

# ***Drafting "Leaky Faucet" (Conduit) Trusts and "Stopped Up Faucet" (Accumulation) Trusts***

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Linda Suzanne Griffin, J.D., LL.M  
1455 Court Street  
Clearwater, Florida 33756  
727.449.9800  
[linda@lawyergriffin.com](mailto:linda@lawyergriffin.com)

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(The speaker expresses great gratitude to Rex E. Moule, Esquire for use of his outline)

## ***Beneficiary Trust Rules for IRA's<sup>1</sup>***

**Rex E. Moule, Esq.  
Moule & Moule, LLP  
Melbourne, Florida**

### **I. TRUST AS BENEFICIARY.**

A. *The Definition of Trust Income Relative to IRA Distributions to a Trust is Important.* Distributions from an IRA to a trust must be allocated between income and principal. This is important for several reasons. First, the rights of an income beneficiary and the remainder beneficiary (who will receive the remaining principal) are different. Second, for marital deduction trusts such as QTIP and general power of appointment trusts, the income of the IRA and the income of the trust must be determined and paid annually to the surviving spouse. So which income definition should be used?

- a) *Trust Accounting Income v. Federal Gross Income.* A distribution to a trust from a retirement plan will, in most all cases, be part of the trust's gross income for federal income tax purposes. However, for trust accounting purposes the distribution will be allocated between income and principal either by the terms of the trust document or by state law if the trust document does not define income for plan distribution purposes. For example, a \$100,000.00 IRA payable to a trust for which the trustee withdraws the full amount immediately after the participant's death will be treated as principal for trust accounting purposes [§738.602 (3), Fla. Stat.], but will be considered income for federal income tax purposes.
  
- b) *Trust Accounting Income v. Minimum Required Distributions.* Minimum required distributions payable to a trust may or may not be trust accounting income. The trustee must allocate each minimum required distribution between income and principal either by referring to the terms of the trust document or in default of such terms by state law.

B. *Importance of Properly Drafted Income Definition.* In all trust documents it is important to draft an appropriate definition of income. It becomes especially important where retirement plan benefits are payable to a trust and when the

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<sup>1</sup> David E. Moule, Esq. contributed invaluable research and writing to this outline.

trust is seeking qualification for the marital deduction. In this case the trust should adopt either the trust-within-a-trust definition of income or the unitrust concept of income. Rev. Rul. 2006-26.

1. *Trust-Within-a-Trust.* The trust-within-a-trust concept of income is that the investment income of the retirement plan is treated as the income of the trust for trust accounting purposes. This approach works well with IRA's where the trustee is investing the assets of the IRA and therefore knows the amount of its investment income. Where the trustee does not have access to investment income information of a retirement plan such as a defined benefit plan, the unitrust approach should be used.
2. *Unitrust Income Definition.* The unitrust income approach gives to the income beneficiary a percentage (between 3% and 5%) of the total value of the trust instead of fiduciary accounting income. This approach has been approved in Florida. §738.1041, Fla. Stat.

Either one of these definitions of income is acceptable by the IRS in qualifying a trust for the marital deduction when the trust is the beneficiary of IRA distributions.

C. *Florida's Definition of Income.* If the trust document does not define income and principal for retirement plan distributions payable to trusts then by default §738.602, Fla. Stat. of the Florida Principal and Income Act will apply. Florida modified its definition of income and principal in 2009 to comply with Rev. Rul. 2006-26 as follows:

1. *Separate Account.* For an IRA holding assets exclusively for the benefit of an account owner and the value of the assets is ascertainable at any time or the administrator of the IRA maintains records that show receipts and disbursements associated with the IRA, income of the IRA may be calculated either under the "trust-within-a-trust" method or the "unitrust income" method. §738.602(2)(a), Fla. Stat.
2. *Nonseparate Account.* For a fund for which the value of the participant's right to receive benefits can be determined only by the occurrence of a date or event as defined in the governing instrument, income of the fund can only be calculated under the "unitrust income" method. §738.602(3), Fla. Stat.

## **II. MINIMUM REQUIRED DISTRIBUTIONS FOR TRUSTS.**

A. *Minimum Required Distributions for Trusts.* It is typically better to have a plan name a Designated Beneficiary (individuals) because of the more favorable distribution treatment, that is, distributions will be made over the life expectancy of the individual beneficiary. When a plan names a non-individual as beneficiary (i.e. there is no Designated Beneficiary) in most all cases the required distributions from the plan are on a faster and usually less desirable schedule. A trust is obviously not an individual and therefore is not a Designated Beneficiary unless the trust qualifies as a “see-through trust.” An estate can never be a Designated Beneficiary even if the will creates a testamentary trust. If plan benefits are left directly to the trustee of the testamentary trust, and not the estate, the testamentary trust may be a Designated Beneficiary if the testamentary trust is a see-through trust.

B. *The Importance of See-Through Trust Status.* Retirement plan benefits left to a see-through trust will allow the benefits to be paid over the life expectancy of the oldest trust beneficiary. Retirement plan benefits left to a trust that does not qualify for see-through status must be distributed using the no Designated Beneficiary rules. The no Designated Beneficiary rules require that the plan must be distributed to the trust beneficiaries over a five or six year period if the participant died before his required beginning date (RBD), and over the remaining life expectancy of the participant if he died after his required beginning date. Usually, distributions over the oldest trust beneficiary's life expectancy creates a longer deferral of benefits than under the no Designated Beneficiary rules.

C. *See-Through Trust Status.* The minimum required distribution (MRD) rules allow plan benefits to be distributed over the life expectancy of a Designated Beneficiary (DB). The general rule is that a DB must be an individual; however, under certain circumstances a trust named as beneficiary may be considered a DB if it is a see-through trust. For a trust to qualify as a see-through trust, it must comply with five rules. Reg. §1.401(a)(9)-4, A-5(b).

Rule 1: The trust must be valid under state law.

Rule 2: The trust is irrevocable or will become irrevocable upon the death of the participant.

Rule 3: The beneficiaries of the trust must be identifiable from the trust document.

Rule 4: The administrator of the plan must timely receive certain documentation.

Rule 5: All the trust beneficiaries must be individuals.

For plan distribution purposes, the beneficiaries of a see-through trust will be treated as if they were named directly as the beneficiaries of the plan, with two exceptions. First, the “separate accounts” rule will not apply, and second, there can be no spousal rollover.

Rules 3, 4 and 5 will be discussed below. Rules 1 and 2 are relatively straight forward and will not be expanded upon in this outline.

1. *The Beneficiaries of the Trust Must Be Identifiable from the Trust Document.* The purpose of the requirement that the trust beneficiaries must be ascertained from the trust document is that the identity of the oldest beneficiary must be known since the minimum required distributions will be based upon the oldest beneficiary’s life expectancy (Applicable Distribution Period). Reg. §1.401(a)(9)-4, A-1 states: “A designated beneficiary need not be specified by name in the plan or by the employee to the plan...so long as the individual who is to be the beneficiary is identifiable under the plan. The members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible to identify the class member with the shortest life expectancy.” Therefore, a trust that has as beneficiaries the participant’s spouse and children will meet this requirement since no one can be added to the class of beneficiaries who may have a shorter life expectancy.<sup>2</sup> However a trust that names the grantor’s children and their spouses as beneficiaries will not pass this requirement because it is possible that a child marries a spouse that is older than the beneficiaries identified as of the participant’s death.

The beneficiary with the shortest life expectancy is initially identified as of the participant’s death. However, if this requirement is not met at that time the trust may still qualify if the unidentifiable class member may be removed by disclaimer or otherwise as of the Beneficiary Finalization Date (September 30<sup>th</sup> of the year after the year of the participant’s death).

2. *The Required Documentation.* The administrator of the plan is typically the custodian of the IRA. The required documents must be received by the administrator by October 31<sup>st</sup> of the year after the year of the participant’s death. In other words, one month after the Beneficiary Finalization Date.

The documentation required to be furnished by the trustee set forth in Reg. §1.401(a)(9)-4, A-6(b) is either:

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<sup>2</sup> It is possible that a participant’s child could adopt someone that is older than the oldest identifiable beneficiary under the trust. This issue has not been addressed by the IRS. The trust document could be drafted to prevent this result.

“Provide the plan administrator with a final list of all beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions on their entitlement) as of September 30 of the calendar year following the calendar year of the [participant’s] death; certify that, to the best of the trustee’s knowledge, this list is correct and complete and that the [other requirements] are satisfied; and agree to provide a copy of the trust instrument to the plan administrator upon demand....” or

“Provide the plan administrator with a copy of the actual trust document for the trust that is named as a beneficiary of the [participant] under the plan as of the [participant’s] date of death.”

3. *All the Trust Beneficiaries must be Individuals.* Meeting the requirements of rules 1-4 above only means that the beneficiaries of the trust will be treated the same as if they were named directly as beneficiaries (except for the separate accounts rule and spousal roll-over). If the trust is going to qualify for see-through trust status and thereby be a Designated Beneficiary, all the beneficiaries of the trust must be individuals.

**III. DETERMINING THE TRUST BENEFICIARIES.** For Minimum Required Distribution (MRD) purposes for a trust, the difficult part is determining if all the beneficiaries of the trust are individuals and which trust beneficiary is the oldest. For this determination, it must be ascertained which trust beneficiary must be included and which beneficiary may be excluded.

A. *Allocating IRA Benefits to a Certain Share of the Trust.* When retirement plan benefits are payable to a trust (“funding trust”) which in turn subdivides into subshares or subtrusts, and the retirement plan benefits are allocated to less than all the subshares or subtrusts, the question arises whether the determination of the identity of beneficiaries (Rule 3) and whether those beneficiaries are individuals (Rule 5) is applied at the trust level or the subshare or subtrust level. For example, a trust that divides upon the participant’s death into a marital trust and a credit shelter trust and which allocates the IRA to the marital trust.

1. *Trust’s Interest in the Benefits.* It appears that if retirement plan benefits are payable to a funding trust (i.e. grantor’s revocable living trust) which in turn get allocated to a subshare or subtrust, only the beneficiaries of the subshare or subtrust will be counted, not all the beneficiaries of the Funding Trust. Reg. §1.401(a)(9)-4, A-5(a).

2. *Subtrust Named Directly.* If a subtrust is named directly and the funding trust does not do the allocation, then only the beneficiaries of the subtrust are counted for Rules 3 and 5.

3. *Retirement Plan Benefits Allocated Pursuant to the Trustee's Discretion.* If the trustee of the funding trust has discretion to determine which assets of the trust, including retirement plan benefits, be distributed to the trust's subshares or subtrusts, and the trustee distributes all of the retirement plan benefits to a particular subshare or subtrust, can the other beneficiaries of the funding trust be disregarded for Minimum Required Distribution purposes? A private letter ruling answered yes to this question where the funding trust had sufficient assets to satisfy pre-residual bequests and the other subshares and subtrust, and where state law did not give the right to beneficiaries to demand that they get paid from the retirement plan benefits. PLR 2002-21061. Of course a private letter ruling can only be relied upon by the parties to it. The better choice would be to name the subshare or subtrust directly.

4. *Retirement Plan Benefits Directed by the Funding Trust be Allocated to Subshare or Subtrust.* If the terms of the funding trust require the retirement plan benefits be distributed to certain beneficiaries or a certain subtrust, or directs that certain beneficiaries or subtrusts cannot be the recipient of the retirement plan beneficiaries, then the other trust beneficiaries should be disregarded. For example, the funding trust directs all retirement plan benefits to the marital trust even though that may leave the credit shelter trust under funded.

B. *IRA Benefits Payable to a Trust or Estate – the Separate Accounts Rule.* When IRA benefits are payable to several individuals, for example equally to the participant's children, the IRA is divided into separate inherited IRAs, one for each beneficiary. The required minimum distribution for each inherited IRA is the life expectancy of its beneficiary. This is called the separate accounts rule. However, when IRA benefits are payable to a trust the separate accounts rule may or may not apply.

1. *Applicable Distribution Period for Benefits Payable to a Trust.* When IRA benefits are payable to a trust and the trust in turn divides the benefits among the beneficiaries, the separate accounts treatment is not available.

*Ruth Example.* Ruth names her revocable trust as the beneficiary of her IRA. Her revocable trust by its terms distributes the trust estate outright and equally among Ruth's children. The successor trustee of Ruth's trust will divide the IRA into separate inherited IRAs, one for each

of Ruth's children, but the separate accounts rule relative to the applicable distribution period will not apply. The applicable distribution period for each of the inherited IRAs will be the life expectancy Ruth's oldest child. Reg. §1.401(a)(9)-4, A-5(c).

*John Example.* John names his estate as the beneficiary of his IRA. By the terms of his will, his estate is divided into separate shares for his children to be held by a trustee for each child until the child reaches a certain age. The personal representative of John's estate will divide the IRA into separate inherited IRAs, one for each child, to be held by the trustee for the benefit of the child. The separate accounts rule relative to the applicable distribution period will not apply. The applicable distribution period for each of the inherited IRAs will not be the life expectancy of John's oldest child as was the case in the above example. Instead, since an estate can never be a designated beneficiary, the applicable distribution period will be determined under the 5 year rule (if John died before his required beginning date) or John's remaining life expectancy (if he died after his required beginning date). Reg. §§1.401(a)(9)-3, A-4(a)(2) and 1.401(a)(9)-5, A-5(a)(2).

2. *Structuring the Trust to Achieve Separate Accounts Status.* If the participant wants to divide his or her IRA among several beneficiaries, and wants each beneficiary to be able to take the benefits over the life expectancy of that beneficiary, then the following steps must be taken. To achieve separate account status for the applicable distribution period, the division of the benefits must be done at the "plan level" and not the "trust level."

*Ruth's Example.* To have each one of Ruth's children take their individual inherited IRA over that child's life expectancy and not over the life expectancy of Ruth's oldest child is easy to accomplish. She would simply name her children as the direct beneficiaries of her IRA and not her revocable trust. The plan does the dividing ("plan level") not her trust ("trust level").

*John's Example.* John situation is more difficult to accomplish separate account status for applicable distribution purposes. John must do two things:

First, his will must establish a separate trust for each one of his children. IRA benefits payable to a testamentary trust which divides the benefits into separate shares is not enough. The testamentary trust must create separate subtrusts that will have their own tax identification number and file their own tax return to achieve separate account status for applicable distribution period purposes. Whether the testamentary trust that divides into subtrust for each beneficiary is created through a will or revocable trust make no difference.

Second, John must designate directly each separate subtrust as a beneficiary of the IRA (the division is being made at “plan level” and not at “trust level”). He can do this in two ways. He could set up a separate IRA for each subtrust and name that subtrust directly as the beneficiary, or he could designate the beneficiaries of a single IRA in some portion to each subtrust.

In following both of these steps, each of John’s children will be able to take his or her inherited IRA over their own life expectancy.

C. *The Beneficiary Finalization Date.*<sup>3</sup> A person or entity named as a beneficiary of a participant’s retirement plan benefits as of the participant’s death will not be counted as a beneficiary if he, she or it does not remain a beneficiary as of the Beneficiary Finalization Date. The Beneficiary Finalization Date is September 30<sup>th</sup> of the year following the year of the participant’s death.

A beneficiary does not remain as such if such beneficiary’s interest in the retirement benefits has been eliminated either by distribution, disclaimer or other means. The purposes of determining who are beneficiaries of a trust for “see-through” status is applied as of the participant’s death, but may be modified as of the Beneficiary Finalization Date.

1. *Distribution on or before September 30<sup>th</sup>.* Here are some situations where “undesirable” beneficiaries were removed by distribution prior to the Beneficiary Finalization Date:

a) *Alda’s Example.* Alda left her IRA to a trust that distributed the plan benefits in specific percentages to her husband and children. The husband took his percentage in full by the Beneficiary Finalization Date and rolled it into his own IRA. The husband was disregarded for determining who was the oldest beneficiary of the trust, leaving the life expectancy of the oldest child as the applicable distribution period.

b) *Thornton’s Example.* Thornton, age 60, left his IRA benefits to his revocable living trust. The beneficiaries of his trust were his nieces and nephews and his church in equal shares. Since not all of the trust beneficiaries are individuals, the trust fails to be a see-through trust and therefore it is not a designated beneficiary. Thornton passed away before his required beginning date resulting in the 5 year payout rule applying. However, the trust had other assets to satisfy the church’s share of the trust estate, and if the church’s share is distributed prior to the Beneficiary Designation Date, the trust is left with only individual beneficiaries, allowing the

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<sup>3</sup> This is not an IRA term. It was coined by Natalie B. Choate “Life and Death Planning for Retirement Benefits” 7<sup>th</sup> Edition, 2011. A book I highly recommend.

IRA benefits to be paid over the life expectancy of the oldest of the nieces and nephews.

2. *Disclaimer Prior to September 30<sup>th</sup>.* If a beneficiary disclaims his entire interest by the Beneficiary Finalization Date, he no longer considered a beneficiary. If the disclaimant was the oldest beneficiary, the next oldest beneficiary's life expectancy will become the applicable distribution period. Here are some examples:

a) *Hilda's Example.* Hilda left her IRA to a trust for the life benefit of her sister with the remainder to Hilda's three nieces. If Hilda's sister (who is older than the nieces) disclaims her interest in the trust prior to the Beneficiary Designation Date leaving the nieces as the sole beneficiaries of the trust, the older nieces life expectancy becomes the applicable designation period.

b) *Ralph's Example.* Ralph, age 75, left his IRA benefits to a marital deduction trust for benefit of his wife, Susie, age 65, for life with the remainder interest equally to his children. Ralph also gave Susie a special power of appointment to appoint the marital trust estate to a class of beneficiaries including his children and charities. The inclusion of charities as a potential beneficiary of the trust makes it flunk the see-through trust rules and the IRA would have to be paid to the trust not over Susie's life expectancy, but over Ralph's life expectancy. If Susie disclaims that part of her special power of appointment relative to the charities, the trust becomes a see-through trust and the benefits will be paid to the trust over Susie's life expectancy.

D. *The Mere Potential Successors Rule.* As of the Beneficiary Designation Date it can be ascertained which beneficiaries of the trust will receive a share of the retirement plan benefits and which beneficiaries potentially may receive a share. The class of such beneficiaries is potentially endless. The question then arises as to which of these beneficiaries must be included for applying the trust rules and which can be disregarded. Reg. §1.401(a)(9)-5, A-7(c) tells us which of these potential trust beneficiaries can be disregarded in applying the trust rules. It is called the "mere potential successor rule" and it reads as follows:

"(c). Successor beneficiary – (1) A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy...or whether a person who is not an individual is a beneficiary, *merely because the person could become the successor* to the interest of one of the employee'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 an employee's benefit beyond being a *mere potential successor* to the interest of one of the employee's beneficiaries upon that beneficiary's death." Emphasis added.

Sure that's clear! The mere potential successor rule divides trust into two classes: "conduit trusts" and "accumulation trusts."

E. *Conduit Trust for One Beneficiary.* A conduit trust is a type of see-through trust where the trustee has no power to accumulate plan distributions in the trust. The IRS considers the conduit trust beneficiary as the sole beneficiary disregarding all potential successor beneficiaries.

1. *So what is a Conduit Trust?* A conduit trust must require the trustee to distribute to the beneficiary any distributions the conduit trust receives after the participant's death and during the beneficiary's lifetime. The trustee has no authority to accumulate any plan distributions inside the conduit trust.

2. *Minimum Required Distributions for a Conduit Trust.* For purposes of the minimum required distribution rules a conduit trust for a single individual, plan benefits are deemed to be paid only to that individual beneficiary, and therefore, the "all beneficiaries must be individuals" test is met. All successor beneficiaries of the trust are deemed to be mere potential successors and therefore disregarded. The conduit trust is a safe harbor guaranteeing see-through trust status where the minimum required distribution is based solely on the life expectancy of the conduit trust beneficiary even though remainder beneficiaries may be older individuals, charities, or an estate.

3. *Payments for the Benefit of the Beneficiary.* Payments to a guardian of a minor child or incapacitated person and payments to a special needs trust for the benefit of a disabled person should be considered payments "to" the conduit beneficiary.

4. *Trust Administration Expense.* Likewise, the fact that trust administration expenses of the conduit trust are paid from plan distributions to the trust, should not disqualify the trust from conduit trust status.

F. *Conduit Trust for Multiple Beneficiaries.* It is possible to draft a conduit trust for multiple beneficiaries if by the terms of the trust (1) all distributions the trust receives from the retirement plan must be immediately paid out to one or more of the conduit beneficiaries, and (2) as long as *any member* of the conduit beneficiaries is living, no plan distributions can be accumulated in the trust for possible distributions to *other* beneficiaries. Here are some examples:

1. *Lillian Example.* Lillian leaves her IRA plan benefits to a trust for the benefit of her children. By the terms of the trust, the trustee is required to distribute upon receipt all plan benefits to Lillian's children in such proportions as the trustee deems advisable for their health, education and maintenance. When the youngest of Lillian's children reaches the age of

30, the trust terminates, and the trustee is required to divide the IRA into separate inherited IRAs for each then living child. This trust would be considered a conduit trust.

2. *Dennis Example.* Dennis's trust is the same as Lillian's, except it provides that if one of Dennis's children passes away before age 40, that child's share would be held for the benefit of that child's children for later distribution. Dennis's trust would not qualify as a conduit trust because plan distributions could be accumulated in the trust while some members of the conduit beneficiaries are still alive.

G. *Accumulation Trusts.* If a trust is not a conduit trust, it is considered an accumulation trust.<sup>4</sup> Unlike the trustee of a conduit trust, the trustee of an accumulation trust has the potential to accumulate, i.e. not pay out to the beneficiaries of the trust, some or all of the retirement plan benefits paid to the trust. Therefore, the remainder beneficiaries of the trust do count for purposes of the minimum required distribution rules.

Reg. §1.401(a)(9)-5, A-7(c) states: "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. Emphasis added.

The potential beneficiaries of an accumulation trust are endless. For example, who are the potential beneficiaries of a trust for the benefit of a surviving spouse for life with a remainder interest to children? Certainly the spouse and children are beneficiaries. But it's possible that a child passes away before the spouse and after the participant, do the beneficiaries that take that child's share either by the terms of the trust or by state law also count to determine the life expectancy of the oldest beneficiary and if all beneficiaries are individuals? Just how far do we go in this endless class of potential beneficiaries? Which beneficiaries count for the trust rules and which are considered "mere potential successors" and not counted?

Example 1 of Reg. §1.401(a)(9)-5 A-7(c)(3) states: "Under the terms of Trust P, all trust income is payable annually to B [spouse of the deceased participant, A], and no one has the power to appoint Trust P principal to any person other than B. A's children, who are all younger than B, are the sole remainder beneficiaries of Trust P. *No other person has a beneficial interest in Trust P.*" Emphasis added.

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<sup>4</sup> This is not an IRS, but is widely used to describe this type of trust.

Example 1 with the interpretation of several private letter rulings has come to mean that we need not consider who would take the benefits if the children of A predeceased the participant's surviving spouse B, because the children of A are outright (unlimited) beneficiaries, and accordingly any beneficiary who takes only if the children of A die before B is a "mere potential successor."

H. *Outright to Now Living Persons.* As explained by Natalie Choate:<sup>5</sup>

Under the approach exemplified in (example 1 and the PLR's interpreting it)...you test an accumulation trust by "counting" all successive beneficiaries down the "chain" of potential beneficiaries who could take under the trust, until you come to the beneficiary(ies) who or which will be entitled to receive the trust property *immediately* and *outright* upon the death of the prior beneficiary(ies). That "immediate outright" person, entity or group is (or are) the last beneficiaries in the "chain" that you need to consider. If the immediate outright beneficiary(ies), and all prior beneficiaries in the "chain," are individuals, then the trust qualifies as a see-through trust, with the life expectancy of the oldest member of that group serving as the (applicable distribution period). Any beneficiary who might receive the benefits as a result of the death(s) of the immediate outright beneficiary(ies) is ignored as a "mere potential successor."

These tests are applied at the time of the participant's death, "as if" the first trust beneficiary died immediately after the participant, and the next beneficiary in the chain died immediately after the first beneficiary, and so on until you reach the first "immediate outright" beneficiary, where you stop. The tests are *not* re-applied at the later actual death of any beneficiary. It makes no difference who *in fact* inherits the benefits when the first beneficiary later dies. Rather, the "snapshot" of the beneficiaries is taken once and only once, at the time of the participant's death, based upon the identities of the beneficiaries *who actually survived the participant* and on the *hypothetical death of each of these beneficiaries* immediately after the participant's death or immediately after the death of the prior beneficiary in the "chain."

Natalie Choate calls this type of trust an "outright-to-now-living-persons" (O/R-2-NLP) trust. She suggests that either a conduit type trust be used or a O/R-2-NLP trust be used since these are only types of trust for which we have guidance.

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<sup>5</sup> Section 6.3.08, Life and Death Planning for Retirement Benefits, 7<sup>th</sup> Edition, 2011.

1. *Steve's Example.* Steve left his IRA benefits to a trust naming his wife as lifetime beneficiary with the trust remainder to his children to be held for their benefit until age 30. When Steve passed away, he was survived by his wife and all of his children were older than 30 years of age. Since Steve's wife did not have full and unlimited benefits in the IRA (she had a life income and principal distributions within the trustee's discretion), the search for beneficiaries who count for the minimum required distribution rules for a trust continues. Upon Steve's death, if his wife immediately passed away, the IRA benefits would pass to his children outright because no child was under the age of thirty. Our search for potential trust beneficiaries ends because we found a beneficiary(ies) who would take the plan benefits completely and outright. Our class of beneficiaries has now been determined to be wife and children, and therefore the age of the oldest beneficiary can be determined (wife) for calculation of the applicable distribution period for the IRA payout. PLR 2004-38044.

2. *Sara's Example.* Sara left her IRA benefits to a trust for the benefit of her son to be held in trust for his benefit until he reached the age of 40. If he passed away before the age of 40, the trust provided that his children would receive his share, and if he had no children, then to his heirs at law. Upon Sara's death, the son survived her but had not reached the age of 40. The son had no children at that time. Since the son did not get the IRA benefits outright, we must look at who are the beneficiaries of the trust if the son immediately passed away after his mother. Since the son did not have children when Sara died, the son's closest relative for his father who would take the benefits outright. The class of beneficiaries of the trust consists of the son and his father. It is the father's life expectancy that will be used to determine the IRA payout. PLR 2008-43042.

I. *Powers of Appointment.* If a remainder interest is subject to a power of appointment upon the death of the life beneficiary of the trust, all potential appointees, as well as those who would take in default of exercise of the power, are considered beneficiaries, unless they can be disregarded under the rules of discussed in section C above.

For a conduit trust with a single beneficiary, the remainder beneficiaries are disregarded. If the single conduit beneficiary has been given a power of appointment, all members of the class of appointees will not be counted even if there are non-individuals, like charities, among the potential appointees.

With an accumulation trust, remainder beneficiaries must be counted. If the accumulation trust wants to qualify for see-through trust status, all potential appointees, as well as all those who would take in default of the exercise of the power, must be (1) identifiable (2) individuals, who are (3) younger than the

beneficiary whose life expectancy is the one the participant wants used as the applicable distribution period.

1. *Power to Appoint to Issue.* A power of appointment given to a surviving spouse with the class of potential beneficiaries being the issue of the participant and his spouse would work. It is a clearly defined group of identifiable younger individuals. PLR 1999-03050.

2. *Power to Appoint to Spouses of Issue.* A power to appoint to someone's spouse is a classic example of creating a nonidentifiable beneficiary (unless it is limited to a specific spouse). Such a power of appointment would make the trust fail the see-through trust status.

3. *Power to Appoint to Charity.* A power of appointment given to a surviving spouse that would allow her to appoint the trust estate to the participant's issue and charities of the spouse's choice would make the trust fail the see-through rules because there is a potential that a non-individual could end up as a beneficiary of the plan benefits.

#### **IV. SOME IDEAS FOR ESTATE PLANNING WITH THE MINIMUM REQUIRED DISTRIBUTION RULES.**

A. *Trust for Disabled Beneficiary.* There are several options available for a trust that is to receive retirement plan benefits to be used for a disabled beneficiary. The option that is best will depend upon whether or not the beneficiary needs to qualify for needs based government benefits and upon the identity of the remainder beneficiary.

1. *Conduit Trust.* Under the conduit trust rules, all the retirement plan benefits received by the trustee will have to be immediately distributed to the beneficiary. This would most likely disqualify the beneficiary for any needs based government programs, and therefore, a conduit trust is not a suitable vehicle when qualifying for a needs based programs is important. However, it may be appropriate where qualification for needs based programs is not important such as when the parents are going to support the child through other means such as a separate trust set up for the disabled child's benefit.

2. *Accumulation Trust.* A supplemental needs trust is designed to meet the supplemental needs of the disabled trust beneficiary. If the trustee is directed to use the income and principle for the disabled beneficiary for his or her health, education and maintenance, but not in such a way that such distributions would disqualify the beneficiary from certain government benefits that would be otherwise available to the disabled beneficiary. This type of special needs trust would be considered an accumulation trust, and therefore, to gain see-through trust status all of the potential beneficiaries would have to be identifiable individuals. A

special needs trust usually lasts for the disabled beneficiary's lifetime, so it is important that the remainder beneficiaries be individuals who are approximately the same age as the disabled beneficiary so that the applicable distribution is not unduly shortened.

3. *Charitable Remainder Trust with Payments to Special Needs Trust Due.* If the plan participant is charitably inclined, it may be considered that the retirement plan benefits be payable to a charitable remainder trust. The charitable remainder trust would pay to the special needs trust set up for the disabled beneficiary the annuity amounts, which in turn the special needs trust would use for the benefit of the disabled person.

B. *Trust for Minors.* How retirement benefits are left to a minor depends upon the planning objective of the participant. Is it the participant's goal to pay the retirement plan benefits over the life expectancy of the minor, or is the goal of the participant to use the money in the retirement plan for the health, education and welfare of the child while the child is growing up?

1. *Conduit Trust.* A conduit trust may be a good choice when the retirement plan benefits are not going to be the primary support source for a minor beneficiary. It is also a safe harbor choice, which, in addition, gives flexibility to designating the remainder beneficiaries. On the other hand, a conduit trust may not be appropriate where the object is to support the minor beneficiary while they are growing up. The required minimum distributions would be small and may not be sufficient to take care of their financial needs while a minor. The conduit trust could be designed so that the trustee has the authority to distribute retirement plan benefits to the minor for his or her health, education and welfare over and above distributing to the minor the required minimum distribution each year.

2. *Circle Trust.* If a conduit trust is not appropriate for the circumstances, an accumulation trust for the minor beneficiary must be used. The problem comes in as to who will receive the benefits if the minor dies while the trust is still in effect. That contingent remainder beneficiary counts as a beneficiary for the purposes of the minimal distribution trust rules, and it can be difficult to figure who that remainder beneficiary should be. The minor's future unborn issue do not count.

If the accumulation trust is for the benefit of several minors, a solution is that the retirement plan benefits can only be used for those minors or the survivor of them. For example, if the trust has three minor children as beneficiaries, the trust would provide that if a minor beneficiary died during the term of the trust the remaining two beneficiaries would be the sole beneficiaries of the trust. Upon the death of the next to last minor beneficiary, the trust would provide that it would terminate and the retirement plan benefits would be paid directly to that last surviving minor

or the minor's guardian. This is called a circle trust. Without a provision such as this in an accumulation trust, the most likely counted remainder beneficiary, if a minor should pass away, would be the minor's closest adult relative which would force the distribution of the retirement plan to be paid out at an accelerated rate.

3. *Outright to Now Living Persons Trust.* For a trust for a minor that is going to receive retirement plan benefits, the problem is who the remainder beneficiaries of the trust are so that it qualifies for see-through trust status. The typical trust for a minor provides that the trust will be held for minor's benefit until he or she reaches a certain age at which time the trust terminates. To use the "outright-to-now-living persons" approach for see-through trust status requires that the remainder beneficiaries be individuals (not entities like charities) who are younger than the minor if the minor's life expectancy is to be used as the applicable distribution period.

The problem with a trust for a minor is that at the time of the participant's death the minor beneficiary does not have children. Therefore, to determine the applicable distribution period for the retirement plan benefits, one must look to the remainder beneficiary who would receive the retirement plan benefits outright. For example, in PLR 2002-28025, which involved a trust for the benefit of two minors, the trust was to terminate and be distributed outright to the minors as each reached the age of thirty, but if they both died before reaching that age, the trust would pass to other relatives, the oldest of whom was sixty-seven at the participant's death. The IRS ruled that the sixty-seven year old life expectancy was the applicable distribution period because he was the oldest trust beneficiary.

Therefore, in designing a trust for a minor that is to receive retirement plan benefits, thought needs be given to who the remainder beneficiary should be if the minor passed away before the trust is terminated. Remember, that the testing period is the participant's date of death when ascertaining the identity of remainder beneficiaries. One solution for a remainder beneficiary of a minority trust is to have the trust name a person, say a niece, a nephew or other relative, who would take in default, and who is younger than the minor child.

Another approach would be to give the trustee the authority to distribute the trust remainder to any individual beneficiary who was born in the same year as the oldest minor child or in a later year. A third approach would be to name as a default beneficiary should all minors pass away, heirs at law who are younger than the oldest minor child.

**V. CONCLUSION.** Naming a trust as the beneficiary of retirement plans benefits should be avoided unless it is in the best interest of the beneficiary. The drafting requirements of the trust are complex, and the retirement plan beneficiary designation form needs to be carefully written.

**LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS**

**NATALIE CHOATE FORMS**

**Forbidding Payment of Benefits to Nonindividuals**

*Version A:*

Notwithstanding any other provision hereof, the trustee may not distribute to or for the benefit of my estate, any charity, or any other nonindividual beneficiary any Deferrable Retirement Benefit payable to this trust. It is my intent that all such Deferrable Retirement Benefits be distributed to or held for only individual beneficiaries, within the meaning of the Minimum Distribution Rules. Accordingly I direct that such benefits may not be used or applied for payment of my debts, taxes, expenses of administration, or other claims against my estate; nor for payment of estate, inheritance or similar transfer taxes due on account of my death. This paragraph shall not apply to any bequest or expense which is specifically directed to be funded with Deferrable Retirement Benefits by other provisions of this instrument.

*Version B:*

Notwithstanding any other provision hereof, the trustee may not, after September 30 of the calendar year following the calendar year in which my death occurs, or such earlier date as may be established under the Minimum Distribution Rules as the final date for determining whether this trust meets the requirements for treatment of the trust's beneficiaries as if they had been named directly as beneficiary of any retirement plan payable to this trust ("Such Date") for purposes of such Rules, distribute to or for the benefit of my estate, any charity, or any

other nonindividual beneficiary any Deferrable Retirement Benefits payable to this trust. It is my intent that all such Deferrable Retirement Benefits held by or payable to this trust as of Such Date be distributed to or held for only individual beneficiaries, within the meaning of the Minimum Distribution Rules. Accordingly I direct that such benefits may not be used or applied after Such Date for payment of my debts, taxes, expenses of administration, or other claims against my estate; nor for payment of estate, inheritance or similar transfer taxes due on account of my death. This paragraph shall not apply to any bequest or expense which is specifically directed to be funded with Deferrable Retirement Benefits by other provisions of this instrument.

### **Excluding Older Adopted Issue**

A person's "issue" shall not include an individual who is such person's issue by virtue of adoption if such individual was so adopted after my death and is older than the oldest individual who was a beneficiary of this trust at my death.

### **Limitation on Powers of Appointment**

Notwithstanding any other provision hereof, no Deferrable Retirement Benefit may be appointed, distributed, or transferred to any other trust unless (1) under the Minimum Distribution Rules, beneficiaries of such other trust are treated as having been designated directly as beneficiaries of such Deferrable Retirement Benefit for purposes of such Rules, and (2) the oldest beneficiary of such other trust was not born in a year earlier than the year of birth of the oldest beneficiary of this trust.

## **Marital Deduction Savings Language**

If this trust is or becomes the beneficiary of any Retirement Benefit, the trustee must withdraw from the trust's share of such Retirement Benefit, each year:

- A. So long as my spouse is living, the net income of the trust's share of such Retirement Benefit for such year; and
- B. Regardless of whether my spouse is then living, such amount or such additional amount (if any) as is required to be distributed from such share under the Minimum Distribution Rules (if applicable).

This paragraph shall not be deemed to limit the trustee's power and right to withdraw from the marital trust's share of the Retirement Benefit in any year more than the amount(s) stated above.

## **Establishing a Conduit Trust for One Beneficiary**

From and after my death, this trust shall be held for the benefit of [NAME OF INDIVIDUAL TRUST BENEFICIARY] (hereinafter referred to as the "Beneficiary"). Each year, beginning with the year of my death, my trustees shall withdraw from any Deferrable Retirement Benefit the Minimum Required Distribution for such Deferrable Retirement Benefit for such year, plus such additional amount or amounts as the trustee deems advisable in its discretion. All amounts so withdrawn (net of expenses properly charged thereto) shall be distributed to the Beneficiary, if the Beneficiary is then living. Upon the death of the Beneficiary (or upon my death if the Beneficiary does not survive me) all remaining property of this trust [here insert the provisions that will apply after the conduit beneficiary's death; since the see-through trust rules "do not care" what these provisions say, they can be

anything you want. Examples: "shall be paid to [NAME OF REMAINDER BENEFICIARY]," or "shall be held in further trust pursuant to the provisions of Article [NUMBER] of this trust instrument.

### **Conduit Trust for Spouse (Marital Deduction)**

From and after my death, this trust shall be held for the benefit of my spouse [NAME OF SPOUSE] (hereinafter referred to as "my spouse"), if my spouse survives me. Each year, beginning with the year of my death, and so long as my spouse is living, the trustee shall withdraw from any Retirement Benefit the income of such Benefit, or (in the case of any Deferrable Retirement Benefit) the Minimum Required Distribution for such Deferrable Retirement Benefit for such year if greater than the income of such Deferrable Retirement Benefit,' plus such additional amount or amounts as the trustee deems advisable in its discretion. All amounts so withdrawn (net of expenses properly charged thereto) shall be paid directly to my spouse upon receipt by the trustee. Upon my spouse's death (or upon my death if my spouse does not survive me) all remaining property of this trust [here insert the provisions that will apply after the conduit beneficiary's death; since the see-through trust rules "do not care" what these provisions say, they can be anything you want. Examples: "shall be paid to [NAME OF REMAINDER BENEFICIARY]," or "shall be held in further trust pursuant to the provisions of Article [NUMBER] of this trust instrument."

### **Conduit Provision Included in "Family Pot" Trust**

This approach works only for benefits that pass directly to this "Family Trust" upon the participant's death under the participant's beneficiary designation form. It will not work for a trust that is not established until the death of a prior beneficiary.

## **Administration of Family Trust**

From and after my death, the trustee shall hold and administer all amounts then held by the trust, or that become payable to this trust as a result of my death, for the benefit of my children surviving me, upon the following terms:

- A. While there is any child of mine living who is under the age of [AGE, such as "thirty"] years, the trustee shall hold, administer, and distribute Deferrable Retirement Benefits as provided in Paragraph B and shall hold, administer, and distribute all other property of the trust as provided in Paragraph C.
- B. Each year, beginning with the year of my death, the trustee shall withdraw from any Deferrable Retirement Benefit the Minimum Required Distribution for such Deferrable Retirement Benefit for such year, plus such additional amount or amounts (if any) as the trustee deems advisable in its discretion. The trustee shall forthwith pay all amounts so withdrawn (net of expenses properly charged thereto) to such one or more of my children as are then living, and in such proportions among them, as the trustee deems advisable in its discretion.
- C. The trustee shall pay such amounts of the income and/or principal of property subject to this paragraph to (or apply it for the benefit of) such one or more of my children as are then living, and in such proportions among them as the trustee deems advisable in its discretion.
- D. At such time as there is no child of mine living who is under the age of [AGE, such as "thirty"] years, the trust shall terminate and be distributed outright and free of trust to my

issue then living by right of representation, or, if there are no such issue then living, shall be distributed to [NAME OF DEFAULT REMAINDER BENEFICIARY].

### **Last Man Standing Trust for Children**

#### **Administration of Family Trust**

From and after my death, the trustee shall hold and administer all amounts then held by the trust, or that become payable to this trust as a result of my death, for the benefit of my children surviving me, upon the following terms. While there is any child of mine living who is under the age of [AGE, such as "thirty"] years, the trustee shall pay such amounts of the income and/or principal of the trust to (or apply it for the benefit of) such one or more individuals as the trustee shall select from the class consisting of all my issue then living, and in such proportions among them as the trustee deems advisable in its discretion for their care, support, education, comfort, and welfare. The trust shall terminate at the earlier of the following times:

- A. Such time as there is no child of mine living who is under the age specified above.
- B. Such time as there is only one child of mine living (regardless of such child's age).

Upon termination, the trust property shall be distributed, outright and free of trusts, to my issue then living, by right of representation.

## **"0/R-2-NTLP" Trust (Spouse then Issue)**

Note that the distribution to issue on the spouse's death must NOT be contingent upon their having reached any particular age. This trust is not intended to qualify for the marital deduction.

Following my death, the trustee shall pay to or apply for the benefit of my spouse, as long as my spouse is living, all income of the trust and such amounts of the principal as the trustee deems advisable in its discretion for my spouse's health and support in the standard of living to which my spouse had become accustomed during my life. Upon my spouse's death (or upon my death, if my spouse does not survive me), the trust shall terminate, and all property of the trust shall be distributed, outright and free of trust, to my issue then living by right of representation.

## **Definitions Used in Certain Trust Forms**

### **Certain Definitions**

The following definitions shall apply in administering this Trust:

1. The **Code** means the Internal Revenue Code of 1986, as amended.

2. A **Retirement Benefit** means the trust's interest in one of the following types of assets if payable to this trust as beneficiary or owned by this trust: a qualified or nonqualified annuity; a benefit under a qualified or nonqualified plan of deferred compensation; any account in or benefit payable under any pension, profit-sharing, stock bonus, or other qualified retirement plan; any individual retirement account or trust; and any and all benefits under any plan or arrangement that is established under § 408, § 408A, § 457, § 403, § 401, or similar

provisions of the Code. **Retirement Benefits** means all of such interests collectively.

3. A **Deferrable Retirement Benefit** means any Retirement Benefit that meets the following two requirements: First, it is subject to the Minimum Distribution Rules. Second, a designated beneficiary of such Benefit has the option (either under the terms of the plan or arrangement that governs such Benefit, or by causing the Benefit to be transferred to an inherited IRA) to take distribution of such Benefit in annual installments over the life expectancy of the (or of the oldest) designated beneficiary. **Deferrable Retirement Benefits** means all of such interests collectively. Benefits payable under a plan or arrangement that is not subject to the Minimum Distribution Rules (such as, under current law, a "nonqualified deferred compensation plan") are not Deferrable Retirement Benefits.

4. The **Minimum Distribution Rules** mean the rules of § 401(a)(9) of the Code, including Regulations thereunder.

5. The **Minimum Required Distribution** for any year means, with respect to any Retirement Benefit: (1) the value of the Retirement Benefit determined as of the preceding year-end, divided by (2) the Applicable Distribution Period; or such greater or lesser amount as the trustee shall be required to withdraw under the laws then applicable to this Trust to avoid penalty. Notwithstanding the foregoing, the Minimum Required Distribution for the year of my death shall mean (1) the amount that was required to be distributed to me with respect to such Benefit during such year under the Minimum Distribution Rules, minus (2) amounts actually distributed to me with respect to such Benefit during such year. The terms "life expectancy," "designated beneficiary," and "Applicable Distribution Period" shall have the same meaning as under the Minimum Distribution Rules.

## **ILS Retirement Benefit Provisions**

### **I. Retirement Benefits**

The following provisions concern Qualified Retirement Benefits that become distributable under this Trust Agreement (whether directly or through the Grantor's estate) by reason of the Grantor's death. "Qualified Retirement Benefits" means amounts held in or payable pursuant to a plan (of whatever type) qualified under Code Sec. 401, an individual retirement arrangement under Code Secs. 408 or 408A, a tax-sheltered annuity under Code Sec. 403 or any other benefit subject to the distribution rules of Code Sec. 401(a)(9), each being a "Qualified Retirement Plan" hereunder).

**A. Property Interests in Other than Participant.** Proceeds and benefits shall be allocated as follows:

b) If the Grantor's Wife has an ownership interest in any Qualified Retirement Benefits payable to the Trustee hereunder at or by reason of the Grantor's death, then the fractional share thereof with respect to such Qualified Retirement Benefit attributable to such interest shall be paid to the Grantor's Wife (to the extent the share so attributable is not payable under the applicable beneficiary designation to the Grantor's Wife or to any trust for the Grantor's Wife's benefit which is either revocable by the Grantor's Wife or otherwise includable by the Grantor's Wife's estate for Federal estate tax purposes).

c) If any person or entity (other than the Grantor) has an ownership interest in any Qualified Retirement Benefits payable to the Trustee hereunder at or by reason of the Grantor's death, then the fractional share thereof with respect to such Qualified Retirement Benefit attributable to such interest shall be paid to such other person or entity (to the extent the proceeds or share so attributable are not already payable to such other person or entity under the applicable beneficiary designation).

**B. Disposition of Participant's Interest.** Subject to the foregoing provisions concerning interests in one other than the participant, the Qualified Retirement Benefits shall be allocated as follows:

b) If the Grantor's Wife survives the Grantor, any benefit excluded for Federal estate tax purposes from the Grantor's gross estate shall be added to (but shall not affect the size of) any Formula Gift that is not made to the Grantor's Wife or any Marital Trust for the Grantor's Wife, or if there is no such gift, to that portion of the Grantor's Residuary Trust Fund that is not left to the Grantor's Wife or any Marital Trust for the Grantor's Wife. No excluded benefit shall, however, be used to satisfy any obligation of the Grantor's estate or any such trust.

c) Subject to the foregoing, to the extent there is insufficient other property to satisfy any of the Formula Gifts, a fractional share (and not a sum, even if the gift is stated as a sum) of the Qualified Retirement Benefits resulting in a value as finally determined for Federal estate tax purposes equal to the insufficiency (or as much of the insufficiency as possible) shall be allocated in satisfaction of such Formula Gifts.

d) The balance of the Qualified Retirement Benefits shall be disposed of in the same manner as the Grantor's Residuary Trust Fund under this Trust Agreement.

**C. Selection of "Payout Schedule."** The Trustee may exercise any right to determine the manner and timing of payment of Qualified Retirement Benefits that is available to the recipient of the benefits, but the Trustee must exercise such rights in a manner consistent with the Federal income tax rules governing required minimum distributions under Code Sec. 401(a)(9). However, if any Qualified Retirement Benefit is payable to the Grantor's Wife or to any Marital Trust (whether pursuant to a separate beneficiary designation or pursuant to this Article) hereunder, the Grantor's Wife shall have the right in her individual capacity and in her sole and absolute discretion, exercisable in all events, to withdraw from the Qualified Retirement Plan from

which the benefits are payable, all the income of the Qualified Retirement Plan annually or at more frequent intervals. To accomplish the foregoing whenever any such Qualified Retirement Benefit is payable to any Marital Trust hereunder, and with specific intent to qualify for the "marital deduction" under Code Section 2056, the Grantor provides the following:

b) The Grantor's Wife shall have the power, exercisable annually, to compel the Trustee to withdraw from the Qualified Retirement Plan an amount equal to all the income of that Qualified Retirement Plan for the year and to distribute that income to the Grantor's Wife. If the Grantor's Wife exercises such power, the Trustee is obligated to withdraw the greater of all of the income of the Qualified Retirement Plan or the annual required minimum distribution amount under § 401(a)(9), and distribute currently to the Grantor's Wife at least the income of that Qualified Retirement Plan. If the Grantor's Wife does not exercise such power to compel a withdrawal from the Qualified Retirement Plan for a particular year, the Trustee shall only be required to withdraw from the Qualified Retirement Plan only the required minimum distribution amount under § 408(a)(6) for that year, as provided elsewhere in this Article. To the extent that distributions are made to the Trustee of a Marital Trust hereunder other than by reason of the Grantor's Wife's exercise of her right to demand income of the Qualified Retirement Plan, as set forth above, such receipts shall be treated as a distribution of income from that Qualified Retirement Plan to the extent that such Qualified Retirement Plan has not otherwise distributed all of its income.

c) For this purpose, "income" means income as defined in Code Sec. 643(b) determined as if the Qualified Retirement Plan were a separate trust under this Trust Agreement. This right of the Grantor's Wife shall take precedence over the right of the Trustee of any Marital Trust to such income and any exercise

of the right shall take precedence over any different payout selected by the Trustee of any Marital Trust. the Grantor directs the Trustee of any Marital Trust to take any steps necessary to enable the Grantor's Wife to exercise this right effectively. Further, the income of the Qualified Retirement Plan and the income of the Trust (excluding the Qualified Retirement Plan) shall be determined separately and without taking into account that the Qualified Retirement Plan distribution is made to the Trust. Additionally, the portion of the Qualified Retirement Plan distribution to the Marital Trust that is allocated to trust income is disregarded in determining the amount of trust income that must be distributed to the Grantor's Wife under the terms of the Marital Trust.

d) The power granted to the Grantor's Wife elsewhere herein to direct the Trustee of a Marital Trust to make any unproductive assets productive of income or to convert any unproductive assets to property that produces income, within a reasonable time, notwithstanding any provision of this Trust Agreement or any applicable law otherwise authorizing the Trustee to retain unproductive property shall expressly be applicable to the Qualified Retirement Plan as well.

**D. Conduit Trust Provisions for Aames Family Trust.** If the Beneficiary, as defined below, survives the Grantor, then the following provisions shall be applicable with respect to all of the Grantor's interest in any Qualified Retirement Benefits which are payable (either directly or by reason of the provisions above) to the Trustee of the Aames Family Trust:

b) Each year, beginning with the year of the Grantor's death, the Trustee of the Aames Family Trust shall withdraw from any such Qualified Retirement Plan the Minimum Required Distribution for such Qualified Retirement Plan for such year, plus such additional amount or amounts as the Trustee (excluding, however, any Interested Trustee) deems advisable in

the Trustee's sole discretion. All amounts so withdrawn (net of expenses) shall be distributed to the Beneficiary (as defined below in this paragraph) free of trust, if the Beneficiary is then living. If the Beneficiary is not then living, the Trustee shall instead distribute the amount which would have been distributed to the Beneficiary had the Beneficiary been then living, in the manner provided for the distribution of the principal of the Aames Family Trust upon the death of the Beneficiary.

c) The following definitions shall apply in administering these provisions relating to the Aames Family Trust. The Minimum Required Distribution for any year shall be, for each Qualified Retirement Plan: (a) the value of the Qualified Retirement Plan determined as of the preceding year end, divided by (b) the Applicable Distribution Period; or such greater amount (if any) as the Trustee shall be required to withdraw under the laws then applicable to such Qualified Retirement Plan to avoid penalty. If the Grantor's death occurred before the Grantor's "required beginning date" with respect to such benefit, the Applicable Distribution Period means the life expectancy of the Beneficiary. If the Grantor's death occurred on or after the Grantor's "required beginning date" with respect to such benefit, the Applicable Distribution Period means the life expectancy of the Beneficiary, or if longer, the Grantor's remaining life expectancy.

d) Notwithstanding the foregoing, if the Grantor's death occurred on or after the Grantor's "required beginning date" with respect to such benefit, the Minimum Required Distribution for the year of the Grantor's death shall mean (a) the amount that was required to be distributed to the Grantor with respect to such benefit during such year, minus (b) amounts actually distributed to the Grantor with respect to such benefit during such year. Life expectancy, and the meaning of "required beginning date" and

others terms in this paragraph, shall be determined in accordance with Code Sec. 401(a)(9).

e) As used in this paragraph to define the person to whom amounts are to be distributed, the term "the Beneficiary" shall refer to the Grantor's Wife.

**E. Exclusion of Qualified Retirement Benefits from Creditors.**

Anything to the contrary in this Trust Agreement notwithstanding, any Qualified Retirement Benefits payable to the Trustee under this Trust Agreement shall, however, never be or become part of the Grantor's probate or testamentary estate hereunder, and nothing in this Trust Agreement shall be deemed to subject those proceeds to payment of the Grantor's debts or expenses.

## DRAFTING A CONDUIT SUBTRUST

### F. Sample Conduit Trust as subtrust in a revocable trust

**Note: This is a supporting document written by Steven E. Trytten for his article “Got Stretch-Out” in the July 2009 Trusts & Estates**

The following clauses illustrate how a conduit trust could be provided at a Settlor's death for his or her children under the Settlor's revocable trust.

**2.5 Division Into Shares.** Upon the death of the Settlor, the Trustee shall divide the remaining assets in such manner as will create, in the aggregate, equal shares consisting of one such share for each child of the Settlor who is then living and one such share for each child of the Settlor who is then deceased but has descendants then living. Each share set aside for a child of the Settlor who is then deceased but has descendants then living shall be further divided into shares for such descendants on the principle of representation. Each share set aside for a child or more remote descendant of the Settlor (each child or more remote descendant is sometimes referred to as the "Beneficiary" of his or her trust) shall constitute a separate trust to be held and distributed in the manner set forth in Section 2.6 unless such Beneficiary shall have then attained Thirty-Five (35) years of age, in which case such Beneficiary's share shall be distributed to him or her outright and free of trust. If no descendant of the Settlor is then living, the Trustee shall distribute the trust estate in the manner set forth in Section 2.7 below.

**2.6 Trusts for Children and More Remote Descendants.** Each trust for a Beneficiary shall commence upon the first receipt of property by the Trustee. Such property and any subsequent additions of property shall constitute the trust estate, which shall be held, administered and distributed pursuant to this Section 2.6.

**Steve suggests indenting the subparagraphs to make the outline structure of the form clearer:**

**2.6.1 Distribution of Income and Principal - In General.** The Trustee shall distribute, from time to time, to or for the benefit of each Beneficiary so much of the net income and principal of assets (other than Stretch-Out Retirement Account assets) held in such Beneficiary's trust as in the reasonable discretion of the Trustee may be required for the health, support or education of such Beneficiary, taking into account the Beneficiary's other resources, including "conduit distributions" made or anticipated under Section 2.6.2.

**2.6.2 "Conduit Distributions" From Stretch-Out Retirement Accounts.** To the extent the Trustee receives distributions from a Stretch-Out Retirement Account as to which the Beneficiary is the Stretch-Out Retirement Beneficiary (as these terms are defined in Sections 12.16 and 12.17), the Trustee shall distribute to or apply for the benefit of the Beneficiary all of said distributions (net of expenses, and net of income, estate, inheritance, generation-skipping transfer tax, or any other tax, to the extent said expenses and taxes are properly allocable to distributions received or to the balance remaining in said Stretch-Out Retirement Account), for as long as the Beneficiary shall live or until the earlier termination of his or her trust.

**2.6.3 Limitations on Trustee's Power to Take Distributions.** For so long as the Beneficiary is the Stretch-Out Retirement Beneficiary of a Stretch-Out Retirement Account, the following individuals, while serving as *Trustee*, are prohibited from withdrawing "Excess Distributions" from said Stretch-Out Retirement Account, and said power shall be reserved to others acting jointly as Trustee who are not prohibited from so acting or, if none, to the Independent Trustee:

(a) **Disclaimant.** Any individual who made a qualified disclaimer of any interest in said Stretch-Out Retirement Account as to which the Beneficiary is the Stretch-Out Retirement Beneficiary.

(b) **Individual With Obligation of Support.** Any individual who owes a legal obligation of support to the Beneficiary.

(c) **Beneficiary.** The Beneficiary.

For purposes of this Section, the term "Excess Distributions" refers, with respect to an interest in a Stretch-Out Retirement Account, to any distribution in excess of those amounts reasonably necessary to: (i) comply with the Minimum Distribution Rules; (ii) provide for the

Beneficiary's health, education, and support in his or her accustomed manner of living; (iii) comply with the legal obligation to pay income, estate, inheritance, generation-skipping transfer tax, or other taxes properly chargeable to distributions received from or the balance remaining in said Stretch-Out Retirement Account; and (iv) provide for payment of trust expenses properly allocable to distributions received from or the balance remaining in said Stretch-Out Retirement Account.

**2.6.4 Termination.** A Beneficiary's trust shall terminate when he or she attains Thirty-Five (35) years of age, and at such time, the Trustee shall distribute the then principal of a Beneficiary's trust to him or her outright and free of trust. For purposes of this Section 2.6.4, when the Trustee is directed to "distribute" an interest in any IRA or Roth IRA account, the Trustee is to arrange for the transfer of said interest from the trust to the Beneficiary so that the Beneficiary holds the various powers over such IRA or Roth IRA (e.g., to direct investments and withdrawals) that would otherwise be held by the Trustee, without necessarily causing a distribution of funds out of the IRA or Roth IRA account. The Trustee may postpone the termination of the trust with respect to any IRA, Roth IRA, or other Retirement Account if doing so will postpone the requirement of a distribution of funds out of said account or otherwise produce a better tax outcome for the Beneficiary, and shall continue to administer said account hereunder as if the Beneficiary had not yet attained Thirty-Five (35) years of age.

**2.6.5 Limited Power of Appointment.** Each Beneficiary who has attained Twenty-Five (25) years of age shall have the limited power to determine the manner in which the principal and any undistributed income of his or her trust shall be distributed at his or her death. This power may be exercised by the Beneficiary in the manner provided in Section 10.11 to provide distributions outright or in further trust in favor of any one or more of *[describe permissible appointees]* (other than his or her creditors, estate, or the creditors of his or her estate) as the Beneficiary shall determine.

**2.6.6 Death Before Complete Distribution.** Upon the death of a Beneficiary, the Trustee shall distribute said Beneficiary's trust (including such items of property as may pass generally to said trust by reason of said Beneficiary's death) in such manner as the Beneficiary shall have effectively appointed, and shall divide the unappointed balance of the trust into shares on the principle of representation for the then living members of the class of descendants identified earliest below with at least one class member then living:

1<sup>st</sup>      The deceased Beneficiary's descendants.

2<sup>nd</sup> If applicable, the descendants of the deceased Beneficiary's closest ancestor who was a descendant of the Settlor.

3<sup>rd</sup> The descendants of the Settlor.

Each share so established for a descendant shall be distributed to him or her outright and free of trust if he or she has then attained Thirty-Five (35) years of age. Each share so established for a descendant who has not attained Thirty-Five (35) years of age shall either be added to the trust then held hereunder for him or her or, if no trust exists for him or her, shall constitute a trust to be held and distributed for him or her as provided in this Section 2.6 (each descendant shall be referred to as the "Beneficiary" of his or her trust). If none of the descendants described above are then living, the Trustee shall instead distribute said unappointed balance as provided in Section 2.6.7.

**2.6.7 Alternate Heirs.** If disposition be made under this Section 2.6.7, the Trustee shall distribute the affected trust estate to

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***Author's Note:*** *The following clause is suggested for inclusion in the "boilerplate" of most trusts.*

**11.15 Trust as Beneficiary of Retirement Account.** The Settlor intends that each trust hereunder that owns an interest in a Retirement Account enjoy the longest possible deferral period under the Minimum Distribution Rules. Accordingly, the following shall apply:

(a) The Trustee of a trust so designated shall, within the time limit prescribed under the Minimum Distribution Rules, deliver documentation required under said rules to the respective administrators and custodians of each Retirement Account.

(b) For purposes of this instrument, when the Trustee is directed to "distribute" an interest in a Retirement Account to an individual or another trust, the Trustee is to arrange for the individual or trustee to hold the various powers over said Retirement Account interest (e.g., to direct investments and withdrawals) that would otherwise be held by the Trustee, and such direction shall not be interpreted as requiring a "taxable distribution" from the Retirement Account for income tax purposes.

(c) The administrators, custodians, or other fiduciaries of the respective Retirement Accounts shall incur no liability to the trust or to any of its beneficiaries for acting upon the written instruction of the Trustee pursuant to this Section 11.15.

**12. Definitions.** (*The following are selected definitions relating to retirement plan issues.*)

**12.8 Minimum Distribution Rules.** The term “Minimum Distribution Rules” refers to the rules of IRC Section 401(a)(9).

**12.10 Retirement Account.** The term “Retirement Account” refers to a Tax-Advantaged Account that is subject to the Minimum Distribution Rules.

**12.16 Stretch-Out Retirement Account.** The term “Stretch-Out Retirement Account” refers, with respect to a trust hereunder, to an interest in a Retirement Account that satisfies the following conditions: (i) the interest in the Retirement Account (or a successor Retirement Account, e.g. an inherited IRA that receives a rollover from a qualified retirement plan) became part of the trust by reason of the Settlor’s death (or the death of another, depending on the context); and (ii) the provisions governing the Retirement Account permit the Trustee of the trust to take distributions following the year of death of the post-death balance of the interest over the life expectancy of a trust beneficiary (or the oldest member of a group of individuals determined under the Minimum Distribution Rules to which a trust beneficiary belongs), assuming said trust otherwise qualifies to do so under the Minimum Distribution Rules.

**12.17 Stretch-Out Retirement Beneficiary.** The term “Stretch-Out Retirement Beneficiary” refers, with respect to a trust hereunder that owns an interest in a “Stretch-Out Retirement Account,” to the trust beneficiary whose life expectancy is or will be used in determining the timing and amount of post-death distributions (or whose life expectancy would have been so used if he or she was the oldest member of the group of individuals determined under the Minimum Distribution Rules to which he or she belongs).

**12.18 Tax-Advantaged Account.** The term “Tax-Advantaged Account” refers to any plan, contract, or other arrangement (other than a life insurance contract) that is allowed under the Internal Revenue Code to accumulate any part of its income in a tax-

advantaged manner (e.g., income tax-deferred or income tax free) for the benefit of an owner, beneficiary, or successor, and includes, by way of example and not limitation, a qualified or non-qualified annuity, a deferred compensation plan, or a retirement or individual retirement account arrangement established under IRC Sections 401, 403, 408, 408A, or 457. A plan account or arrangement that is otherwise a “Tax-Advantaged Account” and that owns one or more life insurance contracts among its assets is a “Tax-Advantaged Account.” A plan, contract, or other arrangement that is reasonably believed to qualify for tax-advantaged treatment under the Internal Revenue Code is a “Tax-Advantaged Account” even if it is subsequently determined it did not so qualify.