch. Div. 1950); *Guild v. Mayor,* 87 N.J. Eq. 38 (1916).

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