

Estate Planning for Owners of Retirement Plan Accounts

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Overview

- Importance of beneficiary designations
- Strategies – Concepts
- Strategies – Drafting

Importance of Beneficiary Designations

- Working with plan administrations
- Working with IRA custodians
- Deferring or avoiding income tax

Strategies - Concepts

Pay to Charity

- Directly
- Not through trust

Naming a Charity as a
Beneficiary of a Retirement Account

- or -

Distribution to a Trust or an
Estate that makes a Charitable
Bequest

What Can Go Wrong?

- Other beneficiaries cannot do stretch IRAs if charity is beneficiary?
- Solutions:
 - cash out charity's share by Sept 30 or
 - separate account for charity

What Can Go Wrong?

Estate or trust has taxable income from receiving IRA distribution, but maybe there is no offsetting charitable income tax deduction when the IRA check is given to a charity.

What Can Go Wrong?

- **IRS Chief Counsel Memorandum ILM 200848020**
- Decedent left his IRA to a trust that benefited his six children and several charities
- Trust received cash from IRA; paid entire charitable share, leaving the six children as the only remaining beneficiaries of the trust.
- IRS: “Taxable income from IRA, but no charitable deduction.” Reason: trust had no instructions to pay income to charities

What Can Go Wrong?

- Solution #1 – Keep IRD off of estate’s/trust’s income tax return
 - a. Name charity as beneficiary of IRA
 - b. “Distribute” IRA to charity if document allows

Caution: IRS memo on danger of using retirement accounts to satisfy pecuniary bequests

What Can Go Wrong?

- SOLUTION #2 – draft document to get an offsetting charitable income tax deduction in case estate or trust has income
 - *I instruct that all of my charitable gifts, bequests and devises shall be made, to the extent possible, from "income in respect of a decedent"*

2008 – Proposed Regulation

-- Confusion over sanction --

- Instructions to distribute specific types of income to a charity or to some other beneficiary will not be respected for federal tax purposes unless the instruction has an “economic effect independent of income tax consequences”
- Reg. Sections 1.642(c)-2(b) contained in REG-101258-08, 2008-28 I.R.B. 111

What Clauses Have “Economic Effect”?

- “Pay all taxable retirement benefits that my estate receives to charity ABC”
(Charity only receives something if the estate receives retirement benefits; other beneficiaries are disinherited from all retirement accounts paid to the estate)
- “Pay the first \$300,000 of taxable retirement benefits that my estate receives to charity XYZ”

What if no “Economic Effect”?

- Sanction under Proposed Regulation: “estate's or trust's income will be allocated between charitable and non-charitable beneficiaries using the same proportionate ratio of all classes of income of the estate or trust”
- Proposed Regulation does not address whether a charitable income tax deduction will be allowed, denied or partially allowed/denied

Strategies - Concepts

Pay to Spouse

- Outright
- Rollover vs. Inherited IRA
- Disadvantage of trust

Strategies - Drafting

- Want separate account treatment
- Coordinate estate tax provisions

Strategies - Drafting

Marital Trust for Spouse – Rev. Rul. 2006-26

- Right to withdraw fund's internal income
- Classify all withdrawals as income to the extent of fund's internal income
- Uniform Principal & Income Act Section 409

Strategies - Drafting

Marital Trust for Spouse

- Lapse in excess of 5% might be a gift
- Power of appointment → incomplete gift
- General power to encourage accumulation

Strategies - Drafting

- Count each beneficiary unless mere successor
- Conduit common
- Limitation on beneficiaries

Strategies - Drafting

Retirement Benefits Trust

- Purifies trust to avoid “bad” provisions
- Need to coordinate with other provisions of main revocable trust

Strategies - Drafting

Elimination of Beneficiaries

- Eliminate charities
- Eliminate probate estate
- Eliminate older beneficiaries

Strategies - Drafting

Elimination of Beneficiaries

- Each level of trust account for accumulated distributions
- Precludes contingent general power of appointment to avoid GST
- Requires last person standing approach
- Spouses, etc. - problematic

Strategies - Drafting

Conduit

- All distributions to one or more beneficiaries
- Use life expectancy of oldest
- Leaky credit shelter or GST-exempt
- No one “correct” answer

Strategies - Drafting

Marital Trust

- Recalculate surviving spouse's life expectancy
- Slower than limitation of beneficiary; much faster than rollover
- Forces principal out to surviving spouse

Strategies – Drafting Conduit

Life Trust for Child

- Child Sole Beneficiary?
- If not, then
 - 1) to child for support
 - 2) to child's descendants for support (limit to education and medical if nonexempt)
 - 3) to child for balance

Strategies – Drafting Conduit

Credit Shelter

Priorities:

- 1) to surviving spouse for support
- 2) to descendants for support
- 3) to descendants, per stirpes