Planning for Qualified Plan and IRA Benefits – the Final Minimum Required Distribution Rules

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OVERVIEW AND BACKGROUND

A. Overview of minimum distribution rules.

The minimum required distribution ("MRD") rules of Internal Revenue Code ("Code") section 401(a)(9) set the outer limits as to the deferral of the commencement and distribution of qualified plan and IRA benefits which a plan sponsor (or IRA custodian, trustee, or issuer) may adopt in a plan or IRA agreement. The proposed Treasury regulations issued in 2001 (referred to in this outline as the "2001 regulations") provided the first comprehensive reinterpretation of the MRD rules since the 1987 proposed Treasury regulations (the "1987 regulations") were published shortly after the current wording of the minimum distribution rules became effective in 1985. The final (and temporary) regulations, published on April 17, 2002 (the "final regulations"), further simplified the provisions of the 2001 regulations, sometimes to the participant's benefit and sometimes not. On June 15, 2004, new regulations regarding payments in annuity form, replacing and improving upon temporary and proposed regulations, were published together with a clarification to the final regulation's rules for creating separate accounts after a participant's death. This outline principally focuses on how the final regulations affect estate planning for defined contribution plan participants and IRA accountowners (generally referred to in this outline as plan or IRA "participants").

1. Rules simplified.

Under the final regulations, the measurement of the maximum "applicable distribution period" over which plan and IRA benefits may be distributed depends upon the identity of the participant's designated beneficiary, if any, and whether payments are being made during the participant's lifetime or following the participant's death. Exhibit A to this outline gives a snapshot of the rules and sections II through IV below discuss these rules in detail.

a. Lifetime distributions.

Beginning in a participant's first distribution calendar year and continuing through the distribution calendar year of the participant's death, distributions for each year are to be made in one of two ways.

i. Uniform lifetime table.

In most cases, distributions are determined using the distribution period shown on the uniform lifetime table for the age attained by the participant in the calendar year of distribution.

ii. Ten years younger spouse.

In the case of a participant who has a spouse who is more than ten years younger than the participant, distributions are determined in accordance with the joint life expectancy of the participant and spouse based on the ages attained in the year of each distribution.

b. Distributions following the participant's death.

Following the participant's death, the amount of required distributions for the distribution calendar year following the year of the participant's death and subsequent calendar years depends upon the identity of the participant's designated beneficiary, if any, and whether the participant dies prior to or after the required beginning date (the "RBD").

i. Nonspouse designated beneficiary.

If the participant has a designated beneficiary other than the participant's spouse or in addition to the participant's spouse, distributions are made over (i) the fixed life expectancy of the participant's oldest designated beneficiary or (ii) over the fixed life expectancy of the participant, if longer (if the participant dies on or after the RBD) or over the fixed life expectancy of the participant's oldest designated beneficiary (if the participant dies before the RBD).

ii. No designated beneficiary.

If the participant has no designated beneficiary, distributions are made over the remaining fixed life expectancy of the participant (if the participant dies on or after the participant's RBD) or distributions must be made before the end of the fifth calendar year following the year of the participant's death (if the participant dies before the RBD).

iii. Spouse is sole designated beneficiary.

If the participant's spouse is the sole designated beneficiary, distributions during the spouse's survivorship period (including the year of the spouse's death) are to be made over the spouse's redetermined life expectancy using the uniform lifetime table for the age attained (or which would have been attained) in the year of distribution, provided, if the participant dies after the RBD, the participant's remaining fixed life expectancy applies, if longer. Upon the spouse's death, distributions beginning in the year after the spouse's death are to be made over the remaining fixed life expectancy of the spouse. A spouse may also (or alternatively) convert an IRA to the spouse's own account or roll over plan or IRA benefits to the spouse's own IRA or plan account in which case the MRD rules apply to the spouse as a participant.

2. Plan and IRA agreement provisions.

A plan or IRA agreement does not need to provide for the maximum deferral available under the MRD rules. Plans may accelerate the otherwise required commencement of benefits and may limit the period over which benefits may be distributed. A required lump sum distribution on the RBD or shortly following the participant's death satisfies the MRD rules. Similarly, many plan and IRA agreements provide that benefits will be distributed upon a beneficiary's death. For these reasons and, in the case of qualified plans which are subject to the spousal rights requirements of Code sections 401(a)(11) and 417, it is necessary to review the plan agreement (or a summary plan description) or the IRA agreement to determine the deferral options available to a participant or beneficiary.

3. The 50% penalty.

Under Code section 4974(a), a 50% tax is imposed (on the payee of the benefits) on the amount of any MRD to the extent the required amount is not actually distributed. The IRS has the power to waive the imposition of the excise tax if the distribution shortfall was due to reasonable error and reasonable steps are being taken to remedy the shortfall. Treas reg 54.4974-2, A-7(a).

4. Aggregation of multiple IRAs.

In Notice 88-38 (1988-1 CB 524), it was provided that, for purposes of determining the minimum required distributions for an IRA accountowner, all IRAs which the individual held as an accountowner as well as all IRAs created by another (deceased) accountowner

of which the individual was beneficiary were to be aggregated and that the aggregate minimum distribution required could be distributed from any one or more of the IRAs involved.

a. Former planning strategy.

Under the Notice 88-38 aggregation rules, it was possible for a surviving spouse who was an accountowner of one or more IRAs and a beneficiary of one or more IRAs established by a deceased spouse to satisfy the minimum required distribution for a distribution calendar year by receiving distributions from IRAs of which the spouse was a beneficiary. Since the distribution period that applied to the IRA of which the spouse was beneficiary was typically shorter than the distribution period for IRAs established by the spouse (which might name children as designated beneficiaries), such a distribution choice preserved the balance of the IRA or IRAs which had the longer distribution period.

b. New IRA aggregation rule.

Under the final regulations, the aggregation rule is modified to state that only (i) IRAs of which an individual is the accountowner **or** (ii) IRAs that an individual holds as a beneficiary of the same decedent and are being distributed over the same period may be aggregated. Treas reg 1.408-8, A-9. This aggregation rule may produce beneficial results in cases where benefits are payable from separate accounts established by the deceased participant for a beneficiary that do not qualify for the separate share rule. See paragraph VII.B.1.c below.

5. Final regulations and estate planning.

Under the 1987 regulations, the fact that a participant had to select and lock in the identity of the participant's oldest designated beneficiary on the participant's RBD meant that many participants made this decision without an awareness of the estate planning implications involved. Moreover, even if advice was sought, there was no effective means of adjusting for changes in the participant's family's circumstances which occurred between the RBD and the participant's subsequent date of death.

a. Disclaimer planning available to all participants.

Under the 1987 regulations, the opportunity to change a participant's potential oldest designated beneficiary following the participant's death by means of having a named beneficiary or beneficiaries disclaim benefits in order to permit another named beneficiary to become the participant's oldest designated beneficiary only was effective in the case of a participant who died prior to the RBD. Under the final regulations, all participants, regardless of whether or not minimum required distributions have commenced, can generally take advantage of the disclaimer technique so as to permit an optional distribution of plan and IRA benefits to occur after the participant's death when all of the facts and circumstances are known.

b. Integration of benefits into estate plan.

As discussed in detail in section VI below, the final regulations do not address many of the numerous questions that have surfaced over the last several years regarding the naming of trusts as beneficiaries of plan and IRA benefits and the application of the "look through" rules to determine a participant's designated beneficiary. However, by providing that the determination of the identity of the participant's designated beneficiary is not determined

until September 30 of the calendar year following the calendar year of the participant's death (referred to in this outline as the "designation date"), the final regulations permit those estate planners who prefer to have plan and IRA benefits be distributed to trusts for family members to provide for a method of changing or eliminating trusts as beneficiaries during the 9 to 21 month window period between the participant's death and the designation date should the look through rules as finally determined prove unworkable.

B. History of the MRD rules – Code.

The precursor to the current wording of Code section 401(a)(9) was the original version of that section which, under the 1954 Code, applied to employees under plans in which self employed individuals described in Code section 401(c) were participants. Individual retirement accounts ("IRAs") as initially introduced contained similar MRD rules (but included special rules for a participant's surviving spouse). Code §408 adopted by section 2002(b) of the Employee Retirement Income Security Act of 1974 ("ERISA") PL 93-406.

(i) The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA", PL 97-248) extended the MRD rules to all qualified plans.

(ii) Effective for plan years after December 31, 1984, section 521(a)(1) of the Deficit Reduction Act of 1984 ("DEFRA", PL 97-248) retroactively repealed section 401(a)(9) enacted by TEFRA and adopted the present wording of section 401(a)(9) with the exception of the definition of "required beginning date" as it applies to employees other than five percent owners (as discussed in II.B below).

(iii) Section 521(b)(1) of DEFRA deleted the separate statement of MRD rules for IRAs and adopted the present wording of Code section 408(a)(6) which reads:

> "Under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained."

(iv) The Tax Reform Act of 1986 (TRA 86, PL 99-514) extended (by cross reference) the MRD rules to tax sheltered annuities and to certain plans of state and local governments and tax exempt organizations, effective for years beginning after December 31, 1988. §1852(a)(3)(A) and §1107(a) adopting new Code §403(b)(10) and amending Code §457(d)(2).

C. Incidental death benefit rule.

Recognizing that the primary purpose of Code section 401 was to provide retirement benefits for participants, Treasury regulations 1.401-1(b)(1) provide that the benefits payable to an employee must be incidental to the primary purpose of distributing the accumulated funds to the employee. The "incidental death benefit" rule, the only pre section 401(a)(9) rule which served as the means of assuring that tax deferred benefits served the intended retirement benefit objective, was set forth in Revenue Ruling 72-241 (1972-1 CB 108):

> "It is held that any settlement option under…a plan…will meet the requirement of section 1.401-1(b)(1) of the regulations that benefits payable to the beneficiary of an

> employee must be incidental to the primary purpose of distributing accumulated funds to the employee, if it contains certain provisions whereby the present value of the payments to be made to the participant is more than 50 percent of the present value of the total payments to be made to the participant and his beneficiaries."

The incidental death benefit rule is satisfied if payments from a qualified plan or IRA comply with the MRD rules. Treas reg 1.401(a)(9)-5, 1.40(a)(9)-6T. When TEFRA imposed the initial version of the MRD rules, participants were entitled to make an election under TEFRA section 242(b)(2) to specify a form of benefit payment permissible under the pre-TEFRA incidental death benefit rule, which, if unchanged, would be grandfathered (for example, to distribute the entire account balance at the date the participant attained the age that represented one half of the participant's life expectancy at the time of the election). The final regulations contain provisions regarding the impact on section 242(b) elections of plan to plan transfers, rollovers, and revocations. Treas reg 1.401(a)(9)-8, A-14, 15, and 16.

D. Proposed and final Treasury regulations – scope and effective dates.

1. The 1987 regulations.

Proposed Treasury regulations with respect to the MRD rules were published on July 27, 1987 under Code sections 401(a)(9), 403(b), 408, and 4974 (52 FR 28070) and were amended on December 30, 1997 (62 FR 67780) to revise the requirements of the "look through" rules applicable to trusts named as beneficiaries. These former proposed regulations are referred to in this outline as the "1987 regulations". These previously proposed regulations were completely replaced by the proposed regulations issued in 2001.

2. The 2001 proposed Treasury regulations.

New proposed regulations (referred to in this outline as the "2001 regulations") were published in the Federal Register (REG-130477-00 and REG-130481-00) on January 17, 2001. Prop Treas regs 1.401(a)(9)-0 through 8, 1.403(b)(2)-2, 1.408-8, and 54.4974-2. The 2001 regulations applied to all qualified plans, IRAs, tax sheltered annuities, and Code section 457(d) plans. The 2001 regulations are generally effective for plan and IRA distributions that occur on or after January 1, 2002. Proposed regulations for eligible government and tax exempt employer plans were published on May 8, 2002. Prop reg 1.457-6(d).

3. The final regulations.

The final regulations (and temporary regulations relating to defined benefit plans) were published on April 17, 2002. 67 Fed Reg 18, 988.

a. Scope – qualified plans, IRAs, tax sheltered annuities, and section 457 plans.

The final regulations (as was the case for the 2001 regulations) apply to all qualified plans (stock bonus, pension, and profit sharing plans), IRAs, tax sheltered annuities, and eligible Code section 457(d) plans. Treas reg 1.401(a)(9)-1, A-1. Final regulations for section 457(d) plans were published on July 11, 2003. Treas reg 1.457-6(d). The portion of the final regulations adopted in 2004 are generally effective for amounts distributed in 2003 and later years. However, a distribution from a defined benefit plan or annuity contract for calendar years 2003, 2004, or 2005 may be made based on reasonable and good faith inter-

pretation of section 401(a)(9) and need not conform to the final regulations promulgated in 2004.

b. Effective dates.

The final regulations are effective for plan and IRA distributions made in calendar years beginning on or after January 1, 2003. Treas reg 1.401(a)(9)-1, A-2.

i. Benefits with respect to pre-January 1, 2003 decedents.

If a participant died before January 1, 2003, the identity of the participant's oldest designated beneficiary, if any, and the applicable distribution period for 2003 and future years must be reconstructed under the final regulations. The amount of required distributions measured by a single designated beneficiary's life expectancy will be reduced. A beneficiary whose applicable distribution period was determined under the 1987 rules based on the fixed joint life expectancy of a participant and beneficiary will be measured by a single fixed life expectancy and, even under the new tables, the amount of distributions will likely increase.

ii. Qualified plan amendments.

Defined contribution plans must be amended to incorporate the final regulation's MRD rule provisions on or before the last day of the plan year beginning on or after January 1, 2003 (that is, December 31 for a calendar year plan). Rev Proc 2002-29, 2002-24 IRB 1176. Defined benefit plans need not be amended to comply with the final and temporary regulations until the end of the EGTRRA remedial amendment period (not sooner than the last day of the 2005 plan year). Rev Proc 2003-10, 2003-2 IRB 1.

iii. IRA agreement amendments.

Pre-EGTRRA and pre-final minimum required distribution regulation IRA agreements may not be used to establish an IRA after October 1, 2002. Announcement 2002-49, 2002-19 IRB 919 (04/19/02) modifying Rev Proc 2002-10, 2002-4 IRB 401 (01/03/02).

iv. Year 2002.

The preamble to the final regulations provides that taxpayers for 2002 distributions may rely upon the final regulations, the 2001 regulations, or the 1987 regulations. Thus, IRA accountowners were able to use the final regulations' distribution tables for 2002. However, qualified plan participants could use the final regulations' tables only if the plan was amended to adopt them effective for 2002 even if those provisions were adopted retroactively by the end of the 2003 plan year. Rev Proc 2002-29, 2002-24 IRB 1176.

c. 2004 changes to final regulations.

On June 15, 2004, final regulations regarding annuity payments from defined benefits plans (and from annuity contracts purchased with the balances of defined contribution plan accounts) were promulgated to replace and liberalize the temporary regulations published in 2002. In addition, special rules were adopted clarifying the establishment of separate accounts for purposes of the separate shares and the treatment of qualified domestic relations orders. Regs §1.401(a)(9)-8 and 1.409(a)(9)-6. 69 Fed Reg 33,288. These regulations are effective in the same manner as the 2002 final regulations described in paragraph b above.

II. DISTRIBUTIONS DURING THE PARTICIPANT'S LIFETIME

A. Code section 401(a)(9)(A) reinterpreted.

Code section 401(a)(9)(A) provides that, on or before participant's RBD, the entire interest of the participant must:

(i) Be distributed to the participant or

(ii) Be distributed, beginning on or before the RBD over:

(a) The life of the participant,

(b) The lives of the participant and a designated beneficiary,

(c) A period not extending beyond the life expectancy of the participant, or

(d) A period not extending beyond the joint life expectancy of the participant and a designated beneficiary.

1. Application to defined contribution plans.

In the case of defined contribution plans and IRAs, distributions were generally measured under the 1987 regulations by one of the life expectancy periods [paragraph (ii)(c) or (d) above], depending upon whether or not the participant, in fact, had a designated beneficiary on the RBD, unless the application of the qualified joint and survivor rules required the purchase of an annuity contract (required in the case of a money purchase pension plan to apply to at least one half of a participant's account unless the participant, with spousal consent, waives the requirement).

a. The final regulations adopt longest statutory distribution period.

With one exception, the uniform lifetime table described in paragraph C below applies to all distributions during the participant's lifetime and treats each participant as if the participant had named a nonspouse beneficiary who was more than ten years younger than the participant under the 1987 proposed regulations' minimum distribution incidental benefit rule ("MDIB rule") regardless of the actual identity of the participant's beneficiary or whether or not there is a beneficiary. The exception, which applies the joint life expectancy of a participant and a spouse sole designated beneficiary who is more than ten years younger than the participant as described in paragraph D below, is also consistent with the 1987 proposed regulations in that the MDIB rules did not apply when a spouse was the designated beneficiary.

(1) The preamble to the 2001 regulations explains that allowing the use of the uniform lifetime table reflects the facts that the participant may retain the ability to change beneficiaries until the participant's death occurs and ultimately may select a beneficiary who is more than ten years younger. While a participant's right to change beneficiaries was recognized under the 1987 regulations, a post RBD change to a beneficiary who was younger than the beneficiary being replaced was not respected for MRD rule pur-

poses, the younger beneficiary's life expectancy being disregarded. Prop Treas reg 1.401(a)(9)-1, A-5(c).

(2) The 2001 regulations' interpretation literally meets the wording of Code section 401(a)(9)(A)(ii)(D) in that a distribution may be made over "a period not extending beyond the life expectancy of such employee and a designated beneficiary" (emphasis added) rather than referring to the participant's specifically named designated beneficiary.

b. No elections to recalculate life expectancies need be made.

Under the 2001 and the final regulations, minimum required distributions made during the participant's lifetime over a period measured by the life expectancies of the participant and a hypothetical ten years younger beneficiary (or the participant's more than ten years younger spouse) are redetermined annually (that is, "recalculated" within the meaning of the 1987 regulations). The life expectancy of the participant's spouse who is the participant's sole beneficiary is similarly redetermined during the spouse's survivorship period. Thus, the previously elective life expectancy recalculations, where applicable, are built into the 2001 and final regulations' applicable distribution periods and no elections to recalculate life expectancies are permitted or required. Under the 1987 regulations, the election to recalculate life expectancy (which effectively assured that the participant's account balance would not be depleted during the participant's lifetime) could also result in the unexpected acceleration of benefit payments on the participant's death.

2. Application to defined benefit plans and payments from annuity contracts.

Defined benefit plan benefits are typically paid in the form of nonincreasing annuity payments under paragraph (A) or (B) of Code section 401(a)(9)(A)(ii), either directly from the plan or by the purchase and distribution of an annuity contract. Defined contribution plans may also permit a participant's account balance to be used to purchase an annuity contract. The 2001 and the temporary regulations essentially continue the 1987 regulations' requirements that an annuity form of payment must meet to satisfy the MRD rules. Prop Treas reg 1.409-6; Temp reg 1.409-6T. Under the 2001 regulations, a defined benefit plan that provides for a nonannuity form of benefit payment is governed by the rules applicable to defined contribution plans. Prop Treas reg 1.401(a)(9)-6, A-1(e). The deletion of this provision from the temporary regulations as a rule having little application drew numerous protest letters. In response, final regulations containing more flexible provisions were adopted in 2004. Treas Reg 1.401(a)(9)-6.These rules are not discussed in detail in this outline which focuses on the application of the new rules of defined contributions plans and IRAs.

B. Required beginning date (RBD).

The term "required beginning date" is defined in Code section 401(a)(9)(C)(i) to mean April 1 of the calendar year following:

(i) In the case of an IRA accountowner or a five percent owner plan participant, the calendar year in which the participant attains age 70 1/2 or

(ii) In the case of a non five percent owner plan participant, the calendar year in which the participant retires from employment with the employer maintaining the plan.

A five percent owner is an employee who is a five percent owner within the meaning of Code section 416 with respect to the plan year ending in the calendar year in which the employee attains age 70 1/2. Treas reg 1.401(a)(9)-2, A-2(c).

1. Non five percent owner participants.

The application of the definition of the RBD to non five percent owner participants is the only aspect of Code section 401(a)(9) which has changed since the present wording of the section was enacted, effective for plan years beginning after December 31, 1984. The postponement of the RBD for a non five percent owner participant until the year after a post-age 70 1/2 retirement was deleted from the 1985 wording of the section by section 1121(b) of the Tax Reform Act of 1986 (PL 99-514), effective for plan years beginning after December 31, 1988. Section 1404(a) of the Small Business Job Protection Act of 1996 (PL 104-188) effectively reinstated the pre-1989 definition of RBD for non five percent owners.

2. Plans may require RBD after age 70 1/2.

The 2001 and the final regulations, consistent with Notice 96-67 (1996-2 CB 235), permit a plan to provide that the RBD for all employees will be April 1 of the calendar year following the calendar year in which the participant (whether or not a five percent owner) attains age 70 1/2. Treas reg 1.401(a)(9)-2, A-2(e).

a. Plan's RBD applies to characterize postdeath distributions.

If the plan so provides, an over age 70 1/2 non five percent owner participant who dies prior to the end of the calendar year following the participant's retirement will nonetheless be considered to have died after the participant's RBD for purposes of determining postdeath minimum required distributions. Treas reg 1.401(a)(9)-2, A-6(b).

b. Character of amounts paid after plan RBD but before code RBD.

If an over age 70 1/2 non five percent owner participant who has not retired and is a participant in a plan that has set the RBD for all participants as April 1 of the calendar year following the calendar year in which a participant attains age 70 1/2 receives distributions from the plan for the calendar year in which age 70 1/2 is attained (or any later calendar year prior to the year following the year of retirement), may the participant roll these distributions over to an IRA? Under Code section 402(c)(4)(B), a plan distribution is not an eligible rollover distribution to the extent it is a minimum required distribution under Code section 401(a)(9)(C).

(1) Since distributions are not required under Code section 401(a)(9)(C) in the case of working non five percent owner participants, amounts distributed are generally eligible rollover distributions.

(2) However, Code section 402(c)(4)(A) provides that an eligible rollover distribution shall not include any distribution which is a series of substantially equal periodic pay-

ments (not less frequently than annually) made over a life expectancy or life expectancies or for a period of ten or more years. Under section 1.402(c)-2 of the Treasury regulations, if amounts are distributed in a series of payments equal to minimum required distributions, the payments will be considered equal periodic payments within the meaning of Code section 402(c)(4)(A), thus foreclosing rollover.

(3) If such distributions are eligible rollover distributions (because they are not periodic payments or to the extent that the amount exceeds the minimum required distribution amount), the 20% income tax withholding requirement of Code section 405(c) will apply unless a direct rollover of the amount involved is made. See Notice 97-75 (1997-51 IRB 1).

C. The uniform lifetime table.

Except in the case of a participant who has as his or her sole beneficiary a spouse who is more than ten years younger, the 2001 and the final regulations provide that the distribution required to be made for any distribution calendar year through and including the distribution calendar year of the participant's death, is determined by dividing the participant's account balance as of the preceding calendar yearend by the "applicable determination period" shown on the table (reproduced as exhibit B) for the age attained by the participant in the distribution calendar year involved. Reg 1.401(a)(9)-5, A-1 and 4. The final regulations responded to the mandate of section 634 of EGTRRA by introducing new life expectancy tables that reflect year 2000 mortality factors. Treas reg 1.401(a)(9)-9.

1. Distribution calendar year.

A "distribution calendar year" is a calendar year for which a minimum distribution is required. The first distribution calendar year is the calendar year preceding the calendar year in which the RBD occurs – that is, the calendar year in which the participant attains age 70 1/2 (or, in the case of a non five percent owner who participates in a qualified plan that permits, the calendar year of the participant's retirement, if later). Treas reg 1.401(a)(9)-5, A-1(b).

2. Payment of distribution for first distribution calendar year.

A distribution required to be made on or before a participant's RBD (whether made in the first distribution calendar year or in the second distribution calendar year prior to the April 1 RBD) is treated as a distribution required for the first distribution calendar year. The distribution required to be made for the second and all later distribution calendar years must be made before the end of the calendar year involved. Treas reg 1.401(a)(9)-5, A-1(c).

> In order to avoid the inclusion of two distributions, one for the first distribution calendar year and one for the second distribution calendar year in the participant's second distribution calendar year's taxable income, the initial required distribution should be made before the end of the first distribution calendar year.

3. Prior yearend account balance.

In the case of an IRA, the prior calendar yearend account balance is the amount by which the applicable determination period for the participant's attained age is divided to determine the minimum distribution required.

a. Plan postvaluation date adjustments.

In the case of a qualified plan, the prior year divisible account balance is determined as of the last plan valuation date to occur in the preceding distribution calendar year, increased by any contributions or forfeitures allocated to the account (provided that contributions allocated as of a date subsequent to the valuation date may be disregarded) and decreased by distributions made after the valuation date and before the calendar yearend. Treas reg 1.401(a)9-5, A-3.

b. Adjustment to second year account balance for pre-RBD distributions eliminated by final regulations.

In the case of a distribution made in the participant's second distribution calendar year from an IRA or from a plan under the 1987 and 2001 regulations, the prior yearend account balance was reduced by any portion of the minimum required distribution for the participant's first distribution calendar year made in the second distribution calendar year on or before the April 1 RBD. Prop Treas reg 1.401(a)(9)-5, A-3. Under the final regulations, in order to simplify the computation of the distribution for a participant's second distribution calendar year, a pre-RBD distribution made in the second distribution calendar year is now disregarded and the second year distribution is based on the prior yearend account balance unreduced by any minimum required distribution made early in the second year. Thus, deferring the initial minimum required distribution to the year of the RBD not only results in two distributions being included in the participant's taxable income for the second distribution calendar year but also increases the amount of the second distribution. Compare prop Treas reg 1.401(a)(9)-5, A-3(c)(2) to Treas reg 1.401(a)(9)-5, A-3.

c. Adjusting for rollovers.

The rules regarding rollovers and plan to plan transfers are coordinated with the rules for determining the account balance on which minimum distributions are computed.

(1) In the case of a rollover or transfer which occurs in a distribution calendar year of a participant, the transferring plan or IRA is required to make a minimum required distribution for the year of transfer (based upon that plan's or IRA's prior yearend account balance) and the receiving plan's yearend account balance for purposes of any minimum required distribution for the year of rollover or transfer is not increased by the rollover amount.

(2) The transferee plan's prior yearend account balance used to determine its minimum required distribution for the distribution calendar year following the year of rollover or transfer will include the rollover amount (in the case of a transfer received by a plan after the last valuation date in the year of receipt, by increasing the valuation date ac-

count balance by the value at time of receipt of the transferred amount).

(3) In the event of overlapping distribution calendar years (that is, the distribution by a transferring plan in one year and the receipt of the transfer by the receiving plan in the following distribution calendar year), the transferred amount is deemed to be received by the transferee in the distribution calendar year in which the amount was distributed by the transferring plan. Treas reg 1.401(a)(9)-7, A-1, 2, 3, and 4.

D. More than ten years younger spouse as sole beneficiary.

If the participant's spouse is the sole designated beneficiary of the participant's entire interest in the plan or IRA (or of a separate share of such interest) at all times during a distribution calendar year, the applicable distribution period is the longer of the applicable distribution period determined by the uniform lifetime table or the joint life expectancy period determined by the attained ages of the participant and the spouse in such year. Treas reg 1.401(a)(9)-5, A-4(b). Joint life expectancy factors, found in the Joint and Last Survivor Table in Treasury regulation 1.401(a)(9), A-3, will produce a longer distribution period if the spouse is 11 or more years younger than the participant. Treas reg 1.401(a)(9)-5, A-6(a).

1. The "at all times" requirement.

If the participant's spouse ceases to be married to the participant or ceases to be the participant's sole beneficiary during any distribution calendar year, the uniform lifetime table applies to determine that year's minimum required distribution. Relaxing the rule in the 2001 regulations that, in order for the Joint and Last Survivor Table to apply, the participant and a more-than-ten-years-younger spouse who is the participant's sole designated beneficiary must be married during the entire calendar year, the final regulations permit the joint life table to apply for the year in which either the participant or spouse dies as long as the couple is married on January 1. The joint life table also applies in the year of a couple's divorce but apparently only if no successor beneficiary is designated during that calendar year. Treas reg 1.401(a)(9)-5, A-4(b).

2. Can a trust for the spouse's benefit be designated beneficiary?

The preamble to the final regulations, in connection with the summary of the documentation rules which must be met to qualify a trust for the look through rules described in section VI.A.2 below, points out that the end of the calendar year following the calendar year of the participant's death (referred to in this outline as the "designation date") is the deadline for complying with the trust documentation requirements for all purposes "unless the lifetime distribution period for an employee is measured by the joint life expectancies of the employee and the employee's spouse" (Trust as Beneficiary – second sentence). However, the provisions of the final regulations that address the applicable distribution period that applies when the participant's sole designated beneficiary is a spouse who is more than ten years younger do not refer to trusts for the benefit of such a spouse.

a. Reasons to name a trust for the spouse as beneficiary.

If a participant does not want the surviving spouse to have full access to plan or IRA benefits following the participant's death because:

(1) The spouse is a spendthrift, suffers from an addiction (such as compulsive gambling), or is incapacitated or

(2) The participant wishes to preserve to the greatest extent possible the benefits that remain upon the spouse's later death for disposition remainder beneficiaries,

the trust intended to accomplish these objectives must be named as beneficiary prior to the participant's death. The final regulations provide that "[F]or example, if a distribution is in the form of a joint and survivor annuity over the life of the employee and another individual, the plan does not satisfy section 401(a)(9) unless such other individual is the designated individual under the plan". Treas reg 1.401(a)(9)-4, A-1.

b. Naming a "conduit" trust as beneficiary.

See the discussion of naming a conduit trust (probably qualifies), a QTIP trust (will not qualify), or a conduit QTIP trust (probably qualifies) in paragraph IV.B.3.c below and the rules for qualifying a trust for the look through rules in paragraph VI.A.2.c below.

III. DISTRIBUTIONS FOLLOWING THE PARTICIPANT'S DEATH –SPOUSE IS NOT SOLE BENEFICIARY

A. Overview.

As under the rules of the 1987 and the 2001 regulations, the applicable distribution period that applies following a participant's death depends upon whether or not the participant has an individual designated beneficiary. While the definition of designated beneficiary has not changed, the time at which the designated beneficiary is determined and the distributions periods that result from having or failing to have a designated beneficiary are different under the final regulations.

B. The new rules.

As noted in section II above regarding distributions to a participant which commence on the RBD, the uniform lifetime table applies in the year of the participant's death. In the case of a participant who dies prior to the RBD, no distribution is required for the year of death. In either case, the initial distribution governed by the postdeath MRD rules is required to be made in the distribution calendar year following the calendar year in which the participant's death occurs. The key question is whether or not the participant has an individual designated beneficiary as of September 30 of the distribution calendar year following the distribution calendar year in which the participant dies (referred to in this outline as the "designation date").

1. Participant has an individual designated beneficiary.

If the participant has an individual designated beneficiary, distributions may be made, beginning in the calendar year following the calendar year of the participant's death, over the longer of (i) the "fixed" life expectancy of the designated beneficiary or (ii) in the case of a

participant who dies after the RBD, the fixed life expectancy of the participant. Treas regs 1.401(a)(9)-3, A-3(a) and 1.401(a)(9)-5, A-5(a)(1) and (c)(1).

a. Determination of annual distributions – beneficiary's fixed life expectancy.

The distribution for the distribution calendar year following the calendar year of the participant's death is determined by dividing the prior yearend balance of the account by the years of life expectancy shown in the Single Life Table in Treasury regulation 1.401(a)(9)-9, A-1 (see exhibit C attached) for the age attained by the beneficiary in that year and each subsequent calendar year's distribution is determined by reducing that initially determined life expectancy factor by one year for each distribution calendar year elapsed since the distribution calendar year following the calendar year of the participant's death (including the year of distribution as an elapsed year for this purpose). Treas reg 1.401(a)(9)-5, A-5(c).

b. Determination of annual distributions – participant's fixed life expectancy.

The distribution for the distribution calendar year following the calendar year of the participant's death is determined by the Single Life Table life expectancy shown for the age which the participant attained (or would have attained) in the calendar year of death reduced by one year. Each subsequent calendar year's distribution is determined by the participant's year of death life expectancy reduced by one year for each distribution calendar year elapsed since the year of death (counting the year of distribution as an elapsed year for this purpose). Treas reg 1.401(a)(9)-5, A-5(c)(1).

c. Plan provisions may limit payout on pre-RBD death.

i. If no plan provision, deferred payment permitted.

While Code sections 401(a)(9)(B)(ii) and (iii) state that, in the case of a participant who dies before the RBD, the " five-year rule" applies unless the "exception to five-year rule for certain amounts payable over life of beneficiary" applies, the 2001 and the final regulations provide that, if there is no plan provision directing that either the five-year rule or the exception to the five-year rule applies, the exception to the five-year rule will apply if the participant has a designated beneficiary on the designation date. Treas reg 1.401(a)(9)-3, A- 4(a). This reverses the presumption made under the 1987 regulations which assumed that the five-year rule applied unless the plan provided for distributions over the participant's lifetime.

ii. If there is a plan provision, it controls.

A plan may specify that either the five-year rule or the exception to the five -year rule will apply in all cases or with respect to certain identified participants or that the participant or the beneficiaries may elect which rule to apply provided that, if no timely election is made, the exception to the five-year rule applies. Treas reg 1.401(a)(9)-3, A-4(b) and (c).

iii. Transition rule.

Under a transition rule, a designated beneficiary who was subject to the five-year rule under the 1987 regulations but did not begin to receive distributions before the end of the year following the participant's death under the exception to the five-year rule may switch to the life expectancy rule if a plan permits, provided that all amounts that would have been required to be distributed under an application of the life expectancy rule were

distributed by the earlier of December 31, 2003 or the end of the five-year rule period. Treas reg 1.401(a)(9)-1, A-2(b)(2).

2. Participant does not have a designated beneficiary.

a. Death after RBD.

If the participant dies after the RBD and has no designated beneficiary on the designation date, distributions will be made over the "fixed" life expectancy of the participant beginning with the distribution calendar year following the calendar year of the participant's death. See paragraph 1.b above re computation of amounts. Treas reg 1.401(a)(9)-3, A-3(a).

b. Death before RBD.

If the participant dies prior to the RBD and has no designated beneficiary on the designation date, the entire benefit will instead be distributed on or before the end of the fifth calendar year following the calendar year of the participant's death. Code §409(a)(B)(iii).

C. Designated beneficiary.

Code section 401(a)(9)(E) provides that the term "designated beneficiary" means any individual designated as a beneficiary by the participant.

1. Designation under plan required.

A beneficiary must be designated under the plan or IRA. An individual may be designated as a beneficiary under a plan either by the terms of the plan or, if the plan so provides, by an affirmative election by the participant (or the participant's surviving spouse if the spouse is deemed to be a participant in the case of a participant's pre-RBD death) specifying the beneficiary. A beneficiary designated as such under the plan is an individual who is entitled to a portion of a participant's benefit, contingent upon the participant's death or another specified event. Treas reg 1.401(a)(9)-4, A-1. In addition –

(a) A designated beneficiary need not be specified by name as long as the individual who is to be the beneficiary is identifiable under the plan as of the designation date.

(b) If a class of beneficiaries is capable of expansion or contraction, the members of the class will be treated as identifiable if it is possible to identify the class member with the shortest life expectancy on the designation date.

(c) An individual to whom an interest in the plan passes under applicable state law is not a designated beneficiary unless the individual is a designated beneficiary under the plan. Treas reg 1.401(a)(9)-4, A- 1.

See section II.D.2 above regarding the application of the designated beneficiary definition to distributions made during the participant's lifetime over the joint life expectancy of the participant and a more than ten years younger spouse.

2. Impact of nonindividual beneficiaries.

A person who is not an individual, such as the participant's estate or a charitable organization, may not be a designated beneficiary. Moreover, unless a nonindividual beneficiary is the beneficiary of a separate share of the participant's benefit, the existence of the nonindividual beneficiary will cause the participant to be treated as having no designated beneficiary even if one or more of the beneficiaries named are individuals. While a trust is not an individual, the naming of a trust as beneficiary will not cause there to be no designated beneficiary if the trust qualifies for the "look through" rules described in section VI.A below. Treas reg 1.401(a)(9)-4, A-3(a).

3. Multiple beneficiaries.

If two or more individuals are designated as beneficiaries on the designation date (one of whom may be the participant's surviving spouse), the individual having the shortest life expectancy (the oldest individual) will be the designated beneficiary for purposes of determining the distribution period unless separate shares in the participant's benefit have been established. Treas reg 1.401(a)(9)-5, A-7(a).

a. Contingent beneficiaries generally taken into account.

If a beneficiary's entitlement to a participant's benefit is contingent on an event other than the death of the participant or the death of another beneficiary (for example, if entitlement were to occur upon a predecessor beneficiary's failing to graduate from college by a stated age), the contingent beneficiary is considered to be a designated beneficiary for purposes of determining the designated beneficiary having the shortest life expectancy and whether or not there is a designated beneficiary. Treas reg 1.401(a)(9)-5, A-7(b).

b. Beneficiary entitled to benefit only due to death of prior beneficiary disregarded.

If a successor beneficiary is entitled to benefit **only if** another beneficiary dies after the designation date and before the entire benefit to which that other beneficiary is entitled has been distributed by the plan, the successor beneficiary may be disregarded in determining the participant's designated beneficiary. Treas reg 1.401(a)(9)-5, A-7(c)(1). However, if a successor beneficiary has any right (including a contingent right) to a participant's benefit beyond being a mere potential successor to the interest of one of the participant's beneficiaries upon that beneficiary's death, the successor will be taken into account. In the language quoted in full in paragraph VI.B.2.b below, the regulations provide (in effect, treating a participant's account, itself, as if it were a trust) that, if one of the participant's beneficiaries has right to receive the income from the account during the beneficiary's lifetime and a second beneficiary has the right to receive the principal of the account following the first beneficiary's death, both beneficiaries would have to be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.

c. Death of designated beneficiary after designation date does not affect distribution period.

Under the 1987 regulations, rules were provided for changes in designated beneficiaries made after the RBD but during the participant's lifetime under which, if a replacement beneficiary having a shorter life expectancy was named in place of the initially named designated beneficiary, the distribution period was accelerated. Former Prop Treas reg

1.401(a)(9)-1, A-E-5. Due to the fact that the designated beneficiary is now determined on the designation date, the rule that applied under the 1987 regulations to changes of designated beneficiaries after the participant's death (namely, that the distribution period continues to be determined by the deceased designated beneficiary's life expectancy regardless of whether the life expectancy of the successor beneficiary is shorter or is longer than the designated beneficiary's life expectancy) is the only rule. Prop Treas reg 1.401(a)(9)-5, A-7(c)(2).

4. Time at which designated beneficiary determined.

The final regulations state that designated beneficiaries are determined based on the beneficiaries designated as of the date of the participant's death who remain beneficiaries as of September 30 of the calendar year following the calendar year of the participant's death (referred to in this outline as the "designation date"). Thus, to be a designated beneficiary, an individual must be a beneficiary as of the participant's date of death as well as on the designation date. Treas reg 1.401(a)(9)-4, A-4. However, see the final regulations' rule described in paragraph D.1 below under which a (or the oldest) designated beneficiary who dies during the window period is deemed to be living on the designation date.

a. Change from 2001 Regulations.

The designation date was moved up from December 31 of the year following the participant's death (as was provided in the 2001 regulations) so as to eliminate the administrative catch-22 of having to make the initial post-death distribution on the same day that the designated beneficiary was to be identified.

b. The "window period".

By introducing the "window period", the 9 to 21 month period between the participant's date of death and the designation date under the final regulations, the 2001 regulations made uniform the post-death planning options that could affect the applicable distribution period (the disclaimer by a beneficiary and the creation of separate accounts). These options were previously available only if a participant died before the RBD. The opportunity to cash out a beneficiary's full benefits before the designation date was also added.

5. Designation of beneficiaries by beneficiaries.

If a plan allows (or gives the participant the power to specify that) any person shall have the discretion to change the participant's beneficiaries after the designation date, the 1987 and the 2001 regulations provided that the participant will be treated as having no designated beneficiary. However, the 2001 regulations, consistent with Private Letter Ruling 199936052, stated that the prohibited discretion will not be found to exist merely because a beneficiary may designate a subsequent beneficiary who would be entitled to benefits after the designating beneficiary dies. Prop Treas reg 1.401(a)(9)-5, A-7(d). Although the final regulations deleted the section of the 2001 regulations related to beneficiaries' designating beneficiaries, it does not appear that the deletion was intended to change the 2001 regulations' rule because reference to the beneficiary of a deceased beneficiary is made in the final regulations' provision regarding the death of a beneficiary during the window period, stating that such a successor beneficiary will be disregarded in determining the participant's designated beneficiary. See section D.1 below. Although the identity of the successor beneficiary of a beneficiary who dies during the window period will not affect the applicable distribution period, in many cases the beneficiary's probate estate (the default

successor to a deceased beneficiary under most IRAs) may not be the optimal choice if probate avoidance is a goal.

D. Planning during the window period.

Any person who is named as a participant's beneficiary as of the participant's date of death but who has ceased to be a beneficiary as of the designation date, because the person disclaims entitlement to the benefits or because the person has received the entire benefit to which the person is entitled, is disregarded in identifying the participant's oldest designated beneficiary (or whether or not the participant has a designated beneficiary) for purposes of determining the applicable distribution period for the calendar year following the participant's death and subsequent years. Treas reg 1.401(a)(9)-4, A-4(a). If a participant has designated multiple beneficiaries to share the benefit, separate shares or accounts may be created by the end of the calendar year following the calendar year of the participant's death in order to have each share or account obtain the applicable distribution period that would apply if the designated beneficiary of that share were the participant's sole designated beneficiary for the purposes of the Code section 401(a)(9)(B) postdeath distribution rules. Treas reg 1.401(a)(9)-8, A-2 and 3.

1. Death of oldest beneficiary during window period.

If a named oldest beneficiary survives the participant but dies prior to the designation date, the postdeath applicable distribution period will be determined by the fixed life expectancy of the deceased beneficiary and the identity of the successor (or remaining) beneficiary or beneficiaries who are living on the designation date are disregarded for purposes of determining the post-death applicable distribution period. Treas reg 1.409(a)(9)-4(c), A-4.

a. Substantial change to apparent rule of 2001 regulations.

It had appeared under the 2001 regulations that, because designated beneficiaries were defined as individuals living on the designation date, the successor to a deceased beneficiary would be taken into account in determining the applicable distribution period for plan and IRA benefits or a separate account. This rule would have caused there to be no designated beneficiary if the beneficiary's estate were the successor or caused a longer payout period if younger generation beneficiaries succeeded.

b. Inclusion in deceased beneficiary's gross estate.

In the case of an IRA and in the case of most plans, a surviving beneficiary's interest in the plan or IRA becomes fully withdrawable immediately upon the participant's death and is thus includable in the beneficiary's gross estate under Code section 2033 (property includable to the extent of the interest of the decedent at the time of death). If the method of benefit payment is required to be in the form of noncommutable installment or annuity payments, the amount includable in the deceased beneficiary's gross estate will be determined under the actuarial tables in the Treasury regulations. Therefore, if a customized beneficiary designation identifying successor beneficiaries in the event of a surviving beneficiary's death is employed, consideration must be given to whether or not estate tax will be payable upon the beneficiary's death and how that obligation will be satisfied.

c. Will a disclaimer by a deceased beneficiary's personal representative be recognized?

Will the disclaimer made by a deceased individual beneficiary's personal representative that is valid under state law be recognized so that the deceased beneficiary will be disregarded if the disclaimer occurs before the designation date? The final regulations require the life expectancy of a deceased beneficiary to be taken into account if the beneficiary dies prior to the designation date "without disclaiming". Treas reg 1.401(a)(9)-4, A-4(c). It is possible that the regulation may be interpreted as requiring that a pre-death disclaimer be made in order for the deceased beneficiary's life expectancy to be disregarded. However, it would seem that a timely qualified disclaimer under Code §2518 by an executor should be honored but the timing of the beneficiary's death would have to be soon after that of the participant to be able to accomplish the disclaimer within the nine month period following the participant's death.

2. Creating separate shares following the participant's death.

If a participant has named multiple beneficiaries for plan death benefits, the ability to obtain the otherwise available maximum applicable distribution period may be curtailed due to:

(a) The existence of a nonindividual beneficiary,

(b) The fact that the spouse is not the sole beneficiary, or

(c) The requirement that the oldest beneficiary's life expectancy governs payments to all beneficiaries.

If separate accounts are established, the MRD rules are applied separately to each account based upon its beneficiaries alone. Treas reg 1.401(a)(9)-8, A-2.

a. Definition of separate accounts or shares.

Consistent with the 1987 and the 2001 regulations, the final regulations provide that a participant's benefit may be divided into separate accounts under the plan or IRA if each separate beneficiary's portion of a participant's benefit is determined by an acceptable separate accounting including the allocation of investment gains and losses, contributions, and forfeitures on a pro rata basis in a reasonable and consistent manner among the separate accounts. Treas reg 1.401(a)(9)-8, A-3(a). A benefit in a defined benefit plan is separated into segregated shares if it consists of separate identifiable components that may be separately distributed. Treas reg 1.401(a)(9)-8, A-3(b).

b. Time at which separate accounts must be established.

Under the final regulations, separate accounts will be recognized if the beneficiaries with respect to a separate account differ from those of another separate account as of the end of the year following the year containing the participant's (or spouse's, if applicable) date of death. For MRDs payable after January 1, 2003, the regulations adopted in 2004 provide that the timely establishment of separate accounts relates back to the participant's date of death and, therefore, applies to distributions made in the year following the participant's death based upon the participant's beneficiaries as of the designation date even though the separate accounts are not established until after the designation date has occurred (that is, during the final three months of the year following the participant's death). Treas reg 1.401(a)(9)-8, A-2.

c. Separate accounts for distributions in 2002 and earlier years.

Under the 2002 regulations, it appeared that the separate applicable distribution period would be available with respect to separate accounts for any year only if the separate accounts were actually established on a date no later than the last day of the preceding calendar year 2002. Treas reg 1.401(a)(9)-8, A-2(a)(2). Particularly, in the case of participants who died late in the calendar year, it was virtually impossible to establish separate accounts in the participant's year of death. As a result, if separate accounts were established in the year following the participant's death, the participant's account will potentially have differing sets of beneficiaries for the year following the participant's death and the second year after the year of the participant's death.

d. Distribution in year after participant's death under 2002 regulations.

The interaction between the rule that the identity of the designated beneficiary for purposes of determining the applicable distribution period is made based on the participant's beneficiaries as of the designation date (September 30 of the year following the year of the participant's death) and the deadline for the establishment of separate accounts (which may occur in the final three months of the year following the year of the participant's death) was not spelled out in the 2002 final regulations. Fortunately, the following questions raised by the 2002 regulations provisions are not a concern for MRDs made for 2003 and future years.

i. Separate accounts established in year of participant's death.

If separate accounts were established in the year of the participant's death in 2001 or earlier years (and are thus taken into account in determining the designated beneficiaries for the purposes of determining the applicable distribution periods for the year following the participant's death), it is clear that each separate account would have a separate designated beneficiary and applicable distribution period for the year after the participant's death.

ii. Separate accounts established in year following the participant's death.

Since separate accounts are not recognized until the calendar year after the accounts have been established under the 2002 final regulations, the separate accounts are aggregated (and all beneficiaries are taken into account) in determining distributions for the year following the participant's death (for example, 2002) if the establishment of separate accounts occurs in that year.

1. Accordingly, if a participant named as beneficiaries a surviving spouse, a charity, and a child in specified percentages, the participant would be deemed to have no designated beneficiary for the calendar year following the year of death (because the charity is not an individual). If the participant died after the RBD, the minimum distribution required would be measured by the participant's fixed life expectancy. If the participant died before the RBD, the five-year rule would apply and no distribu-

tion would be required for the year following the year of the participant's death.

2. The examples in the final regulations imply that, for the year after the year following the participant's death, differing applicable distribution periods would apply to the three separate accounts established for each beneficiary in the year following the participant's death. Thus, in the subsequent year, the charity would receive a distribution determined based on the participant's fixed life expectancy (or under the five-year rule), the surviving spouse's separate account would determine distribution based on the spouse's recalculated single life expectancy, and the child's separate account would determine distributions based on the child's fixed life expectancy.

iii. Risk of having no designated beneficiary if separate accounts do not exist on designation date.

Because the separate account provisions of the 2002 final regulations do not cross-reference the rules for determining the participant's designated beneficiary, there may be a risk that the failure to establish separate accounts in the year of the participant's death in 2001 or earlier years (which may be impossible to accomplish if the participant dies late in the year) would cause the participant to have no designated beneficiary when a nonindividual, such as a charity, is one of multiple beneficiaries as of the designation date. One way to avoid the risk would be to distribute the interest of the nonindividual beneficiary before the designation date.

e. Accounts may be created for separate management at any time.

After the designation date has occurred without separate accounts having been established with respect to a deceased participant's IRA and, for example, benefits distributable to multiple beneficiaries are required to be paid over the life expectancy of the oldest beneficiary, the beneficiaries may wish to create separate accounts in order to separately direct investments or to have different IRA custodians or trustees. In the case of any nonspouse beneficiary, the decedent's IRA account is deemed to be an "inherited" IRA and no rollover is permitted. An IRA for multiple nonspouse beneficiaries can nonetheless be transferred to a new trustee or custodian (or divided into separate accounts by the existing trustee or custodian). Care must be taken that the transfer or division is not treated as a transfer of the inherited IRA to a beneficiary's IRA because such a transfer is not excluded from the beneficiary's gross income.

i. The wrong way.

In Private Letter Ruling 9014071, the transfer of a decedent's IRA account balance to an IRA established in the name of his daughter (the designated beneficiary of the decedent's account) resulted in the inclusion of the transferred account balance in the daughter's taxable income for the year of transfer.

ii. The right way.

In Private Letter Ruling 8716058, the son of a deceased IRA accountowner who was the designated beneficiary of an IRA arranged to have a new IRA account established in his deceased mother's name with an eligible IRA trustee and proposed to have a trustee-to-trustee transfer of the account balance made.

1. After citing Revenue Ruling 78-406 (1978-2 CB 157) which held trustee to trustee transfers between IRAs not to be a distribution or a prohibited rollover, the ruling noted that, even though the designated beneficiary (rather than either the IRA participant or the bank trustee) wished to initiate the transfer, the transfer was not a prohibited rollover because the IRA would be maintained in the name of the deceased IRA participant.
2. In Private Letter Rulings 9623037 through 9623040, four daughters of a deceased accountowner, as designated beneficiaries, proposed to have the existing IRA trustee divide the IRA into four equal shares. Each share was then to be transferred to a new IRA trustee (in a trustee-to-trustee transfer), each recipient IRA remaining in the name of the deceased accountowner, as owner. Each ruling approves the transfer to an account to be maintained in the name of the deceased accountowner with the particular daughter requesting the ruling as the sole designated beneficiary of the IRA.

The separate account should be established in the deceased participant’s name for the benefit of the beneficiary and, contrary to early private letter rulings, should use the beneficiary’s (not the participant’s) social security or taxpayer identification number (as provided in form 1099-R instructions).

iii. Custodian and trustee resistance to creating separate IRAs.

Many private letter rulings have followed the foregoing position.

1. PLR 200343030 approved the transfer of a beneficiary's one third interest in an IRA payable to an estate to an account in the post RBD deceased participant's name which could be paid out over the participant's remaining life expectancy without regard to the distribution pattern adopted by the beneficiaries of the remaining two thirds of the IRA.

2. In PLR 200349009, an IRA participant died before the RBD and designated a trust as beneficiary. The Service ruled that the account could be subdivided with one half being paid outright to one of the two beneficiaries and the remaining one half being continued in an account in the decedent's name for the second beneficiary with MRDs to be made over the life expectancy of the oldest of the two beneficiaries. See also PLRs 200234019, and 200329048, and 200410020.

3. In PLRs 200432027-29, an IRA was payable to a trust that was to terminate on the participant's death and distribute outright to three children. The Service approved the division of the IRA into three IRAs, each payable over the eldest beneficiary's life expectancy.

While practitioners view a quantity of private letter rulings that are consistent in their holdings as a critical mass indicative of IRS policy, many custodians and trustees refuse to adopt a flexible policy on account divisions by trustee to trustee transfer because no formal IRS pronouncements exist (although the final regulations do refer to trustee to trustee IRA transfers). Regs §1.408-8, A-8. As the number of continuing private letter ruling requests for approval of trustee to trustee transfers indicate, not all trustees and custodians will follow the private letter ruling results. If a trustee or custodian refuses to establish separate accounts, the beneficiary's only recourse is to arrange a trustee to trustee transfer of the IRA to a new custodian or trustee (such as Vanguard or Fidelity) that will permit separate accounts to be established.

3. Using disclaimers during the window period to change the designated beneficiary.

The 1987 regulations did not refer to disclaimers but the 2001 and the final regulations expressly recognize that a qualified disclaimer of entitlement to benefits under Code §2518 may eliminate a disclaiming beneficiary prior to the designation date. Treas reg 1.401(a)(9)-4, A-4(a); see also PLR 200013041. In order for a beneficiary who becomes entitled to benefits as a result of a prior beneficiary's disclaimer to be recognized as a designated beneficiary, the successor beneficiary must be designated under the plan or under a beneficiary designation pursuant to the plan. Treas reg 1.401(a)(9)-2, A-1. Accordingly, in order to take advantage of the ability to change beneficiaries during the window period, a ladder of primary and contingent beneficiaries must be included in the participant's (or spouse's) beneficiary designation.

a. Recognition of disclaimers for transfer tax purposes.

For federal transfer (gift and estate) tax purposes, the effect of a qualified disclaimer under Code section 2518(a) is that the disclaimed interest in property is treated as if it has never been transferred to the person making the qualified disclaimer and, instead, had passed, ab initio, directly from the transferor of the property (that is, the deceased testator, trust settlor, or participant) to the person entitled to receive the property as a result of the dis-

claimer. Treas reg 25.2518-1(b). Code section 2654(c) specifically provides that Code section 2518 controls the effect of a qualified disclaimer for purposes of the generation-skipping transfer tax. PLR 9203028.

b. Qualified disclaimer defined.

A "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if:

(1) Such refusal is in writing,

(2) Such writing is received by the transferor of the interest or the holder of the legal title to the property to which the interest relates not later than nine months after the later of the day on which the transfer creating the interest in such person is made or the day on which such person attains age 21,

(3) Such person has not accepted the interest or any of its benefits, and

(4) As a result of such refusal, the interest passes without any direction on the part of the person making such disclaimer and passes either:

(i) To the spouse of the decedent or

(ii) To a person other than the person making the disclaimer. Code §2518(b).

Note that the entitlement to disclaimed benefits may, in turn, be disclaimed by the successor beneficiary in the same manner (that is, within nine months of the original disclaimer creating the successor beneficiary's interest in the benefits).

(1) Pre-disclaimer receipt of an MRD is not an acceptance of an interest in benefits.

Revenue Ruling 2005-36, 2005-26 IRB 1368 (June 27, 2005), applying the Treasury Regulations for qualified disclaimers, concludes that a designated primary beneficiary who has received an MRD payment following a participant's death may nonetheless disclaim the balance of the benefit. If the disclaimer occurs on or before the designation date (September 30 of the calendar year following the calendar year of the participant's death), the disclaiming beneficiary will not be considered to be a designated beneficiary.

(2) Distribution of income attributable to distributed amount required.

Under the Revenue Ruling 2005-36 analysis, the amount of the received MRD is treated as a distribution from corpus of a pecuniary amount. To qualify as a disclaimer, no income or other benefit of the disclaimed amount may inure to the disclaimant. Regs §25.2518-3(e). Accordingly, the receipt of an MRD is considered to be the acceptance of a proportionate amount of the account's income, determined by formula under the qualified disclaimer regulations and, because this income amount cannot be disclaimed, it must be distributed to the recipient on or before the designation date.

(3) Partial disclaimers affirmed.

Revenue Ruling 2005-36 also illustrates fact situations in which the MRD recipient disclaims a pecuniary amount (less than the total benefit) and a fractional (percentage) share of the total benefit, provided in either case, that the income attributable to the disclaimed portion is also disclaimed.

(4) Other indicia of acceptance.

Actions that a beneficiary might take prior to an attempted disclaimer that may indicate acceptance of the benefits include exercising investment control, naming a successor beneficiary, a spouse rolling the benefits over to the beneficiary's own account, or a spouse electing to treat the participant's IRA as the spouse's own account.

(5) Spouse may retain certain interests in disclaimed property.

If a surviving spouse disclaims an interest in property, that interest can pass to a trust with respect to which the spouse is a trust income beneficiary, is a permissible distributee of principal in the discretion of a third party, has a withdrawal right limited by an ascertainable standard, or has a 5 & 5 power without invalidating a qualified disclaimer in favor of that trust. Treas regs 25.2518-2(e)(2) and (5), examples (4), (5), (6), and (7). However, the spouse must have no power with respect to the trust principal (i) which is not subject to the spouse's federal estate or gift tax or (ii) which could determine the ultimate recipient of that trust principal (unless such power is limited by an ascertainable standard).

(6) Spouse may not hold a nongeneral power of appointment over a credit shelter trust.

A disclaimer by a surviving spouse in favor of a nonmarital credit shelter (or bypass) trust will not be a qualified disclaimer if the disclaiming spouse has a nongeneral power of appointment over the trust property – as is often the case where the trust's creator wishes to provide flexibility in his estate plan. Treas reg 25.2518-2(e)(2). However, a spousal disclaimer under those circumstances can still be achieved if the spouse releases all nongeneral powers the spouse has over the trust prior to disclaimer, concurrently disclaims all nongeneral powers, or the decedent's estate plan provides for a "disclaimer trust" (not containing a nongeneral power exercisable by the spouse) to receive the disclaimed interest.

(7) Transfer type disclaimers.

Code section 2518(c)(3) permits a transfer type disclaimer which is intended not to be dependent on complying with any local law disclaimer requirements. A written transfer that otherwise meets the requirements of a qualified disclaimer and that conveys ownership of the disclaimed interest to the person(s) who would have received the property had the disclaimant making the transfer made an effective state law disclaimer **will** be a qualified disclaimer. The wording of the original transfer document (typically the will, trust instrument, or death benefit beneficiary designation) may thus specifically authorize a beneficiary (whether an individual or the trustees of a trust) to accomplish a disclaimer by a written transfer of the right to receive the property interest intended to be disclaimed to the party designated in the transfer document to take in the event of a disclaimer (typically the next designated contingent beneficiary).

(8) Takers in the event of a disclaimer must qualify as individual beneficiaries.

In PLR 200327059, a surviving spouse of a participant who died before the RBD rolled over a portion of an IRA to the spouse's own IRA. The spouse successfully disclaimed the balance of the IRA. However, the disclaimer was in favor of the participant's residuary estate which was to pass to a trust for the spouse's benefit. Because the participant's estate was the beneficiary, the life expectancy of the surviving spouse could not be used as a measure of MRDs and the five year rule instead applied to the benefits that were not rolled over.

c. Income tax impact of a disclaimer.

Private letter rulings have recognized that the recipient of the disclaimed interest becomes the income taxpayer of a disclaimed interest. PLR 9319020 re Code §691, PLR 9037048 re Code §408(d)(1), and PLR 9303027 re Code §402(a).

d. Plan anti-alienation provisions.

General Counsels Memorandum 39858 (published in 1991) held that a disclaimer that satisfies the requirements of state law and Code section 2518(b) is not an assignment of income or an alienation of plan benefits contrary to Code section 401(a)(13) and is not a forfeiture or transfer contrary to Code section 408 in the case of an IRA. The memorandum further states that a plan or IRA distribution is includable in the recipient's taxable income when distributed (rather than in the disclaimant's income when disclaimed).

e. Preapproved customized beneficiary designations or postdeath persuasiveness needed to gain administrative acceptance.

Few, if any, plan or IRA agreements contemplate the disclaimer of benefits by a beneficiary. While many plan administrators, trustees, and custodians are unwilling to accept customized beneficiary designations, some, such as the Vanguard Group, are willing to do so if the designation (or a separate letter or form) holds the custodian or trustee harmless from all liability and responsibility in making distributions based upon the direction of an identified representative of participant or the participant's revocable trust. See the sample clause in the beneficiary designation attached as exhibit G. In order to facilitate postdeath disclaimers, the beneficiary designation should:

(1) Expressly state in the case of each named beneficiary that the plan interest will pass to the next named beneficiary if the trust named beneficiary dies (or is no longer in existence) or if the beneficiary disclaims the benefit and

(2) State the methods by which a disclaimer is made by a beneficiary.

f. Building a disclaimer into beneficiary designation.

While disclaimers of qualified plan benefits have been frequently recognized in letter rulings (for example, PLRs 9016026, 9247026, and 200105058), it is possible that a plan administrator might refuse to recognize a disclaimer by claiming that a disclaimer based on state law that changes a beneficiary is preempted by ERISA. In *Egelhoff v. Egelhoff*, 121 S.G. 1322, 532 U.S. 141 (2001), the court held that a state law that would have voided a beneficiary designation in favor of an ex-spouse was preempted. If a beneficiary designa-

tion accepted by the plan provides that plan benefits pass to contingent beneficiaries if the initial beneficiary dies or disclaims the benefits, a strong argument can be made that the plan's terms recognize the disclaimer.

IV. DISTRIBUTIONS FOLLOWING THE PARTICIPANT'S DEATH – SPOUSE IS SOLE BENEFICIARY

A. Overview.

If a participant's surviving spouse is the sole designated beneficiary of the participant (or the sole beneficiary of a separate account of the participant's benefits), special MRD rules may apply to determine at what time benefits must commence following the participant's death, the applicable distribution period (both during the surviving spouse's lifetime and following the spouse's death), and how the identity of the successor beneficiaries who will receive benefits on the spouse's death will be determined. Moreover, a surviving spouse beneficiary has the ability to elect to treat the participant's account as the spouse's own account or to roll the participant's account over to the spouse's own IRA (or plan).

B. Special MRD rules if spouse is sole designated beneficiary.

Special MRD rules apply to a participant's surviving spouse who is the sole designated beneficiary of the benefits (or a separate account) of a participant unless the surviving spouse, alternatively, takes action under the rules which cut across the MRD rules by:

(i) In the case of an IRA, electing either to treat the participant's account as the spouse's own account under Treasury regulation 1.408-8, A-5 or electing to roll the account over to an IRA in the spouse's name under Code section 408(d)(3)(c)(ii)(II) or

(ii) In the case of a plan, electing to roll a distribution from the account over to the spouse's own IRA under Code section 401(c)(9) or to a plan in which the spouse is a participant under the new EGTRRA rules.

1. Deferral of benefit commencement after participant's pre-RBD death.

Under Code section 401(a)(9)(B)(iv)(II), if the sole designated beneficiary of a participant who dies prior to the participant's RBD is the participant's surviving spouse, the commencement of minimum required distributions which, under the general rule of Code section 401(a)(9)(B)(iii) is to occur in the distribution calendar year following the calendar year of the participant's death, is deferred until the end of the calendar year in which the participant would have attained age 70 1/2 if the participant had survived. Since the usual rule of Code section 401(a)(9)(B)(iii) requires distribution in the year following the year of death, no actual deferral occurs if the participant attained (or would have attained) age 69 1/2 or older in the year of death.

2. Spouse treated as participant if death occurs before benefits commence after a participant's pre-RBD death.

If a surviving spouse beneficiary who survives the participant's pre-RBD death is the sole designated beneficiary of the participant's benefits (or a separate account) as of the desig-

nation date and then dies before the end of the distribution calendar year in which minimum distributions are required to begin (the end of the distribution calendar year in which the participant would have attained age 70 1/2), the postdeath distribution rules (the five-year rule or the payment over a designated beneficiary's life expectancy) apply as if the surviving spouse were the participant. Code §401(a)(9)(B)(iv)(II) and Treas reg 1.401(a)(9)-4, A-4(b). The special rule that applies to a surviving spouse of the participant may not, however, be reapplied to defer the commencement of benefits to a remarried surviving spouse's surviving spouse. Treas reg 1.401(a)(9)-3, A-5. If the surviving spouse is living at the end of the year following the year in which the participant would have attained age 70 1/2 (that is, after benefits are required to commence), the surviving spouse is no longer deemed to be the participant for the purposes of the MRD rules under Code section 401(a)(9)(B)(iv)(II) and, on the spouse's subsequent death, the distributions of any remaining benefits are made over the spouse's fixed life expectancy under paragraph 3.b below rather than in accordance with the five-year rule or its exception.

a. If the spouse's death occurs before the designation date, what is the applicable distribution period?

Notwithstanding the fact that Treasury regulation 1.401(a)(9)-3, A-5(b) stipulates that a surviving spouse of a participant who dies before the RBD will be treated as the participant "if the employee's spouse is the sole designated beneficiary as of September 30 of the calendar year following the calendar year of the employee's death", the special rules of Code section 401(a)(9)(B)(iv)(II) are probably intended to apply to a surviving spouse sole beneficiary who survives the participant but dies prior to the designation date. Though not free from doubt, the rule that the life expectancy of a beneficiary who is a beneficiary as of the participant's death but dies prior to the designation date without disclaiming is taken into account for purposes of determining the oldest beneficiary for MRD rule purposes [contained in the paragraph that follows A-4(b) cited above] probably is intended to apply to a surviving spouse who survives the participant but dies before the designation date because that rule is prefaced by the words "For purposes of this A-4". Treas reg 1.401(a)(9)-4, A-4(c). If this conclusion is not correct, distributions in the event that the spouse sole beneficiary died before the designation date would have to be made in accordance with the five-year rule or over the fixed life expectancy of the spouse rather than over the redetermined single life expectancy of the spouse.

b. If the surviving spouse has no designated beneficiary under the plan or IRA.

If the surviving spouse beneficiary of a participant who died before the RBD has not designated a beneficiary and dies before the benefit commencement date (that is, the end of the year in which the participant would have attained 70 1/2), the five-year rule applies and most IRA agreements name the spouse's estate as designated beneficiary (and any contingent beneficiary named by the participant to succeed to the balance of the benefit upon the spouse's death is ignored).

c. If the surviving spouse has designated a beneficiary.

Since the surviving spouse is deemed to be the participant for purposes of the MRD rules, distributions to the beneficiary designated by the surviving spouse must commence on or before the end of the distribution calendar year following the calendar year of the spouse's death (if deferred payments are to be made over the fixed life expectancy of the benefici-

ary) or in full by the end of the fifth distribution calendar year following the calendar year of the spouse's death (under the five-year rule).

d. Balancing deferral and estate/GST tax exposure.

If the objective of the participant and spouse is to defer the distribution of plan benefits for as long as possible, the proactive approach would be to file beneficiary designations for both the pre-RBD participant and for the spouse at the same time when the plan or IRA benefit is established. In the case of an IRA account and in the case of a plan that permits the surviving spouse to withdraw benefits, the plan benefits will be includable in the surviving spouse's gross estate. If estate tax is expected to be payable and other assets of the spouse are insufficient, the spouse's beneficiary designation might provide that a separate share of the spouse's benefit pass to the spouse's estate or a revocable trust.

3. Applicable distribution period if spouse is sole designated beneficiary on participant's death.

The special applicable distribution periods described in paragraphs a and b below that apply to the surviving spouse of a participant who is the sole designated beneficiary of the participant's benefits (or a separate account) will not apply in the case of a participant who dies after the RBD if the use of an applicable distribution period equal to the participant's fixed life expectancy (see paragraph III.B.1.a above) would produce a lower minimum required distribution for any year. Treas reg 1.401(a)(9), A-5(a).

a. Redetermined life expectancy during spouse's lifetime.

Beginning with the distribution calendar year following the participant's death or, if the commencement date is deferred under Code section 401(a)(9)(B)(vi)(II), beginning with the distribution calendar year in which the participant would have attained age 70 1/2 had the participant survived, benefits are to be distributed to a sole surviving spouse designated beneficiary over the spouse's remaining life expectancy, redetermined annually for each distribution calendar year through the calendar year of the spouse's death. Each year's distribution equals the amount of the preceding yearend account balance divided by the years of life expectancy shown on the Single Life Table for the age attained by the spouse in such year (see exhibit C). Treas reg 1.401(a)(9)-5, A-5(c)(2).

b. Fixed term distribution following surviving spouse's death.

Beginning with the distribution calendar year following the calendar year of surviving spouse's death, distributions are to be made to the contingent beneficiaries designated by the participant (or, if the spouse's death occurs before the deferred commencement date for a spouse who has survived the participant's pre-RBD death as described above, those designated by the spouse) over a fixed term "using the age of the spouse as of the spouse's birthday in the calendar year of the spouse's death" (the number of years of life expectancy shown on the Single Life Table) and reducing the years of life expectancy by one year for each calendar year that has elapsed since the calendar year of the spouse's death (treating the year of distribution as having elapsed for this purpose). Treas reg 1.401(a)(9)-5, A-6(c)(2).

c. Can a trust for the benefit of a spouse qualify for the special minimum required distribution treatment?

Treasury regulation 1.401(a)(9)-5, A-7(c) states that a beneficiary may be disregarded (as merely a "successor beneficiary") in determining the identity of a participant's designated beneficiaries if the successor beneficiary would only receive benefits if another (predecessor) beneficiary dies before the entire plan benefit has been distributed to the predecessor beneficiary by the plan.

i. Surviving spouse is not the sole beneficiary of a QTIP trust.

Example 1(iii) of the above regulation comments on the QTIP trust described in the example that qualifies for the look through rules (see section VI below). The example states that, because some amounts distributed from the plan to the QTIP trust (the amounts in excess of the income earned on the plan benefits which income is required to be distributed to the surviving spouse beneficiary of the trust) may be accumulated in the QTIP trust during the spouse's lifetime for the benefit of the QTIP trust's remainder beneficiaries, the remainder beneficiaries are considered to be designated beneficiaries (even though access to the accumulated amounts is delayed until after the spouse's death).

ii. Conduit trust for surviving spouse satisfies the sole beneficiary rule.

Example 2(ii) of the foregoing regulation describes a conduit trust for the surviving spouse's benefit under the terms of which all amounts distributed to the trust by the plan are paid to the spouse (that is, no plan benefits are accumulated in the trust during the spouse's lifetime for the benefit of any other beneficiary). In this case, because the surviving spouse is the sole beneficiary of the trust's interest in the participant's plan benefits, the commencement of minimum required distributions may be postponed until the end of the calendar year in which the participant would have attained age 70 1/2 if the participant died before the RBD under Code section 401(a)(9)(B)(iv)(I). Treas reg 1.401(a)(9)-5, A-7(c)(3), example 2(ii). A conduit trust may result in minimizing the plan benefit received by the surviving spouse under certain circumstances because minimum required distribution commencement is postponed and, when begun, is made over the spouse's redetermined life expectancy (unless plan distributions are accelerated in the trustee's discretion). If the surviving spouse dies prior to the postponed commencement date, minimum required distributions may be made over the fixed life expectancy of the beneficiaries who survive the spouse [assuming that the Code section 401(a)(9)(B)(iv)(II) provision also will apply to a conduit trust].

C. Overriding rollover and "own IRA" elections.

In lieu of taking advantage (or continuing to take advantage) of the special MRD rules described in paragraph B above, a surviving spouse who is a participant's sole beneficiary may, in the case of a plan benefit, and can, in the case of an IRA benefit, instead elect to roll the benefit over to an IRA in the spouse's name or, beginning in 2002, to a plan in which the spouse participates. A spouse may achieve the same result in the case of an IRA by electing (indirectly or, under the 2001 and the final regulations, directly) to treat a participant's IRA as the spouse's own IRA. While not entirely clear from the final regulations, it appears that the position previously advanced in private letter rulings that a pre-age 59 1/2 surviving spouse was required to choose between taking advantage of the special

MRD rules of Code section 401(a)(9)(B)(iv) and, alternatively, rolling over the benefits (or making an "own IRA" election) has been withdrawn. A rollover or own IRA election by the surviving spouse typically will obtain the longest available applicable distribution period because –

(i) If the spouse's RBD has not yet occurred, the commencement of distributions may be deferred until the spouse's RBD.

(ii) Minimum required distributions made during the spouse's lifetime (including the year of the spouse's death) will be measured by the uniform lifetime table.

(iii) If the spouse names younger generation family members (or trusts for their benefit) as beneficiaries of the IRA, the distributions beginning in the year following the spouse's death will be measured by the fixed life expectancy of the younger beneficiaries, effectively "reloading" the life expectancy deferral opportunity.

1. Rollover by surviving spouse.

Under Code section 402(c)(9), a surviving spouse of a plan participant may generally roll over any distribution from the plan which is attributable to the participant to an IRA in the same manner as the plan participant can roll over an eligible rollover distribution under Code section 402(a)(2). Under Code section 408(d)(3)(c)(ii)(II), a surviving spouse beneficiary (and only a surviving spouse beneficiary) may roll over any amount distributed from the IRA to another IRA. A surviving spouse who wishes to roll over to a new IRA in the name of the deceased participant, and thereby preserve the MRD rules that apply to the deceased participant's account under Code section 401(a)(9)(B), may do so (PLR 94180334). In the case of distributions received after December 31, 2001, a surviving spouse may roll over distributions to any "eligible retirement plan" for the spouse's benefit (as defined in paragraph b below).

a. Required minimum distributions may not be rolled over.

In the case of a distribution from a qualified plan, only a "qualified rollover distribution" may be rolled over. Code section 402(c)(4) defines a qualified rollover distribution as any distribution of all or a portion of the balance to the credit of a participant except:

(1) Any distribution which is a series of substantially equal periodic payments (not less frequently than annually) made (i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee or the employee's designated beneficiary, or (ii) for a specified period of ten years or more,

(2) Any distribution to the extent such distribution is required under Code section 401(a)(9), or

(3) After December 31, 2001, any distribution which is made upon hardship.

In the case of a distribution from an IRA, Code section 408(d)(3)(E) provides that no amount that is a minimum required distribution under Code sections 408(a)(6) or 408(b)(3) may be rolled over.

b. EGTRRA update – eligible retirement plans.

Section 641(d) of EGTRRA permits a surviving spouse to roll over all otherwise taxable distributions made from a deceased participant's IRA to an eligible retirement plan (a qualified plan, tax sheltered annuity, or an eligible government section 457 plan that benefits the spouse as well as to the spouse's own IRA). Code §402(c)(9), as amended.

c. Minimum required distributions from the spouse's rollover IRA.

If the surviving spouse rolls the deceased participant's account over to a new or an existing IRA in the spouse's name, the spouse will be deemed to have elected to treat the interest in the IRA as the spouse's own and minimum required distributions will then be determined by applying the rules to the spouse as participant. Treas reg 1.408-8, A-7; PLRs 9450042 and 9534027. If the spouse's RBD has not yet occurred, no distributions from the spouse's IRA are required until that time. If the spouse's RBD has occurred, distributions with respect to the rolled over amount must begin from the spouse's IRA in the calendar year following the year in which the rollover occurred (consistent with the rollover rules described in section II.C.3.c above).

(1) Even if required minimum distributions have commenced prior to the time of rollover from the deceased participant's IRA or plan, the spouse's age, life expectancy, and designated beneficiaries determine the required payout. See PLRs 9005071, 9311037, 9426049, 9450042, and 9534027.

(2) A surviving spouse may roll over a deceased participant's IRA even though the spouse has attained age 70 1/2 and passed the RBD. PLRs 9005071, 9311037, 9450042, and 9534027.

d. Rescue rollovers if surviving spouse is "in control".

The rollover opportunity may enable a spouse to rescue an unplanned situation where there is no designated beneficiary of a deceased participant's IRA or plan and the deferred payment is otherwise foreclosed. For example, where the participant's estate is named (or by default becomes) the beneficiary of IRA or plan benefits, a spouse may roll over the benefits if the spouse is both executor and sole beneficiary of the estate. PLRs 200433026, 8746055, 9351041, 9402023, 9450041, 9533042, 9545010, and 9537030.

(1) Similarly, if a spouse is the trustee of a trust or a subtrust named as beneficiary and has the power to distribute benefits to him/herself, a rollover may be obtained as if the spouse were designated beneficiary. PLRs 200440024, 200245055, 9016067, 9047060,9235058, 9302022, 9401038, 9426049, 9510049, 9533042, and 9608036.

(2) In general, rollovers have been permitted if the spouse can be considered to have received the benefit from the decedent

(rather than from a trust where the spouse's receipt of benefits is subject to a trustee's exercise of distribution discretion). PLRs 9321032 and 9608036. Thus, a spouse's ability to revoke a trust allowed the distribution to be rolled over in Private Letter Rulings 9401039, 9427035, 9423039, and 9515042. Proceeds received as an elective share were rolled over in Private Letter Rulings 200438045 and 9524020. In Private Letter Ruling 200505030, the members of a surviving spouse's family disclaimed all interest in the participant's estate causing plan benefits to pass directly to the spouse and be eligible for rollover.

(3) Treasury regulation 1.408-8, A-5, relating to the "own IRA" election described in paragraph 2 below, requires that, in order for a spouse to make the election to treat an IRA as the spouse's own IRA, the spouse must be the sole beneficiary of the IRA and have an unlimited withdrawal right (a circumstance which the regulations state cannot be satisfied if a trust for the spouse is named beneficiary). It appears, however, that the final regulations were not intended to restrict rollovers by a spouse trustee and sole beneficiary. See PLR 200304037.

e. Direct rollovers - references to "rollover" made above are generic in nature.

Since the enactment of the Unemployment Compensation Amendments Act ("UCA" PL 102-318) in 1992, a traditional rollover from a qualified plan (the receipt by the participant or spouse of qualified plan funds followed by the deposit of those funds to an IRA) results in the reduction of plan distributions by 20% (for income tax withholding) so that it is preferable to instead transfer the plan funds being rolled over by a plan to plan transfer under Code section 401(a)(31) or "direct rollover" (where no withholding applies). Note also that Code section 408(d)(3)(B) allows only one tax free withdrawal to be made from an IRA during a 12 month period, while the frequency of plan to plan transfers is unlimited.

2. Election by surviving spouse to make a deceased participant's IRA the spouse's IRA.

The surviving spouse of a deceased IRA participant who is the sole beneficiary and has an unlimited withdrawal right over the participant's IRA may elect (sometimes referred to in this outline as making an "own IRA" election) to treat the IRA as the spouse's own IRA, regardless whether or not distributions have commenced to the spouse prior to the election. The election may be made at any time after the distribution of the required minimum distribution amount for the calendar year of the participant's death, if any, has been made. As is the case with a spousal rollover, the spouse becomes the IRA participant for purposes of determining minimum required distributions following the election so that the "lifetime" distribution rules of Code section 401(a)(9)(A) apply rather than the Code section 401(a)(9)(B) postdeath rules that apply with respect to the deceased participant. Treas reg 1.401(a)(9)-5, A-5(a).

a. Required distributions for year "own IRA" election is made.

Treasury regulation 1.401(a)(9)-5, A-5(a) states that the required minimum distribution for the year of the election and each subsequent year will be determined by Code section 401(a)(9)(A) with the spouse as the IRA owner. As noted above, the spouse's election can only be made after any required distribution for the calendar year of the participant's death has been made. This rule (which first appeared in the 2001 regulations) would appear to require that a second minimum distribution is required to be made from the deceased participant's IRA for the deceased participant's year of death if a surviving spouse whose RBD has already occurred makes the election in the year of the participant's death. However, the final regulations provide that if the own IRA election is made in the calendar year containing the IRA owner's death, the spouse is not required to take a required minimum distribution for that year as the IRA owner. Instead, the spouse is required to take a minimum distribution determined with respect to the IRA owner to the extent such a distribution was not made before the IRA owner's death.

b. How the "own IRA" election is made.

The final regulations provide for a direct "own IRA" election in addition to the two transactional methods of election contained in the 1987 regulations. The election is made by:

(1) The surviving spouse's redesignation of the account as an account in the name of the spouse as IRA owner,

(2) The failure to distribute from the IRA (or from any IRA to which the account is rolled over) any minimum distribution which would be required to be distributed to the spouse under Code section 401(a)(9)(B) if the account had continued as the deceased participant's account, or

(3) The contribution to the account (or from any IRA to which the account is rolled over) of any amounts by the spouse that would be subject to the "lifetime" Code section 401(a)(9)(A) MRD rules. Treas reg 1.408-8, A-5(b).

As described in paragraph B.2 above, the surviving spouse beneficiary of a participant who dies before the RBD is considered to be the participant for purposes of MRD rule payments of the spouse dies before benefits are required to commence from the participant's account at the end of the year in which the deceased participant would have attained age 70 1/2. If no minimum required distribution has been made by the required commencement date, the surviving spouse will be considered to have made an "own IRA" election and will continue to be the participant with respect to the account. If a minimum required distribution based on the spouse's single life expectancy is made for the year in which the participant would have attained age 70 1/2, the plan or IRA account will be considered to be the participant's account unless an affirmative own IRA election is made (and, absent such an election, distributions following the spouse's death will be made over the spouse's fixed life expectancy rather than over the fixed life expectancies of the beneficiaries named by the spouse).

c. Own IRA election only available if spouse is the individual beneficiary.

The final regulations expressly state that the requirement that the surviving spouse must be the sole beneficiary of the IRA and have an unlimited right of withdrawal from the IRA in order to make an "own IRA" election is not met if a trust is named as beneficiary of the IRA even if the spouse is the sole beneficiary of the trust. Treas reg 1.401(a)(9), A-5(a).

D. Choosing between the alternatives available to a surviving spouse.

Unless the earlier position taken in certain private letter rulings that a sole surviving spouse beneficiary of a participant who dies prior to the RBD must, in certain circumstances, irrevocably choose between receiving minimum required distributions under Code section 401(a)(9)(B)(iv) on the one hand or a rollover or "own IRA" election on the other is revived, the question becomes when (rather than whether) a spousal rollover or own IRA election should be made.

1. Rollover "reloads" the life expectancy deferral opportunity.

As compared to the Code section 401(a)(9)(B) minimum required distribution provisions under which distributions are made over spouse's redetermined life expectancy during the spouse's lifetime and, upon the spouse's death, over the fixed life expectancy of the spouse, a rollover or an own IRA election permits the use of the more generous uniform lifetime table to determine distributions during the spouse's lifetime and, upon the spouse's death, allows distributions to be made over the fixed life expectancy of the spouse's designated beneficiary. The rollover or own IRA election gives the surviving spouse the fresh start ability to name a new designated beneficiary.

2. Planning for a young surviving spouse of a participant who dies prior to the RBD.

If a surviving spouse who has not attained age 59 1/2 is the sole beneficiary of a participant who dies prior to the RBD, the 10% penalty tax that is assessed on premature distributions does not apply due to the exception for beneficiaries of a deceased accountowner. Code §72(t)(2)(A)(ii). In the event of an "own IRA" election or a rollover, the spouse, as the accountowner, would be subject to the 10% premature distributions tax on pre-age 59 1/2 distributions. If the surviving spouse expects to receive distributions prior to attaining age 59 1/2, the surviving spouse would likely defer a spousal rollover or own IRA election until age 59 1/2 is attained.

a. Private letter rulings require a choice.

In Private Letter Rulings 9418034 and 9608042, it was stated that an irrevocable election of the Code section 401(a)(9)(B)(iv) provision would occur at the time a pre-age 59 1/2 surviving spouse first received IRA distributions from a decedent's IRA and failed to pay the 10% early distribution tax that is imposed under Code section 72(t)(1), a tax that would be payable if an own IRA election had been made and a pre-age 59 1/2 distribution had been received by the spouse. In these rulings, the IRS adopted the view that the exception to the early distribution tax for distributions made to a beneficiary on or after the death of the accountowner [Code §72(t)(2)(A)(i)] which clearly applies to distributions received from an account in the deceased accountowner's name under the Code section 401(a)(9)(B) rules does not apply if the surviving spouse has elected to treat the account as the spouse's own IRA (effectively transforming the spouse from a death benefit beneficiary to an ac-

countowner). The failure to pay tax was construed to be an election out of the "own IRA" election option.

b. Rollover to multiple IRAs to obtain penalty free distribution and deferral.

Private Letter Ruling 9842058 approved a rollover of a deceased accountowner's IRA into two IRAs in the spouse's name. One IRA was funded with an amount that was intended to provide periodic distributions to the surviving spouse that were projected to cover the spouse's needs through age 59 1/2. Payments were arranged to satisfy the exception to the 10% tax for a series of substantially equal periodic payments over the life expectancy of the designated beneficiary. Code §72(t)(2)(A)(i) and Notice 89-29 (1981-1 CB 662). In general, once initiated, if periodic payments are terminated or modified before the fifth anniversary of the initial payment or the beneficiary's attainment of age 59 1/2, if later, the 10% tax for all pre-age 59 1/2 payments is assessed with interest. Note, however, that a one time change in the amount of periodic distributions may now be made without incurring the recapture tax. Rev Rul 2002-42 IRB 1. See Revenue Ruling 2002-42 and recent Private Letter Rulings 200432021, 200432023, and 200437038 regarding methods by which periodic payments may be determined. The second rollover IRA would be expected to defer any distributions until the spouse attained age 59 1/2. Periodic distributions from (and measured by the balance of) just one of several IRAs are permitted since the rule that requires all IRAs to be aggregated for MRD rule purposes does not apply for the 10% excise tax purposes.

c. More recent ruling position permits deferred "own IRA" election.

Private Letter Ruling 200110033 expressly reverses this "irrevocable choice" position and affirms that a younger surviving spouse who has received pre-age 59 1/2 distributions as a beneficiary of a deceased accountowner's IRA may subsequently elect to treat the IRA as the spouse's own or roll over the remaining account balance to the spouse's own IRA without having to remit the 10% penalty tax with respect to prior pre-age 59 1/2 distributions. While this ruling predates the final regulations, note that the new regulations are substantially similar to the previously proposed regulations in this respect but now state that the election to treat a deceased individual's entire interest as a beneficiary in an individual's IRA (or the remaining part of such interest if distribution thereof has commenced for the spouse) as the spouse's own account "is permitted to be made at any time after the individual's date of death". Treas reg 1.408-8, A-5(a).

3. Planning for an older spouse of a participant who dies before the RBD.

In the event that the sole surviving spouse beneficiary of a participant who dies prior to the RBD is at least one year older than the participant, a rollover or own IRA election would accelerate the commencement of MRD rule payments because the spouse has an earlier RBD. If the surviving spouse defers a rollover or own IRA election until the end of the calendar year in which the deceased participant would have attained age 70 1/2, no distribution will be required until the calendar year of election or rollover. In the meantime, the surviving spouse may designate a beneficiary to receive the IRA balance over the beneficiary's life expectancy under Code section 401(a)(9)(B)(vi)(II) should the spouse die prior to the election or rollover being made (thus producing the same deferral, upon the spouse's death, that would be obtained if the account had been rolled over).

V. IRA AND QUALIFIED PLAN PROVISIONS

A. Overview.

If qualified plan or IRA benefits are not made payable to a trust, the plan or IRA agreement and beneficiary designation will control the disposition of these benefits not only upon the participant's death but also upon the death of any designated individual beneficiary who survives the participant. Most existing plan and IRA agreements (sometimes referred to as "inside trusts") do not include provisions that effectively deal with the dispositive contingencies (such as a beneficiary's untimely death, an unexpected order of deaths, or a beneficiary's incapacity) that a client's "outside trust" routinely covers.

1. Agreements conforming to final regulations.

As noted in paragraphs ID3b(3) and (4), the deadline for revising existing IRA agreements has now passed (10/01/02) and the deadline for qualified plan amendments was the last day of the plan year that begins in 2003. It was expected (or hoped) that amendments made to conform plan and IRA agreements to the provisions of the final regulations would include specific administrative guidance regarding window period planning options such as establishing separate accounts for differing designated beneficiaries and the disclaimer of benefits as well as guidance for establishing separate accounts for non MRD rule purposes such as separate investment management. For the most part, updated IRA agreements do not include such guidance.

2. Oversight required to integrate estate planning.

In the case of clients who have substantial assets, most estate planners seek to integrate all of the client's (or married couple's) assets into a comprehensive estate plan that will provide for the disposition of those assets through a central vehicle (a revocable trust or will) which, by formula, will allocate the client's assets among trusts for the client's surviving spouse and descendants in a manner intended to minimize estate and GST taxes. Often the client's assets are ultimately to be transferred to continuing trusts for descendants which, by providing for independent trustees with the power to make discretionary trust distributions or by providing ascertainable standards for trust distributions:

(a) Protect the assets from a descendant's creditors (including divorcing spouses),

(b) Shelter the assets from estate tax on a descendant's death,

(c) Provide asset management guidance and the budgeting of distributions to assure lifetime support, and

(d) Provide a coherent plan for transmitting those assets to lower generation beneficiaries.

To the extent that the estate plan provides for the separate disposition of specific assets (such as IRA and plan benefits), the estate planner must monitor the value of each asset and know the rules that apply to its disposition to assure that the overall estate plan is not jeopardized.

B. IRA agreement provisions.

All IRA agreements either incorporate the final regulations by reference or state that the IRA will be administered, in all respects, in accordance with the final regulations. The absence of an express provision in an IRA agreement does not necessarily mean that the administrative option is foreclosed. However, discussions with the IRA provider and the submission of a customized beneficiary designation will likely be indicated.

1. Participant designates primary and contingent beneficiaries as of participant's death.

Beneficiary designation forms for IRA agreements typically provide entry lines for one or more "primary beneficiaries" and one or more "contingent beneficiaries". The named contingent beneficiaries are entitled to receive benefits only if none of the primary beneficiaries survive. If a primary beneficiary predeceases the participant, the remaining primary beneficiaries (or, if none, the contingent beneficiaries) share the benefits. Unless a customized beneficiary designation is filed and accepted by the plan sponsor that characterizes the contingent beneficiaries as "successor beneficiaries", any interest of the contingent beneficiaries named by the participant in the IRA benefits ceases upon the participant's death if one or more primary beneficiaries survive the participant (regardless whether the surviving primary beneficiary dies prior to or following the MRD rule designation date).

2. The surviving beneficiary usually names successor beneficiaries.

Under many IRA agreements, a beneficiary who survives the participant has the right to designate the primary and contingent beneficiaries who will receive the IRA benefits upon the beneficiary's death. Under a few IRA agreements, the participant has the express power to name successor beneficiaries and, if the participant stipulates a beneficiary to receive the IRA benefits upon a beneficiary's death, the participant's designation takes precedence over the deceased beneficiary's designation.

3. On beneficiary's death, the default beneficiary is beneficiary's estate.

If no beneficiary designation has been filed by a deceased beneficiary who has survived the participant (and no designation of successor beneficiaries, if applicable, has been made by the participant), most IRA agreements provide that the plan benefits are payable to the beneficiary's estate.

a. Minimum required distributions not accelerated.

Under the MRD rules, if the deceased beneficiary is the only beneficiary (and is not the surviving spouse of a participant who died prior to the RBD) or the deceased beneficiary is the oldest named beneficiary, distributions, beginning in the calendar year following the participant's death, would be made over the single life expectancy of the deceased beneficiary. See paragraph III.D.1 above.

b. Beneficiary's beneficiary designation desirable.

Although minimum required distributions are not accelerated if the beneficiary's estate is the default beneficiary of a deceased beneficiary designated by the participant and the IRA account can be divided and assigned to the estate beneficiaries, probate avoidance and the risk of an unintended intestate succession can be avoided if the surviving beneficiary files a beneficiary designation.

4. Provisions for surviving spouses.

Most IRA agreements include the special provisions that apply to a participant's surviving spouse described in section IV above and permit the surviving spouse to designate successor beneficiaries on the surviving spouse's death. Because the maximum stretch out of benefit payments can typically be obtained by a surviving spouse's rollover to the spouse's own IRA or an own IRA election (for the reasons outlined in paragraph IV.C above), a decision will often be made to name the participant's spouse (directly or via post-death disclaimers) as the sole designated beneficiary of all or a portion of the participant's plan or IRA benefits. The spouse's failure to file a beneficiary designation with respect to the inherited IRA will likely sabotage the hoped for extended applicable distribution period.

a. Risk of five-year rule applying.

Under most IRA agreements, the default beneficiary of a surviving spouse who survives the participant and then dies is the spouse's estate. If a surviving spouse of a participant who has died before the participant's RBD subsequently dies without having named a beneficiary, the five-year rule will apply. If the surviving spouse has made an own account election or rolled the benefits over to the spouse's own IRA and the surviving spouse's RBD has not occurred, the five-year rule will similarly apply if no beneficiary designation has been made by the spouse.

b. Payment over spouse's (or participant's) fixed life expectancy.

If the surviving spouse of a participant who has died after the participant's RBD survives the participant and dies without having made a beneficiary designation, distributions beginning in the year following the spouse's death, will be made to the spouse's estate over the longer of the spouse's or the deceased participant's life expectancy. If the surviving spouse has rolled over the benefits or made an own account election, distributions will be made to the spouse's estate over the fixed life expectancy of the spouse. In either case, the opportunity to take advantage of a younger beneficiary's fixed life expectancy is lost.

c. Durable powers of attorney.

Most IRA agreements provide, directly or indirectly, for the recognition of an authorized agent acting under a durable power of attorney. The submission of a power that authorizes the agent to make an own account election, to initiate rollover transfers, and to designate beneficiaries (either in all events or only in the event of the surviving spouse's incapacity) may increase the potential that the deferral objectives will be accomplished.

5. Planning and presumption provisions.

An "inside" trust is not an "outside" trust but may or may not include some of the definitional and presumptive provisions commonly included in a revocable or irrevocable trust that is part of an estate plan. Some IRA agreements define the meaning of "per stirpes" as either traditional descent by right of representation or as being by right of representation if at least one senior generation member survives but per capita among the next generation members if no senior generation members survive. Some IRA agreements include a presumption of survivorship in the event of a common disaster or refer to the law of the participant's domicile. Few IRA agreements include specific provisions regarding disclaimers by beneficiaries (notwithstanding the endorsement of window period disclaimers in the final regulations). Accordingly, facilitating or presumptive provisions often must be incorporated in the participant's or beneficiary's beneficiary designation.

C. Qualified plan provisions.

Because qualified plans are not generally available to the public, it is difficult to anticipate what changes (other than the mandated changes described below) may be made in response to the final regulations. Plan administrators and participants are usually best served if plan benefits can be rolled over to an IRA during the participant's lifetime or by a surviving spouse after the participant's death. CAVEAT: qualified plans that include securities of the employer sponsor distributed as part of a lump sum receive special benefits and employees born before 1936 may be eligible for special income tax averaging.

1. Model amendment for defined contribution plans.

The IRS has published a model amendment that, if timely adopted, will satisfy the requirement that qualified plans be amended for the MRD rules. Rev Proc 2002-29, 2002-24 IRB 1176 (05/28/02). The model amendment presents a detailed description of the pre and post-death MRD rules for the distribution of benefits and includes a statement that "All distributions required under this article will be determined and made in accordance with Treasury regulations under section 401(a)(9) of the Internal Revenue Code". While the September 30 designation date is thus specified, no reference to beneficiary disclaimers or the creation of subaccounts is made.

2. Elimination of plan deferred payment options.

Under the anti-cutback rules of Code section 411(d)(6), any change made to a defined contribution plan's benefit payment options, even changes made to eliminate little used or administratively burdensome options (such as providing for payments in the form of an annuity as a payment option when the plan is not required by the joint and survivor annuity rules to do so) was until recently viewed as a prohibited reduction of participants' benefits. Final Treasury regulations, promulgated on August 31, 2000, increased the ability of employers to make such amendments if participants, upon notice, consented. Treas reg 1.411(d)-4, A-2(e)(1). EGTRRA, except to the extent provided in future regulations permits a plan sponsor to eliminate benefit options previously available as long as an equivalent single sum distribution option is available to participants at the same time and with respect to the same (or a greater portion) of the benefits to which the benefit distribution option eliminated related. Code §411(d)(6)(D), as amended. Final regulations regarding permitted changes in plan benefit options were published on August 11, 2005. Treas Reg 1.411(d)-3.

(a) A participant or surviving spouse may obtain installment distributions under the MRD rules by rolling a single sum distribution over to an IRA. However, non spouse beneficiaries (who have no rollover option) would be able to obtain deferred distributions only if the participant or a surviving spouse has received a pre-death single sum distribution and established an IRA before death.

(b) Of course, the elimination of deferred payment options will not eliminate a surviving spouse's right to death benefits if the plan is a money purchase pension plan. Only a rollover by a participant, if available, made pursuant to a waiver of spousal benefits with spousal consent can eliminate the survivor benefit rules' application in that type of plan.

VI. RULES FOR NAMING TRUSTS AS BENEFICIARIES

A. Qualifying a trust for the "look through" rules.

As an exception to the rule that the naming of a nonindividual as the (or one of the) beneficiaries of a deceased participant results in the participant being treated as having no designated beneficiary for purposes of the MRD rules, the beneficiaries of a trust will be treated as the designated beneficiaries of the participant if the trust meets four regulatory requirements. Treas regs 1.401(a)(9)-4, A-5 and A-6. The final regulations confirm the position taken in Revenue Ruling 2000-2 (2000-1 CB 305) that a testamentary trust may qualify for look through treatment. Treas reg 1.401(a)(9)-5, A-7(c)(3), Example 1. Except for the change in the time at which the requirements must be met, the four requirements are substantially the same as those of the 1987 regulations as amended on December 30, 1997 (62 FR 67780).

1. The four requirements.

In order to treat a trust beneficiary as the participant's designated beneficiary for purposes of the look through rules:

(a) The trust must be a valid trust or would be a valid trust under state law if it had a corpus,

(b) The beneficiaries of the trust entitled to the plan or IRA benefits must be identifiable,

(c) The trust must be either irrevocable or, by its terms, will become irrevocable at the participant's death, and

(d) The documentation requirements described in paragraph 2 below must be satisfied. Treas reg 1.401(a)(9)-4, A-5.

If the beneficiary of a trust is another trust, the beneficiaries of the other trust will be treated as the participant's designated beneficiaries if the four requirements are satisfied with respect to that trust as well. Treas reg 1.401(a))9)-4, A-5(d).

2. Documentation requirements.

The documentation requirements remain the same as those under the 1987 regulations (as amended in late 1997). However, the fact that the RBD is no longer the date as of which the designated beneficiary is determined changes the time at which the requirements must be satisfied.

a. After death requirements.

By October 31 of the calendar year immediately following the calendar year in which the participant died (one month after the designation date), the trustee of the trust must either provide the plan administrator (or IRA trustee or custodian) with:

(1) A copy of the trust agreement of the trust named as beneficiary or

(2) A list of all beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions of their entitlement) and

(i) Certify that, to the best of such trustee's knowledge, the list is correct and complete,

(ii) Certify that the three nondocumentation requirements listed in paragraph 1 above (paragraphs a, b, and c) are satisfied, and

(iii) Agree to provide a copy of the trust agreement to the plan administrator upon demand. Treas regs 1.401(a)(9)-1, A-4(c) and 1.408-8, A-11.

b. One time opportunity to cure defective documentation – October 31, 2003 deadline.

If a trust has failed to provide a copy of the trust document (or a list of beneficiaries) under the proposed regulations' deadlines, the beneficiaries of the trust will nonetheless be treated as designated beneficiaries if such documentation was provided to the plan administrator by October 31, 2003.

c. Lifetime minimum required distributions – trust for ten years younger spouse.

In the case of a conduit trust for a spouse more than ten years younger than the participant that is named as beneficiary for a year in which the participant is living, in order to obtain a joint life expectancy distribution period, the trustee of the trust must provide all of the information described in paragraph a above and must additionally agree that, if the trust agreement is amended during the participant's lifetime, a copy of the amendment or corrected certification, if the amendment changes the information certified, must be furnished to the plan administrator within a reasonable time. Under the 1987 regulations, documentation was required to be furnished by the later of the participant's RBD or the date as of which the trust was named beneficiary. The final regulations do not specify a deadline but presumably the documentation would be required to be delivered prior to the calendar year in which a joint life expectancy distribution is to be made (or, perhaps, prior to the RBD in the case of the first and second distribution calendar years).

B. Identifying the look through designated beneficiaries.

Except in the case of a conduit trust for the benefit of a surviving spouse of a participant who dies before the participant's RBD discussed in sections II.D.2 above and IV.B.3.c above, minimum required distributions must be made, beginning with the calendar year following the calendar year of the participant's death, over the life expectancy of the oldest trust beneficiary determined as of the designation date. If the primary trust beneficiary (for example, the participant's spouse) is not the oldest beneficiary (for example, because a parent of the participant becomes a trust beneficiary if living on the spouse's death), the applicable distribution period will be shorter. If there is no designated beneficiary on the designation date because one or more of the trust beneficiaries required to be taken into account is a nonindividual (or trust funds may be paid after September 30 of the calendar year following the participant's death to or for the benefit of the participant's estate to cover taxes and expenses), minimum required distributions to the trust will be made by the end of the fifth calendar year following the year of the participant's death (if the participant dies

before the participant's RBD) or over the participant's remaining fixed life expectancy (if the participant dies after the participant's RBD).

1. Applying the designated beneficiary definition to trust beneficiaries – in general.

The final regulations, in the provision that authorizes the look through rules for trusts, state that the beneficiaries of a trust that is named as the beneficiary of plan benefits will be treated as having been designated as beneficiaries of the participant under the plan for purposes of the MRD rules. Treas reg 1.401(a)(9)-4, A-5. Question A-5 speaks of "the beneficiaries of the trust with respect to the trust's interest in the participant's benefit" as being the look through beneficiaries so that a trust agreement may presumably provide that less than all of the trust's beneficiaries have an interest in the trust's interest in the benefits and exclude from consideration those beneficiaries who do not have such an interest. However, see paragraph 9 below re applying the separate share rules to trusts.

2. Disregarding contingent beneficiaries – death contingency nontrust rules.

The 1987 regulations provided that, in the case of a series of successive individual beneficiaries:

> "If a beneficiary's entitlement to an employee's benefit is contingent on the death of a prior beneficiary, such contingent beneficiary will not be considered a beneficiary for purposes of determining who is the designated beneficiary with the shortest life expectancy under paragraph (a) or whether a beneficiary who is not an individual is a beneficiary." Former prop Treas reg 1.401(a)(9)-1, A-5(e)(1).

a. 2001 regulations.

The 2001 regulations modified the definition of a disregardable contingent beneficiary to clarify that a contingent beneficiary may be disregarded "only if another beneficiary dies before the entire benefit to which that other beneficiary is entitled has been distributed by the plan". Treas reg 1.401(a)(9)-5, A-7(c)(1). The premise in a nontrust setting is that if plan benefits are to be distributed over the life expectancy of a beneficiary, the beneficiary will receive all of the benefits from the plan if the beneficiary lives out the life expectancy period. The contingent beneficiary may be disregarded under this rule only if the premature death of the predecessor beneficiary is the sole circumstance under which the contingent beneficiary will receive benefits. See Treas reg 1.401(a)(9)-5, A-7(c)(3), example 1.

b. Final regulations.

The final regulations generally state that, if a beneficiary's entitlement to a participant's benefit after the participant's death is a contingent right, such contingent beneficiary shall nonetheless be considered a designated beneficiary in determining the identity of the oldest designated beneficiary or whether there is a nonindividual beneficiary. A person will not be considered a beneficiary for purposes of identifying the oldest (or a nonindividual) beneficiary merely because the person could become a successor to the interest of one of the participant's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to a participant's benefit beyond being a mere potential successor to the interest of one of the participant's beneficiaries upon that beneficiary's death. Treas reg 1.401(a)(9)-5, A-7(c).

3. Disregarding contingent trust beneficiaries – death contingency in a trust setting.

The final regulations state:

"Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries." Treas reg 1.401(a)(9)-5, A-7(c)(1).

By analogy to the foregoing broadly worded rule applicable to participant's account, if a trust named as beneficiary allows plan or IRA benefits that are received from a participant's account to be accumulated in the trust for payment in the future to beneficiaries other than the trust's current primary beneficiary, all such future beneficiaries must presumably be taken into account.

a. The "normal" meaning of "contingent" does not apply.

The future trust beneficiaries are taken into account under this view even though the successor beneficiaries will not benefit in the future unless and until they, in fact, survive the initial designated beneficiary. Note that the possibility that the benefits will be completely distributed to a predecessor beneficiary (for example, by exercise of trustee discretion) is not considered to be relevant.

b. Charities as remainder beneficiaries.

In Private Letter Ruling 9820021, the plan benefits of a participant who died prior to the RBD were payable to a marital trust that was to pay all income to the spouse together with principal invasions under an ascertainable standard. Charitable organizations were named as remainder beneficiaries. The five-year rule applied to the marital trust to determine the payment of benefits upon the participant's death due to the fact that there was no designated beneficiary because the charities were deemed to be "entitled" to trust benefits and were thus taken into account in the designated beneficiary determination. In effect, the primary beneficiary's death affected only the timing of the receipt by (rather than the actual entitlement of the charities to) the benefits.

4. Identifying all trust beneficiaries.

As illustrated by the final regulations' examples concerning the circumstances under which a surviving spouse of a participant can be considered to be the sole beneficiary of a trust (discussed in paragraph IV.B.3.c above), the fact that a trust does not require the distribution of the plan benefits it receives to the spouse as the oldest beneficiary and may instead hold the benefits for distribution to other trust beneficiaries after the spouse's death prevents the remaining trust beneficiaries from being disregarded under the death contingency provision even if the trust were to require that no distributions of plan benefits could occur to a successor trust beneficiary until the primary beneficiary died. In the terminology of the 2001 regulations, the predecessor (or primary) beneficiary of a trust is not entitled to the benefits distributed by the plan and successor trust beneficiaries can therefore not be disregarded as contingent beneficiaries.

a. The erratic evolution of rules to permit certain contingent trust beneficiaries to be disregarded.

The elliptical provisions of the final regulations have done little to advance the search for a bright line test under which contingent trust beneficiaries can be eliminated from the pool of beneficiaries that must be considered in order to determine the measuring life for MRDs. As had been the case under previous regulations, practitioners are forced to attempt to discern guidelines from private letter rulings – a difficult task due to the brevity of the factual descriptions often provided, the focus of the discussion on the particular issues identified by the requesting taxpayer, and the fact that the negotiated resolution of other issues not described in the ruling may have influenced the outcome.

(1) The emerging rule appears to be that if there are younger contingent beneficiaries who have an unrestricted right to receive the trust assets (including IRA and plan benefits) upon the trust's termination at the time of the initial beneficiary's death, further contingent beneficiaries may be disregarded. In other words, the possibility that the younger beneficiaries may not survive until the trust's termination may be ignored and the actuarial likelihood of the younger beneficiaries' survival will serve to cut off successor beneficiaries to them.

(2) Until such time as the rules for disregarding contingent beneficiaries are promulgated in a revenue ruling or amended regulations, conservative practitioners will recommend the use of conduit trusts (the only vehicle that clear circumscribes the pool of potential designated beneficiaries).

(3) If the developing bright line test described in the private letter rulings below is employed, it is advisable to nonetheless limit the successor beneficiaries which the test appears to exclude (i) to individual beneficiaries younger than the initial beneficiaries intended to be the measuring lives for MRD purposes and (ii) to permit the disinterested trustees of the trust to disclaim plan and IRA benefits in favor of the initial current trust beneficiaries as a safety valve in the event that the bright line test has changed at the time of the participant's death.

b. Disregarding identified younger beneficiaries – The Example 1 "flat earth" trust.

In example 1 of Treas reg 1.401(a)(9)-5, A-7, the surviving spouse is considered to be the oldest designated beneficiary because the trust remaindermen (the children) who will succeed her when the trust terminates upon her death are all younger than the spouse. The example stipulates that no other person has a beneficial interest in the trust. The lack of alternative trust provisions that would apply if the remaindermen should fail to survive the surviving spouse has caused the example 1 trust to be dubbed the "flat earth" trust by commentator Virginia Coleman of Boston. In the absence of additional trust dispositive provi-

sions, were the children to predecease the surviving spouse, the trust assets (including the plan benefits) would become payable to the spouse's estate or the children's estates depending on state law. The fact that an estate might potentially be a successor to the trust beneficiaries' interests in example 1 (and cause the participant to have no designated beneficiary if that ultimate disposition were taken into account) was not discussed implies that the ultimate disposition of trust property upon an exhaustion of trust beneficiaries will be disregarded in determining the oldest designated beneficiary.

c. The actuarial approach - if a trust is to terminate within the life expectancies of identifiable beneficiaries, may certain successor beneficiaries be disregarded?

But for the fact posited in example 1 that there are no cleanup beneficiaries, example 1 is consistent with earlier private letter rulings based on an "actuarial" approach. In Private Letter Ruling 9846034, the exception to the five-year rule applied to allow distributions payable to a trust named as beneficiary to be made over the spouse's (oldest current beneficiary's) fixed life expectancy following the participant's death. The trust, a QTIP trust, was to continue for the spouse's lifetime and, on the spouse's death, was to terminate and make outright distributions to the spouse's descendants.

(1) The "cleanup" beneficiaries who would have benefited only if the children successor beneficiaries failed to survive their mother (which, if the children lived out their life expectancies, the children would clearly do) were ignored as "contingent" beneficiaries within the meaning of former proposed Treasury regulation 1.401(a)(9)-1, E-5(e)(1). The cleanup beneficiaries in this instance were the participant's heirs at law (and thus might have included the participant's siblings who, if not disregarded, might have been older than the participant's surviving spouse).

(2) As a result, in what appeared to be an actuarial analysis, this ruling seems to say that if a look through beneficiary who lived out his or her life expectancy would receive from the trust all of the plan or IRA benefits if such beneficiary would survive an older predecessor beneficiary based on normal life expectancy assumptions, any successor beneficiaries who are older than the predecessor younger successor beneficiary could be disregarded. While the existence of the trust means that the life beneficiary will not receive all of the plan or IRA benefits, the fact that the remainder beneficiaries need only survive to receive them effectively makes all subsequent beneficiaries mere successors.

(3) It is not clear whether the fact that the flat earth trust of Example 1 had no named clean up beneficiaries is material to the result. Thus, the result in Private Letter Ruling 9846034 may (or may not) continue to apply.

(4) If a primary beneficiary has a withdrawal right, the beneficial interests of future, contingent beneficiaries would also presumably be disregarded. PLR 199903050.

d. It cannot be assumed that a beneficiary will survive to a stated age.

In Private Letter Ruling 200228025 (issued under the proposed 2001 regulations), a discretionary trust was established for the participant's two minor grandsons with each grandson having the right to withdraw his entire share at age 30. If either grandson should die before attaining age 30, the surviving grandchild beneficiary would receive all of the trust's distributions and, if both the beneficiaries should die before attaining age 30, contingent beneficiaries (including an aunt who was age 67 at the time of the participant's death) would receive the trust benefits. In holding that the 67 year old beneficiary must be taken into account, the ruling states that:

"In this case, the discretion the trustee of Trust X has with respect to the payment of trust amounts to the Grandchildren, who are the primary beneficiaries, is a contingency over and above the death of a prior beneficiary."

(1) While this ruling appeared to be inconsistent with an actuarial analysis in Private Letter Ruling 9846034, the grandson beneficiaries must do more than merely survive to obtain the full amount of the IRA benefits (that is, attain age 30).

(2) Contrast this result with the snapshot approach discussed below.

e. Disregarding contingent beneficiaries under the "snapshot" approach.

In Private Letter Ruling 200438044, the number of potential contingent see through beneficiaries required to be taken into account was limited in the case of a QTIP and a credit shelter trust created upon the participant's death for the benefit of the surviving spouse. During the spouse's lifetime, each trust was to pay income to the spouse with discretionary principal invasions for the spouse's welfare. Upon the spouse's death, the trust assets were to be held in separate trusts for the participant's descendants, per stirpes, with each descendant's trust to terminate when the descendant attained age 30, distributing the trust assets (including the trust's interest in IRA benefits) outright. At the time of the participant's death, he was survived by three children each of whom had attained age 30.

(1) The idea of the snapshot approach is to analyze the beneficiaries' status as look through beneficiaries by assuming that the primary beneficiary (or the current income beneficiaries or permissible distributees) died at the time the snapshot is taken (here, at the time the trust was established upon the participant's death).

(2) In PLR 200438044, the Service concluded that each of the three age 30 children had an "unrestricted right to a portion of the remainder interest" because, if the spouse's interest

were terminated on the snapshot date, the descendants' trust would immediately terminate and distribute outright. Thus, any lower generation descendants who might receive an interest in the trust assets should any of the age 30 children in fact predecease the spouse are ignored.

(3) The snapshot approach is consistent with the private letter rulings described in paragraphs c and d above in that, if successor beneficiaries need only survive in order to receive the IRA benefits outright, further successor beneficiaries may be disregarded.

f. Trusts that defer termination for minor beneficiaries.

If the foregoing test is to be relied upon to disregard beneficiaries who might succeed a participant's children upon a trust termination, take care that the trust agreement's normal trusts for minors provision (which allows the trustee to extend the trust beyond its otherwise scheduled termination date at the time of the initial beneficiary's death – for example the surviving spouse's death) do not apply if plan or IRA benefits are paid to the trust.

g. Can any trust beneficiary, however remote the interest, be disregarded if trust termination is deferred?

In the case of trusts intended to continue for the rule against perpetuities period (or indefinitely), may remote contingent beneficiaries (charities or the participant's heirs at law determined under the state of domicile) that might benefit under a clean up clause or failure of issue situation be disregarded under any circumstances? This question as of yet has not been answered by any published ruling.

(1) The principal purpose of the quest under the look through rules to identify the oldest beneficiary and foreclose non-individual recipients is to prevent any individual beneficiary or any entity from receiving the benefits over an applicable distribution period that is longer than the applicable distribution period that would be available to that individual or entity were there no trust involved.

(2) If the trust agreement's terms limit the pool of beneficiaries that may ultimately receive trust distributions to the oldest individual beneficiary and individuals who are younger than that oldest individual whose measuring life is intended to determine the applicable distribution period, the purpose of the look through rules would appear to be served regardless how long the trust remains in existence before ultimately making distributions to beneficiaries upon termination. Trusts designed to limit beneficiaries in this matter have been variously referred to as "last man standing trusts", "circle trusts", or "individuals only trusts". See the discussion in paragraph VII D 2 below.

(3) On May 27, 2003, the Employee Benefits Committee of the American College of Trusts and Estate Counsel

(ACTEC) submitted a request for further published guidance to the IRS regarding the distinction between a "contingent beneficiary" and a "successor beneficiary" under Treasury regulations 1.401(a)(9)-5, A-7(b) and (c). The submission poses six fact settings involving plan and IRA benefits payable to a trust, discusses the existing regulatory and private letter ruling guidance, presents suggested (and alternative) results, and requests that the IRS publish guidance. Due to existing IRS guidance projects and the need to issue guidance regarding the extensive legislation recently enacted, it is not expected that a response to this request for guidance will be on a fast track.

5. Are the potential beneficiaries of unexercised powers of appointment taken into account?

If a beneficiary holds a broad nongeneral power of appointment (which could be exercised in favor of older or nonindividual beneficiaries), the IRS will likely take the position that such hypothetical appointees must be counted as beneficiaries. While the meaning and scope of Treasury regulation 1.401(a)(9)-5, A-7(c) is far from certain, private letter rulings involving trusts containing powers of appointment (for example, in Private Letter Rulings 19993050 and 199918065) have not often involved a discussion of the issue.

a. Limiting permissible appointees.

In Private Letter Rulings 200235038-041, the existence of special powers of appointment held by children that limited permissible appointees to individuals no older than the oldest child was stipulated as a fact in a ruling that permitted the oldest child's measuring life to determine the maximum payout period. In Private Letter Ruling 200235088, a special power's permissible distributees were limited to all individuals of the same age or younger than the powerholder. The ruling effectively concluded that this group represented a class of identifiable beneficiaries.

(1) If beneficiaries at different generational levels hold (or will potentially hold) powers of appointment, the permissible appointees of which are to be limited to individuals no older than the oldest beneficiary intended to be the measuring life for MRD purposes, reference should be made to the oldest current beneficiary of the trust or any predecessor trust (income beneficiary or permissible distributee) who is living at the time of the participant's death and who has not disclaimed benefits under the trust as of the participant's designation date nor received a full distribution (cash out) of trust benefits by that time.

(2) Typically, the limiting of permissible appointees will involve excluding nonindividual beneficiaries and spouses of descendants who may be older than the current oldest beneficiary who holds the power of appointment. If eliminating older spouses may distort the dispositive plan, the permissible appointees could be limited to individuals a

certain number of years older than the oldest descendant (say, five years) without sacrificing much of the stretch out in distributions if the oldest beneficiary is a child of the participant.

b. Disclaiming a special power.

In Private Letter Ruling 200438044 discussed in paragraph 4.e above, the surviving spouse disclaimed a special power of appointment exercisable in favor of the participant's lineal descendants and their spouses. The ruling does not discuss the disclaimer but the fact that a descendant's spouse could, in theory, be older than the surviving spouse probably made the disclaimer a relevant fact in the holding.

c. GST nonexempt trusts.

In the case of generation skipping transfer (GST) tax nonexempt trusts, practitioners often include provisions intended to cause the inclusion of trust assets in a beneficiary's taxable estate. These inclusionary provisions are motivated by the goal of reducing the transfer tax rate applicable to the nonexempt property (applying the lower estate tax rate instead of the maximum GST tax rate) and of permitting the deceased beneficiary's executors (if the beneficiary's taxable estate is less than the beneficiary's unused GST exemption amount for the year of the beneficiary's death) to allocate GST exemption to the included GST non-exempt trust assets. These provisions may grant the beneficiary a power of appointment exercisable in favor of the beneficiary's probate estate (only exercisable with the consent of a disinterested trustee) or give a disinterested trustee the power to grant such a power to the beneficiary.

(1) If the power of appointment is intended solely for GST tax purposes, an alternative would be to grant the beneficiary a withdrawal right, exercisable only with the consent of a disinterested trustee. Such a withdrawal power would cause inclusion under IRC §2041 but would eliminate potential older and nonindividual beneficiaries.

(2) Now that the estate tax and GST tax rates are converging, the existence of the nonexempt trust general powers may be less important as a planning strategy in many cases.

6. Use of benefits to pay estate expenses.

The IRS has implied that a participant may have no designated beneficiary if the participant's estate may receive (or indirectly benefit from) the use of plan or IRA benefits payable to a deceased participant's revocable trust if trust assets may be used to pay estate expenses of the deceased participant. Private letter rulings point out that the absence of a provision permitting such a use of trust funds is a favorable factor when allowing look through treatment for trusts named as beneficiary. See PLRs 9809059, 9820021, 199912041, and 200010055. Payments made from plan or IRA benefits for estate taxes or estate expenses are arguably not payments to a beneficiary at all but rather payments to creditors to which the benefits may be legally (and are equitably) subject. Even in the case of a nontrust beneficiary, benefits may be required to be paid for estate expenses. If a trust agreement provides that plan and IRA benefits payable to the trust may not be utilized to

pay estate expenses on or after September 30 of the calendar year following the participant's death, the fact that benefits may be so applied prior to the designation date should arguably not cause the participant's estate to be a beneficiary on the designation date. Recent private letter rulings may indicate that the IRS is taking a flexible position on such clauses.

a. Payment of estate expense by a trust prior to the designation date.

In PLRs 200432027-029, the trustee of a trust named as an IRA beneficiary withdrew IRA funds to pay estate, last illness, funeral, burial, administrative expenses, and estate taxes prior to the designation date. The trust did not contain a clause restricting post-designation date withdrawals to pay expenses. The taxpayer's representative apparently asserted that all expenses were covered by the withdrawals. The ruling holds that, because the withdrawals to pay expenses were made prior to the designation date, the participant's estate was not a beneficiary of the trust. The Service also noted that the remote possibility that the trust assets may be required to pay further estate taxes did not change the conclusion. The representative stated that any additional estate taxes would be paid first from other estate assets and the IRA would be tapped only if there were no other estate assets in which case, "your authorized representative asserts that such payment is required by Code §6324(a)(2)."

b. State law creditor protection.

In PLR 200433019, two IRAs named a trust for the benefit of an only child as beneficiary. The trust authorized the trustee to pay the decedent's debts, expenses, estate and inheritance taxes, and administration expenses but provided that no such expenses were to be paid from assets that were exempt from creditors' claims under applicable state or federal law. No IRA assets were used to pay any of the expenses. The Service agreed that state courts would rule that the IRAs were exempt from creditor's claims and concluded that the participant's estate was not a trust beneficiary.

c. State law creditor protection with actual expense payment.

PLR 200440031 produces a puzzling but taxpayer favorable result. A trust named as beneficiary of two retirement plans expressly permitted the use of plan funds to pay taxes, administrative expenses, and funeral expenses. State law protected that plan assets from creditors' claim but a state court ruled that the plan assets should be used to pay estate expenses in the absence of other assets. However, the Service ruled that the use of plan assets to pay estate expenses did not make the estate a beneficiary of the trust for MRD purposes, and recognized the oldest trust beneficiary as the measuring life for MRD distributions.

7. Dynasty trusts and an expanding class of beneficiaries.

A beneficiary need not be specified by name in the plan or by the participant in order to be a designated beneficiary as long as the individual who is to be the beneficiary is identifiable under the plan as of the date the beneficiary is to be determined. Treas reg 1.401(a)(9)-4, A-1. The members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible, as of the date the beneficiary is determined, to identify the class member with the shortest life expectancy. Does a class of trust beneficiaries defined as "all of my descendants now living or hereafter born" set forth in a trust that will continue for a period equal to rule against perpetuities (or indefinitely in

jurisdictions that permit) constitute a group of identifiable beneficiaries? Under the death contingency beneficiary rules as they appear to be presently interpreted by the IRS, no descendant could be disregarded because no predecessor beneficiary will necessarily receive the benefits involved. Accordingly, it appears that the exercise of discretionary trustee distribution authority and beneficiary held powers of appointment would need to be limited to the beneficiaries (or classes of beneficiaries) that are taken into account for purposes of determining the trust beneficiary who is treated as the designated beneficiary for payout period determination purposes.

8. Section 645 election.

Under Code section 645, the executor of a participant's estate (if any) and/or the trustee of a participant's qualified revocable trust can elect for the trust to be treated as and be subject to income tax as a part of the participant's estate (rather than as a separate trust). The election, if made, applies for purposes of the Subtitle A income tax of the Code, which include the minimum required distribution rules. While the impact of a section 645 election was not addressed in the final regulations, the preamble to the regulation (under the heading "Trust as Beneficiary") states that a revocable trust will not fail to be a trust for minimum required distribution purposes merely because the trust elects to be treated as an estate under section 645, as long as the trust continues to be a trust under state law.

9. Recognizing separate trusts created under a single trust agreement as separate beneficiaries.

The final regulations state that "[T]he separate account rules under A-2 of Section 1.401(a)(9)-8 are not available to beneficiaries of a trust with respect to the trust's interest in the employee's benefit". Treas reg 1.401(a)(9)-4, A-5(c). This language confirms the rule that applied under the proposed regulations as well, that separate account rules apply at the level of the plan or IRA. Thus, a single trust having multiple beneficiaries could not establish separate accounts or IRAs in the separate trust beneficiaries' names with respect to the trust's interest in the benefits payable to the trust as beneficiary (even if the separate percentage interests or shares of the beneficiaries in the single trust are identifiable). If the dispositive plan is to have two or more separate trusts each receive a portion of the participant's plan or IRA benefits (and to have the look through rules apply separately to each trust), separate accounts or separate IRAs must be created by the end of the year following the participant's death.

a. Private letter rulings refuse to recognize separate trusts created on participant's death.

In three private letter rulings dated December 19, 2002, a participant's beneficiary designation named a single trust that, by its terms was to divide into three separate equal subaccounts for the trust's three surviving beneficiaries effective as of the participant's date of death. Although decided under the pre final regulation rules, the IRS, citing the final regulation provision quoted above, held that the benefit amounts "passed through" the single trust and that, even though the IRA had been divided into three separate IRAs, the life expectancy of the oldest child who was a beneficiary of the single individual trust must be used to determine the MRD rule payout period from all three IRAs. PLRs 200317041, 200317043, and 200317044. These rulings reverse a prior ruling that recognized separate subtrusts created under a single trust agreement effective on the participant's death. See PLR 200234074.

b. Naming ultimate trust or subaccount in beneficiary designation.

It is clearly arguable that separate subaccounts or separate trusts that are required to be created (without any trustee discretion) effective upon the participant's death (and thus, from a trust law perspective are separate legal entities) should be recognized as separate beneficiaries and that the separate share rules in the regulations are irrelevant in making this determination. The recognition of separate trusts or subtrusts created from a preexisting single trust effective as of the participant's death can be likely obtained by naming the separate trusts or subtrusts (rather than the single trust, itself) as separate beneficiaries in the beneficiary designation. Until the IRS position is clarified, some practitioners may decide to create separate trusts under separate trust agreements to be designated as beneficiaries to provide protection against the possibility that the cloudy analysis in the private letter rulings will be further extended.

c. Formula allocations to resulting trusts.

Based on the concept of the foregoing private letter rulings, a trust agreement formula allocation of plan benefits (for example, an allocation between marital and bypass trusts) will not be considered to create separate marital trust and bypass look through trusts for the MRD rule purposes (even if the formula's application is mandatory and involves no trustee discretion) because the plan benefits are viewed as passing through the original trust named as the participant's beneficiary.

(1) As a result, if the planning objective is to establish two separate look through trusts (for example, in the case of a marital trust, bypass trust division where the participant's surviving spouse is not a beneficiary of the bypass trust), a specific marital deduction allocation formula must be included in the participant's beneficiary designation.

(2) For example, if the provisions of the beneficiary designation provides that if the participant's spouse survives, income in respect of a decedent is to be transferred in kind to the QTIP marital trust created under the trust agreement except that such transfer will abate in favor of the credit shelter trust created under the trust agreement to the extent that the transfer would cause the "reduce to zero" marital deduction formula of the trust agreement to be reduced below zero, the formula (if it names the trustees of the resulting trusts directly as beneficiaries) should identify the trusts that are the beneficiaries on the designation date (since the amount receivable by each trust is determinable as of the participant's date of death or as of the sixth month alternate valuation date).

10. Changing a trust's look through beneficiaries during the window period.

The "window period", the period of time between the participant's date of death and the designation date, may present an opportunity to cash out certain look through beneficiaries or to modify powers of appointment that might, depending on how the look through rules develop, otherwise cause the participant to be treated as having no designated beneficiary.

a. Payment by trust of estate taxes and estate expenses.

If payment of estate taxes and expenses (or the payment of estate taxes other than any attributable to the inclusion of the plan or IRA benefits in the participant's gross estate, if that turns out to be the rule) are considered to make the participant's estate one of a trust's multiple beneficiaries, the full payment of such expenses prior to the designation date should avoid having the trust be treated as having no designated beneficiary due to the inclusion of the nonindividual estate in the beneficiary pool.

(1) Limiting payment obligation as of designation date - since the window period may extend from just over nine months to just under 21 months, a final determination of the participant's death tax obligations may or may not occur during the window period and a potential estate tax obligation may exist on the designation date. If it is possible to anticipate that the maximum amount of taxes and expenses potentially payable on the designation date can be paid from trust assets other than plan or IRA benefits, the trust agreement might provide that the trustee has the discretion to require that plan or IRA benefits become payable to a subaccount of the trust which prohibits the use of benefits for the payment of such expenses from and after the designation date (perhaps, drawing down a portion of the benefits to cover post designation date expenses prior to the allocation of the balance of the benefits to such a subaccount).

(2) Surviving spouse's estate tax payable by QTIP trust - the fact that a QTIP trust to which plan or IRA benefits are payable may, upon the surviving spouse's death, be used (or required to be used) to pay an estate tax obligation of the surviving spouse's estate could, if the look through rules are applied so as to take into account every future beneficiary, prevent the QTIP trust from having a designated beneficiary. However, the approval of QTIP trusts as look through trusts described in paragraph C below implies that the Service will not press this potential issue.

b. Payment of charitable bequests.

If a participant's revocable trust is required to pay benefits from the trust or to satisfy charitable bequests made in the participant's will, if need be, the payment of a bequest before the designation date should eliminate the charity as a nonindividual look through beneficiary of the trust. Nonindividual cleanup beneficiaries, if taken into account, under the look through rules as ultimately developed, remain a problem.

c. Partial disclaimer or release of nongeneral powers of appointment.

If the potential appointees of a broad nongeneral power of appointment held by a trust beneficiary are considered to be look through trust beneficiaries under the look through rules as ultimately developed, the adult donee of the power may partially disclaim or release the power in order to eliminate nonindividual or older permissible appointees.

11. Estates do not qualify for the look through rules.

The final regulations expressly provide that a person who is not an individual, such as an employee's estate, may not be a designated beneficiary. Treas reg 1.401(a) (9)-4, A-3(a). While the ostensible reason for providing that nonindividual beneficiaries cannot qualify as designated beneficiaries is based on the Code section 401(a)(9)(E) definition of a designated beneficiary as "any individual designated by the employee", it is not clear why look through rules are permitted to apply to trusts named as beneficiaries and are not permitted to apply to a participant's estate (particularly if the participant dies testate). From the viewpoint of administering the income tax purpose of the MRD rules, the key requirement is that there be an individual identified for purposes of determining the applicable distribution period. The final regulations' provision that states that the fact that an employee's interest in a plan which passes to a certain individual under applicable state law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan, would seem to apply (or not apply) equally to a trust arrangement (created under state law) or to an estate (created under the participant's will). Treas reg 1.409(a)-4, A-1.

C. QTIP trusts named as beneficiaries.

An example included in the final regulations confirms the holding of Revenue Ruling 2000-2 (2000-1 CB 305) that the income received by a qualified terminable interest property trust (QTIP trust) does not have to be immediately distributed by the trust to the spouse beneficiary as was required by obsolete Revenue Ruling 89-89 (1999-2 CB 231) if the requirements of a marital deduction savings clause are met. Treas reg 1.401(a)(9)-5, A-7(c)(3), Example 1.

1. Revenue Ruling 2000-2.

Revenue Ruling 2000-2 holds that:

"An executor may elect under section 2056(b)(7) to treat an IRA and a trust as QTIP when the trustee of the trust is the named beneficiary of the decedent's IRA, the surviving spouse can compel the trustee to withdraw from the IRA an amount equal to all the income earned on the IRA assets at least annually and to distribute that amount to the spouse and no person has a power to appoint any part of the trust property to any person other than the spouse."

Such a holding was clearly required by the final QTIP regulations published on February 28, 1994 [Treas reg 20.2056(b)-7(d)(2)] which confirmed that the principles of Treasury regulations 20.2056(b)-5(f)(4) and (5) which set forth savings clauses that establish a surviving spouse's right to income under a "life estate with power of appointment" marital trust apply equally to the determination of whether a surviving spouse beneficiary of a QTIP trust has a "qualifying income interest for life". Note that a QTIP election apparently must be made for both the QTIP trust and for the IRA arrangement.

2. Productivity of plan/IRA assets.

Revenue Ruling 2000-2 stipulates that "[t]he IRA is invested only in productive assets".

(a) It is unlikely that the IRS intended to abandon the requirement that a surviving spouse have the power to make the plan or IRA investments productive if they become unproductive and it would be desirable for the QTIP trust document (or beneficiary

designation or both) to give the spouse the power to require the plan or account property to be reasonably productive of income.

(b) Alternatively, an "(f)(4)/(5) savings clause" may be used to give the surviving spouse the power (under the beneficiary designation form, the QTIP agreement, or both) to require the QTIP trustee to make distributions to the surviving spouse from the assets of the QTIP trust (including amounts withdrawn from the IRA or plan account). The additional amount subject to such a spousal direction would be equal to the excess of the income the IRA or plan account assets would have earned if such assets were reasonably productive of income [perhaps as measured by an identified rate of return index representative of the rate of return earned by funds that are reasonably productive (such as the current dividend yield index for the S&P 500)] over the income actually earned.

3. Identification of "trust accounting income" in IRAs and qualified plans.

Because income and principal are not typically pertinent to accounting for IRAs or retirement trusts, difficulty may be encountered in ascertaining the "income" of the IRA account or plan fund attributable to the benefits. This difficulty may be overcome, at least in the case of an IRA or individual account plan, if:

(a) The IRA or plan governing document requires the trustee or custodian to maintain records in sufficient detail to permit the amount of trust accounting income earned by the account to be determined annually or

(b) There is a written undertaking by the trustee or custodian to furnish such information (see PLR 9232036).

4. Disadvantages of QTIP trust as beneficiary.

If a QTIP trust is named beneficiary for plan or IRA benefits, alternatives available to a spouse, individually or as the beneficiary of a conduit trust, are lost.

(a) The "own IRA" election or spousal rollover to defer the commencement of minimum distributions until the spouse reaches his or her RBD, to have distributions made over the spouse's lifetime using the uniform lifetime table, and to have distributions after the spouse's death made over the fixed life expectancy of the spouse's designated beneficiary is not available in the case of a spouse designated beneficiary of a marital trust (see paragraph IV above).

(b) The ability of the spouse to defer benefit commencement until the end of the calendar year in which the deceased participant would have attained age 70 1/2 is foreclosed (see paragraph IV above) except in the case of a conduit QTIP trust.

(c) The IRA and plan distributions are subject to the high trust income tax brackets if accumulated by the marital trust.

Notwithstanding the disadvantages, where a QTIP trust is desirable for reasons other than preserving trust assets for specific remainder beneficiaries such as participant's children from another marriage (such as to preserve flexibility in determining the marital deduction amount, to allow reverse QTIP elections for GST purposes, or to provide for a spouse for whom asset management is necessary), the use of the savings clause approach of Revenue Ruling 2000-2 (instead of the pure conduit approach of Revenue Ruling 89-89) to secure QTIP treatment allows the full amount of the plan benefits to be retained by the QTIP trust if the surviving spouse has no need for the benefits.

D. Drafting "safe harbor" trusts to receive plan and IRA benefits.

In light of final minimum required distribution regulations and private letter rulings discussed in paragraph C.4 above, many trusts as they are now drafted may not qualify for the maximum payout period that is available to individual designated beneficiaries after a participant's death. Beneficiary designations naming trusts as beneficiaries and trust provisions drafted to qualify for the maximum distribution period for income tax purposes may require that estate and GST tax planning objectives be partially compromised and/or that normal dispositive objectives be altered. The limited guidance now available describes only two kinds of trusts (the conduit and the "example 1" trusts) that have clear minimum required distribution consequences, suggests a third kind of trust (the "individuals only" or "nonconduit" trust described below) that may produce clear MRD rule consequences, and provides only a limited conceptual framework from which to analyze many common flexible estate planning trust provisions. Due to the fact that the look through rules have in the past been subject to IRS interpretations beyond the ken of estate planners, it is recommended that the trustees of trusts named as beneficiaries be given the safety valve power to disclaim benefits in favor of individual trust beneficiaries if such a power is not contrary to the dispositive plan.

1. Conduit trusts.

All amounts received by the trustees during the lifetime of the oldest individual look through beneficiary of a conduit trust are, upon receipt, required to be distributed by the trustees to that individual (or to other individual trust beneficiaries). Treas reg 1.401(a)(9)-5, A-7(c)(3), Example 2. As in the case of an individual designated beneficiary, the designated beneficiary of a conduit trust will receive all of the plan or IRA benefits if the beneficiary lives out his or her life expectancy. As a consequence, any successor beneficiary of the trust is treated as a "mere potential successor" and may be disregarded. Compared to a continuing trust that provides for distributions in the discretion of an independent trustee (or pursuant to an ascertainable standard), a continuing conduit trust erodes the shelter (creditor, beneficiary's estate tax, management, and spendthrift protections) and places an increasing portion of the assets under the dispositive control of the beneficiary. The benefit of a conduit trust is that the look through designated beneficiary is clearly identifiable, affording an applicable distribution period that equals the period that would apply were the trust beneficiary directly designated. The conduit trust also preserves some of the benefits of a shelter trust.

a. Continuing conduit shelter trusts for descendants.

In the case of a single participant or a participant whose surviving spouse is not named as a bypass trust beneficiary, trusts that follow the example 1 model (continuing for the lifetime of the child who is the primary beneficiary and oldest look through designated beneficiary and then distributing outright to the child's children) may be an option. However, in most cases, the participant's dispositive plan would provide for a child's siblings to be successor beneficiaries if a child has no descendants at the time of the child's death. Moreover, depending upon the age of the children, the number of children, and how prolific the children are, the participant may be unwilling to risk having the benefits pass under a deceased beneficiary's estate rather than expressly providing for a "clean up" disposition that may involve collateral family lines that have family members older than the children or charitable organizations. Subject to the comments below regarding continuing trusts that are intended to benefit individuals only, a conduit trust may be an appropriate vehicle.

i. Conduit trust controls flow of plan/IRA distribution.

While it is true that the benefits for which a continuing shelter trust for a child is formed are diminished over time as plan and IRA distributions to the trust are passed through to the trust's primary beneficiary, the rate of that diminishment will correspond to the beneficiary's increasing maturity. Even a beneficiary who attains age 60 in the calendar year following the participant's death will receive an initial minimum required distribution equal to only 4% of the previous yearend benefit fund value unless the conduit trust trustees accelerate distributions from the plan or IRA. A beneficiary age 40 would receive only 2.29% of the fund value.

ii. Conduit distributions cease on designated beneficiary's death.

Compared to naming a child, individually, as the beneficiary of an IRA or plan account, naming a conduit trust gives the conduit trust trustees spendthrift control over the plan and IRA benefits not yet required to be distributed under the MRD rules. Moreover, plan or IRA benefits distributed after the death of the conduit beneficiary are no longer subject to passthrough and may be retained in trust for successor beneficiaries.

iii. Example retirement benefit conduit subtrust.

Exhibit D titled "Retirement Benefit Conduit Subtrust" is intended as a starting point for drafting a provision to take advantage of the conduit trust rules. In order to be effective, the subtrust (rather than the separate trust for the oldest current beneficiary and that beneficiary's family of which it is a part) must be named as beneficiary in the participant's beneficiary designation (see exhibit H, involving an individuals only trust for a format of such a designation).

iv. Caveat re trustee authority.

Note that exhibit D contemplates that the retirement benefit plan subtrust has an independent (or disinterested) trustee. In the event that the subtrust does not have an independent trustee, the clause regarding the trustee's authority to withdraw amounts in excess of minimum required distribution amounts (which amounts must, in turn, be distributed to the beneficiary or beneficiaries) may need to be restricted by an ascertainable standard in order to avoid having the trustee beneficiary hold a general power of appointment.

v. Provisions for taxes and expenses.

Steven E. Trytten, a practitioner from Pasadena, California, has suggested that specific provision be made in a conduit trust authorizing the trustee to divert amounts from the conduit pass through in order to pay the subtrust's share of trust administrative expenses as well as income, estate, and GST taxes to the extent such expenses and taxes are chargeable to or otherwise payable by the subtrust with respect to the plan benefits received or receivable. The exhibit D draft does not refer to the payment of such amounts in order to literally meet the requirement for conduit trusts that all IRA and plan amounts received by the trustee be distributed. In the case of a subtrust that is part of a separate trust that will contain non plan and IRA assets, it is assumed that administrative expenses will be born by the trust as a whole and will not be charged back to the subtrust. If the conduit trust is a separate trust, a provision permitting the payment of expenses would seem to be unavoidable.

b. Conduit QTIP trusts.

A conduit QTIP trust for the participant's surviving spouse [described in paragraph IV.B.3.c.ii above] activates the special rules that apply to a surviving spouse sole beneficiary of a participant's account (the deferred commencement of minimum required distributions if the participant had died before the RBD, distributions based on the recalculated single life expectancy of the spouse, and, if the spouse dies before minimum required distributions are required to commence, distributions based on the fixed life expectancies of the remainder beneficiaries).

i. Disadvantages.

Since the surviving spouse may receive all (or virtually all) of the benefit distributions, a conduit trust is inappropriate if the QTIP trust is intended to preserve the trust principal for the remainder beneficiaries. As compared to naming the surviving spouse as the direct beneficiary of the IRA with the opportunity to roll the amount over or make an own IRA election, the conduit trust (using the recalculated single life table) will distribute much more rapidly than the uniform lifetime table available on a rollover.

ii. Advantage.

By permitting the QTIP trustees to limit distributions to the greater of trust income (computed taking the income from benefits into account) or the MRD amount for each year, the conduit trust provides a limited spendthrift benefit while slowing the rate of minimum required distributions when compared to the distribution over the fixed life expectancy of the surviving spouse (or of the participant, if longer, in the case of a post RBD death) required by a nonconduit QTIP trust.

2. "Individuals only" (nonconduit) subtrusts.

Under the final regulations, the members of a class of beneficiaries capable of expansion of contraction will be treated as being identifiable if it is possible to identify the class member with the shortest life expectancy. Treas reg 1.401(a)(9)-4, A-1. If a subtrust for a class of beneficiaries, such as the participant's descendants, must by its terms terminate and distribute all assets including accumulated plan and IRA benefits to living members of the class prior to the death of the last living member of the class, distributions should be measured under the MRD rules by the fixed life expectancy of the oldest living class member. An individual's only trust places the distribution decisions in the hands of the trustees and preserves the trust's shelter benefits.

a. Specified termination in favor of individual beneficiaries.

For example, the trust provisions might require that the subtrust terminate at the end of the rule against perpetuities period or when only one descendant of the participant is living, if earlier (or perhaps, when there are two or three descendants living to avoid a common disaster possibility). While this kind of tontine disposition may not reflect the typical plan that a participant would provide for other assets, the plan/IRA subtrust would not limit the ability of the trustees to make discretionary distributions from the subtrust prior to the subtrust's termination date.

b. Oldest descendant as designated beneficiary.

Unless the participant's descending family lines are all well populated, it is likely that, upon the failure of a family line, the trust's provisions would allocate the remaining trust assets to trusts for a child's siblings and their descendants. Unlike a conduit trust, both current and contingent trust beneficiary's must be taken into account in determining the oldest look through beneficiary over whose fixed life expectancy MRD rules payments will be measured. If all of the oldest members of each family line are of the same generation, the increase in the rate of distribution for the younger siblings (compared to a conduit trust) will generally not be significant.

c. Limiting "older" spouse beneficiaries and appointees.

Further subtrust limitations for an individuals only trust must be provided if the class of beneficiaries is expanded to include spouses of descendants [so as to limit the spouses taken into account to those who are younger than the oldest descendant (whether a current or contingent beneficiary) who is the oldest look through designated beneficiary] and/or if trust beneficiaries have the power to exercise nongeneral powers of appointment (so as to limit appointees to the participant's descendants and younger spouses and, if exercisable in further trust, to require that all subtrust dispositive restrictions continue to apply).

d. Subtrust administration.

Unlike a conduit subtrust, the individuals only subtrust requires the maintenance of an accounting separate from the trust of which it is a part in order to track the fund created by accumulated plan or IRA distributions received.

e. Example nonconduit subtrust.

Without further guidance from the IRS, it is not clear whether an individuals only trust will allow minimum required distributions to be made over the oldest class member's life expectancy. The example subtrust wording attached (exhibit E) is presented as a drafting starting point and is not recommended for use until the IRS has provided more guidance unless the participant's beneficiary designation provides for safety valve disclaimers by the trust's trustees in favor of the trust beneficiaries individually. As in the case of a conduit subtrust, the beneficiary designation must specifically name the subtrust as beneficiary.

3. "Example 1" trust.

An "example 1" trust – a trust which requires that all of the income of the trust (including the income of an IRA or qualified plan account of which the trust is beneficiary and which the trustees are entitled to withdraw) be distributed to the oldest look through designated beneficiary and which has identifiable remainder beneficiaries all of whom are younger than the oldest look through designated beneficiary. Treas reg 1.401(a)(9)-5, A-7(c)(3),

Example 1. This minimalist example appears to assume that the younger remainder beneficiaries will receive the trust principal outright upon the oldest look through beneficiary's death. Since the example describes a QTIP trust, the requirement that trust income be distributed is probably not material to the look through treatment. However, the fact that no remote contingent beneficiary is named to receive benefits if the younger identified contingent beneficiaries fail to survive is likely material (at least until the application of the snap shot approach is further confirmed).

a. Possible use of example 1 trusts for marital-bypass primary planning.

If a participant's plan calls for the creation of marital and bypass trusts that are to terminate and distribute outright to descendants upon the surviving spouse's death, the participant, depending on the family's size, may be willing to accept the risk that the example 1 trust has no cleanup provision in the event that all descendants predecease the surviving spouse.

b. Implications of example 1 trust as a model.

Except as the example 1 trust serves as an indication that an individuals only trust will be respected or that the ultimate potential distribution to a deceased beneficiary's estate will not cause there to be no designated beneficiary, it is difficult to imagine an estate planner recommending a plan of disposition that does not specifically contain a specific (rather than statutory) disposition upon a beneficiary's death.

4. Using trusts that do not qualify for the look through rules.

In considering the alternatives, it is important to keep in mind that, while the MRD rules that apply to a trust that has a look through designated beneficiary produce essentially the same MRD rule payout period regardless of whether the participant's death occurs before or after the participant's RBD, the failure to have a look through designated beneficiary will require the distribution to the trust of all benefits before the end of the calendar year in which the fifth anniversary of the participant's death occurs if the participant dies before the RBD. In contrast, the lack of a designated beneficiary in the case of the participant's post-RBD death will result in distributions over the remaining fixed single life expectancy of the participant (which is a period of five or fewer years only if the participant dies after attaining age 88). If the participant's spouse is intended to be the oldest beneficiary of both the marital trust and the bypass trust, the spouse is one or more years older than the participant, and the participant dies after the RBD, the post death MRD rule payout period will not be increased by assuring that the trust qualifies for the look through rules. Thus, if the participant and spouse are close in age, the participant may well decide that the preservation of the estate plan's dispositive pattern is more important than qualifying for the look through rules. In that case, the participant may plan, after reaching the RBD, to utilize the default payout rule rather than to name a subtrust designed to meet the look through rule requirements.

VII. ASSESSING DEATH BENEFIT PLANNING ALTERNATIVES

A. Balancing the planning objectives.

Depending upon the value and asset make up of a participant's estate, the following three planning goals may compete for priority in planning for the disposition of qualified plan and IRA death benefits. The proper disposition of plan and IRA death benefits requires an

exploration of these three priorities with the client and the formulation of an explanation of how these priorities are balanced in the planning alternatives available under the provisions of the final regulations as they are presently understood.

1. The participant's dispositive goals.

Each participant has a preferred plan for providing for his or her immediate family members for the balance of their lifetimes and for the ultimate disposition of his assets upon a family member's death. Depending on the age, health, and character of these family members, the protection and management of the assets during the lifetime of one or more family members may be indicated.

2. The participant's transfer tax goals.

If the value of a married couple's assets exceed the current applicable exclusion amount, the participant will wish to dispose of his or her assets in a manner so as to minimize or avoid potential estate and GST taxes. To the extent that plan and IRA benefits constitute a substantial portion of the participant's assets, the funding of a nonmarital share (whether in trust or not) so as to avoid tax on the surviving spouse's death may be a significant goal.

3. Income tax and investment goals.

Under the post-death MRD rules, the income tax exempt investment of the plan or IRA benefits (and the ultimate after income tax amounts received by the plan or IRD beneficiaries) will be maximized if plan and IRA benefits are paid to a surviving spouse individually or in a conduit trust or to children (or grandchildren) as individual beneficiaries.

B. Integrating plan and IRA benefits into a trust based estate plan.

As noted in paragraph V.A.2 above, in the case of clients who have substantial assets, most estate planners seek to integrate all of the client's (or married couple's) assets into a comprehensive estate plan that will provide for the disposition of those assets through a central vehicle (a revocable trust or will) which, by formula, will allocate the client's assets among trusts for the client's surviving spouse and descendants in a manner intended to minimize estate and GST taxes. Often the client's assets are ultimately to be transferred to continuing trusts for descendants in order to protect the assets from a descendant's creditors (including divorcing spouses), shelter the assets from estate tax on a descendant's death, and provide a coherent plan for transmitting those assets to lower generation beneficiaries. Assuming the dispositive and transfer tax goals are important priorities, what options available to preserve the tax exempt benefits to the maximum extent possible?

1. Revocable trust disclaimer method – disqualified trusts where surviving spouse's welfare is chief concern.

If, and only if, the participant and spouse are close in age and the participant has passed the RBD (the five-year rule will apply if the participant dies before the RBD), the revocable trust and beneficiary designation provisions that were used prior to the final regulations (as part of a plan that permits trustee disclaimers to change the outcome) may still be viable. In this situation, it is assumed that the surviving spouse will be the primary beneficiary of both a QTIP marital trust and a residuary (bypass) trust and that minimum required distributions beginning in the year following the participant's death will be made under the default rule (the longer of the participant's or the surviving spouse's fixed life expectancy).

a. Ignoring the look through rules.

Because the default MRD rules are being applied, there is no need to restrict potential trust beneficiaries. The formula allocation of benefits (together with all other income in respect of a decedent) to the marital trust except to the extent that such an allocation will "over-qualify" the marital deduction and under fund the bypass (residuary) trust can be contained in the trust agreement since it does not matter if the plan and IRA benefits are considered to "pass through" the terminating original trust.

b. Revocable trust disclaimer method.

An example beneficiary designation (exhibit H) is one component of a revocable trust disclaimer method that may be used to integrate plan and IRA benefits into a typical marital/nonmarital type estate plan which is intended to preserve the flexibility to select the optimal income and estate tax treatment form the alternatives available after the participant's death when the alternatives can be best evaluated. The other necessary component is the inclusion in the revocable trust of provisions (i) intended to accomplish, before any disclaimers, what is presumed to be the most advantageous allocation of the benefits involved and (ii) to facilitate disclaimers by the trustees of the original trust, the trustees of the marital trust, and the spouse to permit changes to that initially provided allocation of benefits.

i. The beneficiary designation.

Under such a standardized approach, all of the participant's qualified plan and IRA death benefits would be made payable (in separate but virtually identical beneficiary designation forms for each IRA or plan) as follows if the participant's spouse survives:

First beneficiary	–	The participant's revocable trust (which by its terms provides for a specific allocation of benefits to a subtrust of the marital trust except that, if and to the extent such an allocation would cause the marital deduction to be overqualified, benefits are instead allocated to the residuary or nonmarital trust),
Second beneficiary	–	The marital trust (or, if the participant's spouse does not survive, the residuary trust) under the revocable trust document,
Third beneficiary	–	The participant's spouse, and
Fourth beneficiary	–	The participant's descendants, per stirpes.

The beneficiary designations should provide that –

(a) Each successive beneficiary would be entitled to receive such death benefits only in the event of either:

(1) The nonexistence (or prior death) of the preceding beneficiary (or beneficiaries) or

(2) A timely and proper section 2518 disclaimer by the preceding beneficiary (or beneficiaries) of part or all of such benefit.

(b) The wording of the beneficiary designation would specifically permit a disclaimer of part or all of the death benefits to be made by a written transfer of the right to receive the disclaimed benefits – provided that such "transfer" type disclaimer meets the requirements of section 2518(c)(3) (thereby avoiding the need for such disclaimer to comply with any local law requirements).

(c) The plan administrator would be held harmless from liability in making distributions based on written representations and opinions furnished by counsel for any designated beneficiary (for example, as to whether a trust has been revoked or cannot come into existence, whether a disclaimer is effective, and so on).

(d) In the event that a marital trust is named as beneficiary the installment or annuity payments will all be received only by the marital trust (even if it means continuing the trust in existence to receive the last payments after the spouse's death).

ii. Required governing trust instrument provisions.

Under such a standardized approach, the trust document that establishes and governs (i) the revocable trust (after death referred to as the "terminating original trust"), (ii) the marital trust, and (iii) the nonmarital bypass (or residuary) trust (that are referred to in the beneficiary designation) must contain provisions that accomplish the following two objectives.

(a) Specific allocation of all other IRD to marital trust.

The governing trust document would specifically allocate to the marital trust all "income in respect of a decedent" (IRD) property [as defined in Code section 691(a)] – except that any such IRD property which, if so allocated:

(1) Would not qualify for the marital deduction or

(2) Would cause overfunding of the marital deduction formula amount,

will instead be allocated to the nonmarital trust. This specific allocation of all other IRD property has the effect of:

(i) Eliminating the risk that might otherwise exist that the allocation of these other items of IRD to the marital (or residuary) trust pursuant to any pecuniary marital deduction (or credit shelter) formula (or perhaps even a nonpro rata fractional share formula) would be treated as requiring the accelerated reporting of the taxable income involved in such IRD properties and

(ii) Assuring that (insofar as a marital deduction is called for) such remaining IRD properties (i) will qualify for the marital deduction and (ii) insofar as possible, will be burdened with the income tax liability that each inherently carries with it (so as to thereby reduce the surviving spouse's gross estate),

(iii) But, at the same time, allocating to a "benefit sub-trust" of the marital trust all qualified plan, tax sheltered annuity, and IRA death benefits included among such IRD properties otherwise allocable to the marital trust so as to facilitate their separate disclaimer by the surviving spouse from the marital trust into the credit shelter trust under separate marital trust disclaimer provisions.

(b) Fiduciary disclaimer authorization.

In order to permit:

(1) The terminating original trust trustees to disclaim to the marital trust:

(i) Benefits allocable to the marital trust that they believe should be rolled over to a spousal IRA (which might not be possible absent such a disclaimer by both the original trust and marital trust trustees) and/or

(ii) Benefits that would otherwise be allocated to the residuary trust which, because no estate tax appears likely on the surviving spouse's death, should similarly be made eligible for a spousal rollover IRA,

and

(2) The marital trust trustees to disclaim to the surviving spouse any benefits otherwise receivable by the marital trust which it would be preferable to have rolled over into a spousal IRA,

the governing trust instrument should specifically authorize the trustees of each trust thereunder to make tax elections (such as disclaimers) in such manner as the trustees (other than any who are beneficiaries), in their sole (but reasonably exercised) judgment, determine will achieve the overall minimum of present and future tax and expense burden to the settlor's family as a whole (without adjustments or liability on account of such trustee actions if taken in good faith). See exhibit F for an example of a provision authorizing trustee disclaimers.

c. Distribution from separate accounts for marital and nonmarital trusts.

As described in paragraph I.A.4.b above, IRAs that an individual holds as a beneficiary of the same decedent and are being distributed over the same period are aggregated Treas reg 1.408-8, A-9. The 2004 Treasury Regulations provide that, except to the extent separate shares are established, all separate accounts "will be aggregated for the purposes of section 401(a)(9)" Treas reg 1.401(a)(9)-8, A-2 (a)(1). In the case of benefits payable "through" a participant's revocable trust, no separate share treatment is permitted and separate IRA accounts established in the deceased participant's name for the marital trust and the non-marital trust must be aggregated. The annual MRD for the entire inherited IRA (both shares) is thus determined by reference to the oldest beneficiary, the surviving spouse, of each separate IRA based on the entire account balance of both IRAs. Can the MRD for the aggregate IRA be paid from the marital trust IRA, permitting the nonmarital IRA account grow? It would appear to be the case.

2. Disclaimer plan where a portion of benefits are needed to fund a by-pass trust.

In the case of the revocable trust disclaimer method described in paragraph 1 above, the preferred allocation of benefits is accomplished by the initial beneficiary designated (the revocable trust which contains the anticipated optimal tax allocation) and the disclaimer ladder serves as an opportunity to second guess that preferred disposition. If a look through trust is to be a beneficiary (or one of the beneficiaries), the marital deduction by-pass formula would have to be contained in the beneficiary designation, itself – a level of complexity even the most cooperative IRA provider may refuse to accept.

a. Premium on immediate post-death planning.

As a result of the foregoing, the initial beneficiary named on the disclaimer ladder will typically be the bypass (residuary) trust or the surviving spouse. Since it is intended that a portion of the benefits become payable to the bypass trust and a portion to a marital trust (or the surviving spouse), timely post-death action must be taken to identify disclaimer amounts.

b. Two approaches to initial beneficiary named.

The two basic approaches are –

(1) To designate the participant's spouse or the marital trust as the primary beneficiary of the plan and IRA benefits and provide that, if the spouse fails to survive the participant or to the extent that the spouse (or marital trust trustees) disclaims (or disclaim) the benefits, the benefits will pass to the bypass trust (or separate resulting trusts) as the contingent beneficiary. See Private Letter Ruling 200522012 for an example of multiple post death disclaimers by a surviving spouse beneficiary pursuant to a laddered beneficiary designation.

(2) To designate the bypass trust (or separate resulting trusts) as primary beneficiary and provide that, to the extent that the bypass trust trustees disclaim the benefits, the benefits

will pass to the spouse (or to the marital trust which the marital trust trustees may in turn disclaim in favor of the spouse, individually) as a contingent beneficiary.

The choice of designation may depend upon a predeath projection of the expected division of the participant's assets between the marital and bypass trusts. Naming the bypass trust as primary beneficiary has the advantage of relying on the bypass trust's trustees (rather than the participant's surviving spouse) to carry out the disclaimer and of permitting the surviving spouse to retain a nongeneral power of appointment over the bypass trust. This power of appointment would have to be also disclaimed if the plan/IRA benefits pass to the bypass trust pursuant to the spouse's disclaimer.

c. Example beneficiary designation naming bypass trust first.

Exhibit H is an IRA beneficiary designation that, if the participant's spouse survives, names a retirement benefit nonconduit subtrust of the bypass trust as initial beneficiary. It is expected that, to the extent the benefits would otherwise cause the bypass trust assets to exceed the participant's available applicable exclusion amount (or other target amount that takes into account state death taxes), the subtrust's trustees will disclaim the benefits (causing them to pass to the retirement benefit nonconduit subtrust of the martial trust).

d. Post-death evaluation of marital trust or spousal rollover.

If there is no perceived need to retain the disclaimed benefits in the marital trust, the marital trusts subtrust trustees may also disclaim the benefits, in whole or in part, causing the spouse, individually, to become the beneficiary. The spouse may receive a distribution of the benefits and roll them over to a separate IRA (or, if a separate IRA has been timely established with respect to the benefits for the spouse, make an own IRA election) so as to maximize the minimum required distribution applicable distribution period.

e. Creation of separate accounts if one trust is qualified.

If the participant and the spouse are close in age and the participant has passed the RBD, the initial beneficiary named might instead be the bypass trust, itself, rather than a more restrictive subtrust. If the balance of the benefits are disclaimed by the bypass trust trustees and the marital trust retirement benefit nonconduit subtrust retains the benefits that are intended to qualify for the look though rules, the marital trust will not be able to qualify for the look through rules unless separate IRA accounts are created during the window period because the participant's IRA will otherwise have multiple (trust) beneficiaries one of whom is a nonindividual on the designation date.

3. Conduit and nonconduit subtrusts of continuing shelter trusts.

The provisions of the exhibit H beneficiary designation that apply if the participant survives the spouse provide for a division of the benefits into equal shares, one for each surviving child and one for each deceased child who has a "qualified surviving spouse" or descendants who survive the participant. Each share is then allocated between retirement benefit conduit subtrusts of GST exempt and nonexempt continuing shelter trusts. Nonconduit subtrusts could alternatively be named but, in either case, the subtrust trustees have a safety valve power to disclaim benefits in which case the child or descendants who would be subtrust beneficiaries become individual beneficiaries of the IRA benefits.