"ESTATE AND POST-MORTEM PLANNING OPPORTUNITIES WITH IRAs"

Are IRAs a Blessing in Disguise?

Presented by
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CIRCULAR 230 DISCLOSURE

The Top 10 List

1. **New planning opportunities, pre and post mortem, are available under the New Final IRA Regulations.**

2. **Do not assume that you know who the beneficiary of the IRA will be.**

3. **The new augmented elective share could change the recipient of the IRA proceeds.**

4. **Layering beneficiaries on the designation form provides maximum flexibility in post-mortem planning.**

5. **Beware of naming trusts as beneficiaries – there are more requirements than specified in the regulations.**

6. **The new Uniform Principal and Income Act defines the tax treatment of distributions from IRAs.**

7. **IRAs are still protected from creditors, especially after the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act – most of the time.**

8. **IRAs can be invested in many non-traditional types of investments – caveat emptor.**

9. **There are new reporting requirements for trustees and custodians - and new pitfalls.**

10. **Be aware of the potential for malpractice and breach of fiduciary duty claims.**

Significant changes effecting IRAs:

- **New final IRA regulations released in April 2002 effective January 1, 2003.**

- **Changes to the elective share in Florida effective for persons dying on or after October 1, 2001.**

- **Repeal of the estate tax (or is it really repealed?).**

- **The new Uniform Principal and Income Act.**

- **The new Bankruptcy Abuse Prevention and Consumer Protection Act.**

Changes in the New Final Regulations:

- **For most people, there is a new formula for distributions during the IRA owner's lifetime - Uniform Table. See Appendix A at J-48 . The only exception is IRA owner with spouse more than 10 years younger. See Appendix B at J-49 .**

- **There are new post-mortem planning opportunities and responsibilities - new deadlines for beneficiary determination.**

- **New reporting responsibilities for IRA trustees and custodians - starting in 2004 trustees and custodians must report on Form 5498 all IRAs requiring minimum distributions.**

IRA Rules that remain unaffected by the new regulations:

- **The penalties – premature distribution penalty, excess accumulation penalty**

- **The Required Beginning Date for the IRA owner during lifetime - April 1st of year after owner turns 70 ½**

Example

Jack, who is the owner of an IRA, was born on June 28, 1934. His required beginning date is April 1, 2005.

Jill, who is the owner of an IRA, was born on July 15, 1934. Her required beginning date is April 1, 2006.

- **Underlying definition of a designated beneficiary**

What are the Rules?

- **Unless a qualified exception applies, the money cannot be withdrawn prior to age 59 ½ without a penalty:**

- **Substantially equal periodic payments (Rev. Ruling 2002-62 allows one-time modification)**

- **Other exceptions: medical, educational, first time home purchase**

- **The IRA owner must begin drawing money out by April 1st of the year following the year in which they reach age 70 ½**

What are the Penalties?
"Too soon, too little, too late . . ."

- **Early distribution penalty**

  - **Drawing out money before age 59 ½ can result in a 10% penalty, unless a qualified exception applies.**

- **Excess accumulation penalty**

  - **Drawing out insufficient amounts, or not drawing money when you should after age 70 ½, can result in a penalty of 50% of the total amount that should have been removed, but was not.**

Introduction to Required Minimum Distributions
See Appendix D at J-53 and Appendix F at J-57

- **Individual Retirement Accounts (IRAs)**

- **Required Minimum Distributions begin at age 70 ½ or death of IRA owner, whichever is first.**

Examples

Donald (who turns age 78 on 7/22/03) is the owner of IRA #1. Donald's wife, Ivana (who turns age 71 on 2/14/03), is named as primary beneficiary of the account. The account balance of this IRA as of 12/31/02 is $406,000.00. Donald's required minimum distribution for 2003 from IRA #1 is $20,000.00. This result is reached by dividing the value of the account balance of the IRA as of the end of the preceding year ($406,000.00) by the Applicable Distribution Period ("ADP") (20.3) which, in this case, is found in the uniform lifetime table. Ivana's age, even though she is married to Donald and is named as beneficiary of IRA #1, does not affect this calculation (because she is less than ten years younger than Donald is).

Assume that for year 2004 - when Donald and Ivana turn ages 79 and 72 respectively Ivana is named as beneficiary of IRA #1 until the couple divorces on March 15, 2004, and Donald subsequently names his estate as beneficiary thereof. The account balance of this IRA as of 12/31/03 is $585,000.00. Donald's required minimum distribution for 2004 from IRA #1 is $30,000.00. As with the previous year, this result is reached by dividing the value of the account balance of the IRA as of the end of the preceding year ($585,000.00) by the ADP (19.5) found in the uniform lifetime table - the ADP is recalculated according to the age found in the uniform lifetime table. The fact that Donald has changed the IRA's beneficiary or no longer has a "designated beneficiary" is immaterial to this calculation.

Assume that for year 2005 - when Donald turns age 80 - his estate is still named as beneficiary of IRA #1. The account balance of this IRA as of 12/31/04 is $187,000.00. Donald's required minimum distribution for 2005 from IRA #1 is $10,000.00. As with the previous year, this result is reached by dividing the value of the account balance of the IRA as of the end of the preceding year ($187,000.00) by the ADP (18.7) found in the uniform lifetime table. As with the preceding years, the ADP is recalculated according to the age found in the uniform lifetime table.

Elizabeth (who turns age 75 on 5/1/03) is the owner of IRA #2. Elizabeth's husband, Curley (who turns age 61 on 8/27/03), is named as primary beneficiary of the account (as of 1/1/03). The account balance of this IRA as of 12/31/02 is $514,000.00. Elizabeth's required minimum distribution for 2003 from IRA #2 is $20,000.00. This result is reached by dividing the value of the account balance of the IRA as of the end of the preceding year ($514,000.00) by the ADP (25.7) which, in this case, is found in the Joint Last and Survivor Table. (SEE APPENDIX B at J-   ) The reason that this particular table is used is because Curley was the <u>sole</u> beneficiary of the Elizabeth's IRA as of 1/1/03, they were married to each other as of that date, and Curley is more than ten years younger than Elizabeth.

Assume that for year 2004 - when Elizabeth and Curley turn ages 76 and 62, respectively Curley is still named as beneficiary of IRA #2 until the couple divorces on December 16, 2004. On December 17, 2004, Elizabeth marries Mo (who turned age 70 on 1/21/04) and names Mo (on 12/17/04) as beneficiary of IRA #2. The account balance of this IRA as of 12/31/03 is $744,000.00. Elizabeth's required minimum distribution for 2004 from IRA #2 is $30,000.00. As with the previous year, this result is reached by dividing the value of the account balance of the IRA as of the end of the preceding year ($744,000.00) by the ADP (24.8) found in the Joint Last and Survivor Table in Appendix B at J-49 - the ADP is recalculated according to the age found in this table. The fact that Elizabeth divorced Curley in 2004 and named another spouse IRA beneficiary (who is her spouse and is not more than ten years younger than her) is immaterial to this calculation.

Assume that for year 2005 - when Elizabeth and Mo turn ages 77 and 71, respectively the couple is married throughout the entire year and Mo is named as beneficiary of IRA #2 up and until July 6, 2005. On July 7, 2005, Elizabeth changes the beneficiary on her account so that her friends, Richard, Eddie, Arthur, and Michael are named as equal beneficiaries of IRA #2. The account balance of this IRA as of 12/31/04 is $424,000.00. Elizabeth's required minimum distribution for 2005 from IRA #2 is $20,000.00. This result is reached by dividing the value of the account balance of the IRA as of the end of the preceding year ($424,000.00) by the ADP (21.2) found in the

Uniform Lifetime Table. The ADP is recalculated according to the age found in this table. Use of the Joint and Survivor Life Table in this situation is not warranted because Mo is not more than ten years younger than Elizabeth. Also, the fact that Elizabeth changed her beneficiary designation to someone other than her spouse is immaterial to this calculation.

Elvis, whose birthday is May 4, 1934, owns an IRA. Since he turns 70 ½ in 2004, his "70 ½ year" is 2004. Therefore, he will have to take a required minimum distribution for this IRA in the period beginning on January 1, 2004, and ending with April 1, 2005. This minimum distribution will he calculated by dividing the account balance as of December 31, 2003, by Elvis' ADP, which is found in the uniform life table (this assumes that Elvis has not named a spouse that is more than ten years younger than him as beneficiary of the IRA). The ADP for a 70 year old is 27.4 (i.e., the ADP for a 70 year old under the table).

Assume that Elvis takes his 2004 required minimum distribution on April 1, 2005 (i.e., the RBD). For the purpose of determining Elvis' year 2005 required minimum distribution, the December 31, 2004, account balance is no longer reduced to account for the required minimum distribution for the first distribution calendar year (i.e., 2004).

- **There are two different sets of rules depending on whether the IRA owner died prior to age 70 ½ or after**.

IRA Distribution Rules: Death before "Required Beginning Date"

See Chart at Appendix G at J-58

No "Designated Beneficiary"

- **All IRA assets must be distributed by the end of the fifth calendar year following the owner's death (IRC§401(a)(9)(B)(ii)).**

Example

Rube, who would have turned age 65 in 2002 dies. He was the owner of an IRA of which his estate is the beneficiary. Since Rube's estate is not a "designated beneficiary", then his estate may take distributions from the IRA in any manner provided that all of the funds are depleted from the IRA by December 31, 2007.

Query: Is the estate kept open?

Individual Non-Spouse Beneficiary or Qualified Trust

- **The default is now distributions based on individual beneficiary=s life expectancy; however, distributions must begin by the end of the calendar year following the calendar year of the owner's death (IRC §401(a)(9)(B)(iii))or it will be assumed that the five year rule is being used**.

Examples

Don, who is the owner of an IRA, dies on April 6, 2003, prior to his RBD. At the time of his death Bob (DOB 3/22/53) is the beneficiary of the IRA. Bob does not elect to take distributions under the five year rule. In 2004, Bob's minimum distribution from the IRA is calculated by dividing his single life expectancy (which is found in the Single Life Table, (SEE APPENDIX C at J-52) Reg. Sec. l.401 (a)(9)-9, A-i (2002)) into the IRA's 12/31/03 balance. In subsequent years, minimum distributions will be calculated by reducing Bob's available life expectancy by one until the account is exhausted. The ADP for 2004 will therefore be 33.3 - the number representing the life expectancy of a 51 year old under the single life table. In 2005, the ADP will be reduced by one to 32.3, to 31.3 in 2006, to 30.3 in 2007, to 29.3 in 2008, and so on in subsequent years (with similar reductions) until the account is exhausted.

The facts are the same as in the preceding example, however, Bob elects to take distributions under the five year rule. During the five year period ending with December 31, 2008, Bob may take distributions from the IRA in any manner provided that all of the funds are depleted from the IRA by December 31, 2008.

Spouse as Beneficiary

- **Spouse can treat IRA as her own and delay distributions until his or her Required Beginning Date.**

Example if spouse is sole designated beneficiary

Burt, who is the owner of an IRA, dies on November 16, 2004, prior to his RBD (Burt would have attained age 70 ½ in 2008). At the time of his death, Burt's wife, Lonnie (DOB 3/22/43) is the beneficiary of the IRA. Lonnie does not elect to take distributions under the five year rule. Lonnie does not have to take minimum distributions from the IRA until December 31, 2008 — December 31 of the year which Burt would have turned 70 ½. In 2008, Lonnie's minimum distribution from the IRA is calculated by dividing her single life expectancy (which is found in the Single Life Table, Reg. Sec.l.401(a)(9)-9, A-i(2002)) into the IRA's 12/31/07 account balance. In subsequent years, minimum distributions will be calculated by redetermining Lonnie's life expectancy under this table until the account is exhausted. The ADP for 2008 will therefore be 21 - the number representing the life expectancy of a 65 year old under the single life table. In 2009, the ADP will be 20.2 the number representing the life expectancy of a 66 year old under the Single Life Table. In 2010, the ADP will be 19.4 the number representing the life expectancy of a 67 *year old under the single life table. As long as Lonnie is alive, her life expectancy will continue to be redetermined for the purpose of determining the required minimum distribution from this IRA.*

Example if surviving spouse dies before distributions have begun

The facts are the same as in the preceding example, however, Lonnie dies in 2006 "before distributions have begun" to her. Since Lonnie died before distributions have begun to be made to her from the IRA, then she will be treated as the employee for determining the Required Minimum Distributions that will have to be made from the plan. In this case, since Lonnie had not reached her RBD, then either the life expectancy rule or the five year rule will govern the calculation of Required Minimum Distributions from the plan — dependent upon the identity of Lonnie's beneficiary and the election (i.e., five year rule) such beneficiary has made. If there is no designated beneficiary as of September 30, 2007,then distributions must be made in accordance with the "five year rule".

Example if surviving spouse dies after distributions have begun

The facts are the same as in the preceding example, however, Lonnie dies on May 1, 2009. Prior to her death, Lonnie had received $5,500.00 of the $16,000.00 required minimum distribution for 2009 (the ADP for 2009 was 20.2). The next beneficiary of the account is to take the remaining $10,500.00 of the $16,000.00 required minimum distribution. The ADP for the 2010 distribution to the next beneficiary of the account is 19.2 Reg. Sec. l.401(a)(9)-5, A-5 (c)(2) (2002). The ADP for subsequent distribution years will likewise be reduced by one until all of the funds are depleted from the IRA.

- **In fact, spouse can now just have the name on the account changed to reflect the ownership of the surviving spouse**.

- **Distributions can be deferred until owner's Required Beginning Date.**

- **Spouse can receive distributions using five-year rule. (IRC §401(a)(9)(B)(iv)).**

Why is age 70 ½ so Important?

- **According to the distribution rules, an IRA owner has to begin taking required distributions by April 1st of the year after the year in which they turn 70 ½ (IRC Sections 401(a)(9), 408(a)(6)). If the first distribution is postponed until the beginning of the year after age 70 ½, the IRA owner must take a second distribution for that calendar year by 12/31.**

- **This is referred to as the IRA owner's Required Beginning Date (RBD).**

- **Important change in the Final Regulations is the method of computing the**

second distribution if deferred. Calculation is now based on year end balance alone instead of year end balance less amount of deferred distribution.

IRA Distribution Rules: Death after "Required Beginning Date"

See Timeline in Appendix E at J-54 and Chart at Appendix G at J-58

No "Designated Beneficiary"

- **All IRA assets may be distributed over the remaining non-recalculated single life expectancy of the deceased IRA owner (IRC §401(a)(9)(B)(I)).**

Example

Stella, who would have turned age 85 in 2005, dies on April 4, 2005. She was the owner of an IRA of which her estate is the beneficiary. In 2005, Stella had taken $45,000 of her $65,000.00 required minimum distribution. Her estate (because it is beneficiary of the account) is required to take the remaining $20,000.00 required minimum distribution for 2005. In 2006, a required distribution must be made to Stella's estate her beneficiary over her remaining life expectancy; the ADP for 2006 is 6.6 (her ADP in 2005, as found in the Single Life Table at Appendix C on J- , for an 85 year old is 7.6, which is reduced by one). The ADP for 2007 will be 5.6, for 2008 it will be 4.6, for 2009 it will be 3.6, and so on until all of the funds are depleted from the IRA.

Individual Non-Spouse Beneficiary or Qualified Trust

- **Distributions may be taken out over the life expectancy of each non-spouse beneficiary that is considered to have a separate share. Identification of these beneficiaries must be ascertained by September 30th of the year after the year of the IRA owner's death but the separate accounts do not have to be established until December 31st of the year after the year of the IRA owner's death. (IRC §401(a)(9)- 4 (A-4)).**

Example

The facts are the same as in the preceding example, however, SteIla had named Blanche (DOB 2/14/54) as beneficiary of her IRA. Blanche (because she is beneficiary of the account) is required to take the remaining $20,000.00 required minimum distribution for 2005. In 2006, a required distribution must be made to Blanche Stella's beneficiary over Blanche's remaining life expectancy (which will be reduced by one in subsequent years); the ADP for 2006 is 32.3 (the ADP, as found in the Single Life Table, for a 52 year old). The ADP for 2007 will be reduced by one to 31.3, for

2008 it will be reduced 30.3, for 2009 it will be reduced to 29.3, and soon until all of the funds are depleted from the IRA.

Spouse as Beneficiary

- **Spouse can treat IRA as her own and delay distributions until his or her required beginning date.**

Examples

The facts are the same as in the preceding example, however, Stella had named her husband, Stanley (DUB 2/14/3 8) as beneficiary of her IRA. Stanley (because he is beneficiary of the account) is required to take the remaining $20,000.00 required minimum distribution for 2005. In 2006, a required distribution must be made to Stanley Stella's beneficiary - over his remaining life expectancy (which will be redetermined in subsequent years until Stanley's death); the ADP for 2006 is 18.6 (the ADP, as found in the Single Life Table, for a 68 year old). The ADP for 2007 will be 17.8 (the life expectancy of a 69 year old under the Single Life Table), for 2008 it will be 17.0 (the life expectancy of a 70 year old under the Single Life Table), for 2009 it will be 16.3 (the life expectancy of a 71 year old under the Single Life Table), and so on until all of the funds are depleted from the IRA.

The facts are the same as in the preceding example, however, Stanley dies in 2008. Prior to his death, Stanley had received $95,000.00 of the $160,000.00 required minimum distribution for 2008 (the ADP for 2008 was 17.0). The next beneficiary of the account is to take the remaining $65,000.00 of the $160,000.00 required minimum distribution. The ADP for the 2009 distribution to the next beneficiary of the account is 16.0. Reg. Sec. 1.40 1(a)(9)-5, A-5 ©)(2) (2002). The ADP for subsequent distribution years will likewise be reduced by one until all of the funds are depleted from the IRA.

- **In fact, spouse can now just have the name on the account changed to reflect the ownership of the surviving spouse.**

- **Distributions can be deferred until owner=s Required Beginning Date.**

- **Spouse can receive distributions using five-year rule. (IRC 401(a)(9)(B)(iv)).**

Important Changes in the New Final Regulations

- **There is a new deadline for determining the identity of the "designated beneficiaries" of the IRA after the owner dies. That deadline is September 30th in the year after the year of the owner's death.**

- **There is a new date for establishing separate accounts for the separate shares of the IRA. That date is December 31st in the year after the year of the owner's death.**

- **Required minimum distributions still have to be taken out in a timely manner.**

- **The standard of review for abatement of penalties for missed Required minimum distributions has been raised.**

- **There are new reporting requirements for IRA trustees and custodians.**

Who can be a "Designated" Beneficiary

- **Any legal entity can be a valid beneficiary of an IRA for the purpose of receiving the proceeds upon the IRA owner's death, but to be a "designated" beneficiary that meets the IRS requirements for taking death distributions based on individual life expectancy, the beneficiary must be one of the following:**

    - **any individual**

    - **any trust that meets the requirements specified by the Internal Revenue Service**

    - **An IRA owner may name a charity, their estate, or a trust not meeting the Internal Revenue Service requirements but it will not be treated as a "designated" beneficiary for life expectancy purposes.**

Spouse as Beneficiary

- **May roll over into their own name and make new 70 ½ elections regardless of their age when they inherit, or may change name on**

the account.

- **May leave IRA in name of decedent and continue distribution method in place.**

Multiple Beneficiaries

- **Life expectancy of beneficiary with the shortest life expectancy will be used to calculate the ADP**

Example

George H., who is the owner of an IRA, dies on November 16, 2004, after his RBD. At the time of his death, George H's sons, Wayne (DOB 4/22/52), Jeb (DOB 7/01/55), and Neil (DOB 12/12/56) had been named as equal one-third beneficiaries of the IRA (pursuant to George H's beneficiary designation). In 2004, George H. had taken $450,000 of his $600,000.00 2004 required minimum distribution from the IRA — Wayne, Jeb, and Neil are required to take (i.e., split equally) the remaining $150,000.00, 2004 required minimum distribution. Separate accounts for this IRA were not established prior to December 31, 2005. In 2005, required distributions (in equal 1/3 amounts) must be made to Wayne, Jeb, and Neil — George H's beneficiaries - over Wayne's remaining life expectancy (which will be reduced by one in subsequent years). The reason that Wayne's life expectancy is used is because he is the beneficiary with the shortest life expectancy. Accordingly, the ADP for 2005 will be 31.4 (the ADP, as found in the Single Life Table, for a 53 year old). The ADF for 2006 will be reduced by one to 30.4, for 2007 it will be reduced to 29.4,for 2008 it will be reduced to 28.4, and soon until all of the finds are depleted from the IRA.

Trust as Beneficiary

- **IRA owner must provide a list of the trust beneficiaries to the IRA, custodian or Trustee has until October 31 of year after IRA owner's death to provide trust document or list of beneficiaries, although to be practical the trustee or custodian should have the documentation prior to the September 30 determination date.**

- **Trust must be valid under State law**.

- **Trust must become irrevocable by its own terms upon the death of the IRA owner.**

- Beneficiaries must be easily identifiable through the trust document

Contingent Beneficiaries

Example

Marilyn owns an IRA in which she has named a trust as beneficiary. The trust provides that the income and principal thereof may be distributed in the discretion of the trustee pursuant to ascertainable standards to Marilyn's husband, Joe, during his life (should he survive Marilyn). At the latter of Joe and Marilyn's deaths, the trust is to be distributed per stirpes to Joe and Marilyn's then living issue; in default of such issue to a charity. Marilyn dies and is survived by Joe. If the charity's contingent interest has to be taken into account in determining whether the IRA has a designated beneficiary, then the IRA will be deemed not to have a designated beneficiary. If charity's interest does not have to be taken into account, then the IRA will be deemed to have a designated beneficiary and the measuring life will be that of Joe (i.e., the trust's oldest living identifiable individual beneficiary). The IRS is unclear as to how it would resolve this issue.

Successor Beneficiaries

Examples

The facts are the same as in the preceding example except that Marilyn names Joe as her beneficiary of the IRA; in default of Joe to Joe and Marilyn's issue per stirpes; and in default thereof to a charity. The interests of the issue and the charity are mere potential successor's to Joe's interest in the IRA, and therefore will be disregarded for purposes of determining (I) who is the beneficiary with the shortest life expectancy and (2) whether a person who is not an individual is a beneficiary. Reg. Sec I.401(a)(9)-5,A-7(c) (2002).

The facts are the same as the preceding example except that the testamentary trust Marilyn established is a "conduit trust" for the benefit of Joe during his lifetime. In this case, the residuary beneficiaries of the trust may be considered mere potential successor's to Joe's interest in the IRA and they may be disregarded for purposes of determining (1) who is the beneficiary with the shortest life expectancy and (2) whether a person who is not an individual is a beneficiary. Reg. Sec 1.401(a)(9)-5, A-7(c)(3) , Example 2 (2002).

QTIP Trust as Beneficiary

- **Desirable for second marriage situation;**

- **Spouse may not rollover;**

- **Rev. Rul. 89 - 89 required that for this to qualify for the marital deduction the language had to require that the greater of required minimum distribution or income must be payable to the trust, and that the spouse receive all the income earned annually. Rev. Rul. 2000-2 changes this by approving the marital deduction when the spouse has the right to all the income as opposed to receiving actual distribution of the income. Distributions of Required minimum distribution must still be made from the IRA to the QTIP if Required minimum distribution is greater than the income earned. See Uniform Principal and Income Act for trust accounting;**

- **To the extent funds are paid to the trust from the IRA they will be taxed at the trust's income tax rate (39.6%) regardless of income or principal, although the trust accounting income will probably be passed out to the spouse;**

- **At the IRA owner's death, distributions will have to begin the year after death and can, at best, be based on the spouse's life expectancy, which is shorter than the children's life expectancy; and**

- **The shorter deferral period and the higher income tax rate will mean less money for the spouse during their lifetime than if the IRA were left directly to the spouse, and it will mean less deferral available for the children.**

Credit Shelter Trust as IRA Beneficiary

- **This may be necessary where the owner does not have other funds available to use owner's remaining unified credit;**

- **It is generally better to use assets other than IRAs (or any type of income in respect of decedent) to fund Credit Shelter Trust;**

- **The best way to use IRA assets for unified credit is to leave directly to children because of income deferral;**

- **If the spouse will need some access to the credit shelter funds, then a credit shelter trust will be the best alternative but:**

- **to the extent funds are paid to the trust from the IRA they will be taxed at the trust's income tax rate (39.6%) regardless of income or principal, although the trust accounting income will probably be passed out to the spouse;**

- **at the IRA owner's death, distributions will have to begin the year after death and can, at best, be based on the spouse's life expectancy, which is shorter than the children's life expectancy; and the shorter deferral period and the higher income tax rate will mean less money for the spouse during their lifetime than if the IRA were left directly to the spouse, and it will mean less deferral available for the children**

Two suggested ways to fund a Credit Shelter Trust:

First (better for first marriages):

- **Name the IRA owner's revocable trust as the IRA beneficiary;**

- **In the trust document, direct that all retirement assets be distributed directly to the spouse (for rollover ability);**

- **Provide in the trust that if the spouse should disclaim the option to take them outright, the retirement assets will be divided by a fractional formula;**

- **Benefits will then go to the credit shelter to the extent necessary to use up the unified credit (taking into account, of course, current estate tax issues).**

- **The balance will go to the Marital trust, which could then be distributed outright to the spouse for rollover or held in trust.**

Second:

- **Designate marital trust as the primary beneficiary on the retirement assets;**

- **Name credit shelter trust as the contingent beneficiary;**

- **Put language in the trust document that allows the trustee of the marital trust to disclaim any amount of the IRA necessary to satisfy the available unified credit (or up to a specified dollar amount);**

- **Have the trustee disclaim and then the remaining IRA assets would be payable to the credit shelter trust.**

*******It is always better, if possible, to name the trusts themselves rather than naming the revocable trust so as not to run afoul of the "separate share" rules, for example, "The John Smith Marital Trust created under the John Smith Revocable Trust dated 1/1/03".**

Other Considerations in Naming a Trust as Beneficiary

- **For treatment as separate shares, two requirements must be met:**

  - **The interests of the beneficiaries must be expressed as fractional or percentage interests as of the date of death of the IRA owner.**

  - **Separate accounts must be established by December 31st of the year after the IRA owner's death.**

Examples

The facts are the same as in the example described under Multiple Beneficiaries, however, the IRA was divided into equal one-third separate accounts (for Wayne, Jeb and Neil) on November13, 2005. The 2004 required minimum distribution will be the same as in he preceding example. The 2005 minimum distributions will be calculated as follows: (1) Wayne will have to take a distribution equal to one-third of the December 31, 2004, account balance divided by 31.4 (the ADP, as found in the Single Life Table, for a 53 year old), (2) Jeb will have to take a distribution equal to one-third of the December 31, 2004, account balance divided by 34.2 (the ADP, as found in the Single Life Table, for a 50 year old), and (3) Neil will have to take a distribution equal to one-third of the December 31, 2004, account balance divided by 35.1 (the ADP, as found in the Single Life Table, for a 49 year old).

The facts are the same as in the preceding example, however, George H's beneficiary designation named a trust as beneficiary of his IRA. The trust at George H's death is to be divided into three separate shares for Wayne, Jeb and Neil, *provided that they survive George H. The 2004 required minimum distribution will be the same as in the preceding example. The 2005 minimum distributions will also be calculated the same way in the preceding example – i.e., required distributions (in equal one-third amounts) must be made to Wayne, Jeb, and Neil – George H's beneficiaries - over Wayne's remaining life expectancy. The reason for this is because the final regulations make it abundantly clear the authority for the establishment of separate accounts must be in the beneficiary designation and not in an outside trust. Reg. Sec. l.40l(a)(9)-4, A-5(c) (2002).*

- **This is important because without separate share treatment, the trust will be limited to using the life expectancy of the oldest beneficiary. If the goal was to pay the IRA to separate sub-trusts, this may be a trap for the unwary.**

- **The IRS has issued conflicting Private Letter Rulings (PLRs) on the subject. Although PLRs cannot be used as precedent unless your client has the exact same facts and circumstances as the taxpayer in the PLR, it is the closest thing we have to case law in regard to IRS interpretation issues.**

- **PLR 200234074 was issued prior to but in the same month as the final regulations. In this PLR, the IRA was payable to a trust. Trust One was then divided into two subtrusts. Subtrust A was payable to the surviving spouse outright. Subtrust B provided for lifetime income to the surviving spouse, with the remainder paid outright and equally to three children beneficiaries. The trustee of Trust One then split the IRA into four separate inherited IRAs (one for Subtrust A and three for the children. At the time, the IRS ruled that each child could use his or her own life expectancy, as SubTrust B was viewed as a "look-through" trust.**

- **Then came the final regulations.**

- **The next series of PLRs on this issue had a completely different result. PLRs 200317041, 200317043, and 200317044 are eerily similar to PLR 200234074. In all three cases, the IRA was payable to a trust upon the death of the IRA owner. In each case, that trust was payable equally to the owner's children, with no discretion in regard to the amount of the share each child would receive. In all three cases the IRS denied separate share treatment. The IRS position seems to hinge on a new sentence in the final regulations in Reg. § 1.401(a)(9)-4, A-5(c). The sentence reads, in part "the separate account rules under A-2 of § 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." In effect, the new position of the IRS is to "look no further than the beneficiary form", much like the policy has been on estates. If an estate is the beneficiary of an IRA, then it is made clear in the final regulations that even if the estate is then distributed out to the ultimate beneficiaries, there is no additional life expectancy gained by doing so. Because the estate is not considered a designated beneficiary, it does not matter who ultimately receives the IRA assets (other than for income tax purposes) because they will be limited to deferral based on the remaining single non-recalculated life expectancy of the IRA owner at the time of their death.

- **It is equally clear from the regulations that a trust is considered to be a designated beneficiary if it meets the requirements we have already discussed earlier in this outline. It appears that the IRS' new position is that, as a designated beneficiary, the trust has a life expectancy of its own and that life expectancy is based on the life expectancy of the oldest beneficiary of the trust.**

- **Although this is a troubling interpretation and certainly not what the professional community was lead to believe would be the IRS position in the final regulations, it is not a complete disaster. What this does require is some creative drafting.**

- **Be sure to designate subtrusts specifically on the beneficiary form. Do not make the IRA payable to the master trust but rather list specific subtrusts and the percentage or fraction that each subtrust will inherit.**

- **Plan for contingencies. Leave an exit strategy. If the plan is to leave it to a trust with income for life to the surviving spouse and then to children, specify on the beneficiary form "If my spouse survives me, I designate the John Smith Trust as beneficiary of my IRA. If my spouse does not survive me, then I designate my children as beneficiaries of my IRA in equal shares."**

- **Allow for disclaimers. It is a gift that the IRS has specifically endorsed the use of qualified disclaimers in order to determine designated beneficiaries. Name as many contingencies as possible. That way, it may be possible to fix an outdated beneficiary form post-mortem and still achieve the desired result.**

- **Beware of the contingent beneficiaries of any trust that you name on the beneficiary designation. PLR 200252097 had a troubling result in that it was possible pursuant to the terms of the trust that someone older than the primary beneficiary of the trust might inherit the IRA proceeds. This being the case, the IRS ruled that the older contingent beneficiary's life expectancy had to be taken into account. To avoid this potential pitfall until the IRS clarifies its position, be sure that the benefits of any subtrust named directly as an IRA beneficiary will not revert to someone older than the beneficiary whose life expectancy you want to be able to use.**

Conduit Trusts

- **Final regulations approve conduit trust**

- **All distributions from the IRA must be distributed to the beneficiary**

- **If the trust beneficiary lives to life expectancy, then the beneficiary will receive all the MRDs.**

- **Uniform Principal and Income Act should be abrogated to qualify trust as conduit trust.**

- **See Appendix K at J -102.**

Examples

Michael, who is the owner of an IRA, has named his wife, Lisa, as beneficiary thereof, in the event that Lisa predeceases Michael, then Michael's brother, Tito, becomes the beneficiary of the IRA. Lisa is currently sole beneficiary of the IRA.

Example if Conduit Trust

The facts are the same as in the preceding example, however Michael has named a trust as beneficiary of his IRA. The trust is a "conduit trust" for Lisa (if she survives Michael) with remainder over to Tito. If Lisa does not survive Michael, then Tito becomes the beneficiary of the IRA. Lisa is currently sole beneficiary of the IRA and will continue to be so if she survives Michael.

- **If the trust is not a conduit trust, then it <u>may</u> <u>be</u> the case that none of the beneficiaries of the trust are sole beneficiaries of the plan or account. Reg. Sec. 1.40l(a)(9)-4, A-5(c) <u>Example 1(2002)</u>.**

Examples if Non Conduit Trust

The facts are the same as in the preceding example, however, the trust provides (if Lisa survives Michael) that she is to received all of the income from the trust and the principal therefrom in the discretion of the trustee, with the remainder over to Tito. If Lisa does not survive Michael, then Tito becomes the beneficiary of the IRA. The trust contains no provision requiring that all Required Minimum Distributions paid to the trust be, in turn, paid over to Lisa. It is clear that Lisa is currently not the sole beneficiary of the IRA and will not considered as such in the future.

The facts are the same as in the preceding example, however, the trust provides (if Lisa survives Michael) that in addition to her receiving all trust income, and giving the trustee discretion to give her trust principal, Lisa also has the unlimited right at any time during life to withdraw all of the trust's assets. Tito still has a remainder interest and becomes beneficiary of the IRA if Lisa does not survive Michael. The trust, however, contains no provision requiring that all Required Minimum Distributions paid to the trust be, in turn, paid over to Lisa. It is unclear as to whether Lisa is currently sole beneficiary of the IRA and whether she will be so if she survives Michael.

Charity as Beneficiary

- **It is beneficial to name a charity as beneficiary, as the charity does not pay income tax and the estate will get a deduction for the full amount of the charitable gift;**
- **To avoid recognition of income by the estate, benefits should not be used to fund a pecuniary charitable bequest;**
- **If only a portion of an IRA passes to charity, establish a separate share so other beneficiaries may still be "designated" beneficiaries;**
- **Or, distribute the charity's portion prior to the September 30 deadline for beneficiary determination.**

Estate as Beneficiary

As discussed earlier, estates are not considered designated beneficiaries. Even so, there is good news within the final regulations. Under the new rules, an estate may use the remaining single non - recalculated life expectancy of the IRA owner if the IRA owner dies after attaining age 70½. The old rule was that the IRA had to be distributed by December 31st of the year after the IRA owner's death. This new rule means that even if some disaster occurs where disclaimers and distributions will not work to fix a bad beneficiary designation(or perhaps no designation at all!), there is still some time for deferral.

Be aware:

- **PLR 200013041 concluded that when the trust that was the beneficiary of the IRA terminated, the trust could distribute share of the IRA to the subsequent beneficiaries and there would be no change in the tax status of these accounts. The new accounts were funded as a result of the trustee assigning the interests in the IRA to the subsequent beneficiaries and trustee to trustee transfers being executed. The IRAs were set up in the name of the decedent for benefit of (FBO) the beneficiary. There was no additional deferral or acceleration of tax liability.**

- **Likewise, PLR 200234019 reflects the same result with regard to estates.**

- **Be aware that although the IRS will most likely allow these transfers without any tax implications, it is sometimes difficult to find an IRA trustee or custodian who is willing to divide the IRA and allow continued deferral.**

Beware the Vanishing Beneficiary

A very real and practical problem is . . . what happens if the beneficiary designated on the account dies prior to taking distribution of the entire IRA? In the case of a surviving spouse, if the spouse dies shortly after the IRA owner, most people assume that the contingent beneficiary (assuming there is one) will step up. Not necessarily true. If the surviving spouse lives long enough to become the designated beneficiary but not long enough to roll the IRA over, then it may inadvertently become payable to the surviving spouse's estate. Also, even a non-spouse beneficiary has the right to designate a subsequent beneficiary. By doing so, the payout period is not extended beyond the original deferral period but some planning might allow other beneficiaries to enjoy the remaining deferral period and might prevent the deceased beneficiary from having a probate estate due to the income stream from the IRA. Please note, although this is allowable by the IRS, not all trustees and custodians are prepared to allow for a beneficiary to designate a subsequent beneficiary.

Practical Problems

Who is going to be responsible for making sure all this happens according to schedule?

The post mortem planning opportunities occur with the ability to disclaim, distribute or divide the assets.

To disclaim, it must be done in compliance with section 2518 and must generally be done within nine months of the decedent's date of death - this is not extended to the September 30th beneficiary determination deadline.

To distribute to a beneficiary that is not a "designated" beneficiary and not have it throw off everyone else in the mix, this must be done prior to September 30th.

If the accounts are going to be set up in separate accounts, then the accounts must be set up by December 31st of the year after death but must be determined by the September 30th deadline.

TITLING OF AN IRA FOLLOWING THE DEATH OF AN ACCOUNT OWNER

At the death of an IRA owner, the title of the account should be changed to reflect that it is an inherited IRA. The following IRA designations can be used to indicate that the IRA is an inherited IRA: "Decedent (i.e., IRA owner's name) IRA, deceased — Taxpayer (i.e., name of the beneficiary), beneficiary" or 'Taxpayer (i.e., name of the beneficiary) as Beneficiary of Decedent (i.e., IRA owner's name) Taxpayer, Deceased" For distributions to a beneficiary from an inherited IRA, the beneficiary's tax identification number should be used for reporting on Form 1099-R.

Examples

Frank, the owner of an IRA, dies. At the time of his death, Frank's son, George is named as the beneficiary of his IRA. The IRA provider should re-title this IRA so that it reads as one of the following: "Frank IRA, deceased — George, beneficiary" or "George as Beneficiary of Frank, Deceased". George's tax identification number will be used to report distributions to him on Form 1099-R.

The facts are the same as in the preceding example except that "The Kramer Trust" is named as the beneficiary of his IRA at the time of Frank's death. In this situation, The IRA provider should re-title this IRA so that it reads as one of the following: 'Frank IRA, deceased — The Kramer Trust, beneficiary" or "The Kramer Trust as Beneficiary of Frank, Deceased". The Kramer Trust's tax identification number will be used to report distributions to it on Form 1099-R.

ROLLOVERS, DIRECT ROLLOVERS, DIRECT TRANSFERS. AND SPOUSAL ELECTION (TO TREAT IRA AS HIS/HER OWN)

- **A rollover is the tax-free movement to an IRA of an eligible rollover**

distribution made from a plan or an IRA (to a distributee). Any distribution that is received and is not subsequently rolled over is taxable to the distributee in the calendar year of the distribution.

Example

Ward (who turns age 69 on 6/30/03) is the owner of one IRA. He will therefore turn age 70 ½ in 2004 and will have a RBD of 4/1/05. On June 1,2003, a distribution of$17,000,00 is made to Ward from his IRA. On June 15, 2003, Ward rolls over the entire$17,000.00 distribution to another IRA. As a result of this rollover, the distribution of $17,000.00 to Ward is not subject to income tax.

Example

The facts are the same as in the preceding example except that Ward does not roll over any part of the IRA distribution that was made on June 1, 2003. As a result, the distribution of $17,000.00 to Ward is subject to income tax in 2003.

- **To qualify for rollover treatment, the amount rolled over must be completed within 60 days of the distribution. Movement of distributed assets to another IRA after the 60 day period may subject the disposition to the 6% excise tax for having made an excess IRA contribution (to this second IRA). IRC Section 4973.**

- **To be eligible to be rolled over, then (among other requirements) it cannot be part of a required minimum distribution or part of a substantially equal periodic payment**

Example

The fact are the same in the preceding example except that it is 2007 and Ward is now 73. His 2007 required minimum distribution is $11,500.00. On July 13, 2007, a distribution of $19,500.00 is made to Ward from his IRA. Since Ward's 2007 required minimum distribution from this IRA is $11,500.00, only $8,000.00 of the $19,500.00 distribution is eligible to be rolled over.

- **A direct rollover is the tax-free movement of qualified retirement plan benefits (provided that they are part of an eligible rollover distribution) directly to an IRA from a qualified plan (as opposed to an IRA).**

- **As with a rollover, a direct rollover cannot be part of a required minimum distribution or part of a substantially equal periodic payment**

- **As with a rollover only a plan participant (during life) or a spouse beneficiary (following the participant's death) can make a direct rollover.**

- **A direct rollover will be reported on the distributee's individual federal income tax return (the amount that is the subject of the direct rollover is reported as a distribution to the taxpayer).**

- **The most important distinction between direct rollovers and regular rollovers is that there is <u>no</u> mandatory withholding with direct rollovers. Furthermore, there is <u>no</u> sixty day requirement or one direct rollover per year rule for direct rollovers.**

Examples

Archie (who turns age 65 on 4/3/03) is a participant in a qualified retirement plan (the plan) offered by his company. Archie's wife, Edith (who turns age 62 on 9/23/03), is named as primary beneficiary of Archie's interest in the plan. On February 11, 2003, the plan distributes $10,000.00 to Archie. This distribution is subject to mandatory withholding of $2,000.00 (20% of $10,000.00). Therefore, Archie will only receive $8,000.00. Although he is permitted to roll over $10,000.00 to his IRA (provided that this action occurs within 60 days of the distribution), he can do so only if finds an alternative source of cash for the $2,000.00 that was withheld.

The facts are the same as in the preceding example except that the plan distributes $10,000.00 directly to Archie's IRA in a direct rollover. This distribution is not subject to mandatory withholding because it is a direct rollover.

The facts are the same as in the preceding example except that Archie dies in 2003 before any funds are distributed to him from the plan. Edith can make a direct rollover to her IRA without being subject to mandatory withholding.

- **A direct transfer is the tax-free movement of IRA assets one IRA to another IRA.**

Examples

Jack (who turns age 75 on 11/3/03) is the owner of one IRA . IRA #1. Jack's wife, Shirley (who turns age 71 on 8/1/03), is named as primary beneficiary of IRA #1. The 2003 required minimum distribution for IRA #1 is $150,00000. In 2003, Jack decides to open IRA #2 with a fiduciary that is different from the fiduciary of IRA #2. Jack can then make (in 2003) a direct transfer of all of the assets in IRA #1 to IRA#2 without first having to take the $150,000.00 required minimum distribution from IRA #1. This does not, however, absolve Jack from having to take a $150,000.00 required minimum distribution from IRA #2 in 2003.

The facts are the same as in the preceding example except that Jack dies in 2003 before any funds are distributed to him from IRA #1. Shirley can make a direct transfer of all the assets in IRA #1 to an IRA that she establishes - this IRA would initially be titled as the IRA of Jack, deceased . Shirley, *beneficiary. Shirley is still required to take Jack's 2003 required minimum distribution of $150,000.00 in 2003.*

- **Direct transfers come in several different forms — trustee to trustee, trustee to custodian, custodian to trustee and custodian to custodian — dependent upon whom the IRAs' fiduciaries are.**

- **During the lifetime of the IRA owner, such owner is the only individual that is eligible to make a direct transfer of IRA assets. At the death of such owner, the IRA beneficiary (whether it be an individual or non-individual) may make a direct transfer of IRA assets of which he/she/it is beneficiary.**

- **Many of the technical rollover requirements do not apply to direct transfers. For instance, Required Minimum Distributions can be the subject of a direct transfer (this is new under the final regulations), and there is neither a sixty day requirement or one transfer per year rule for direct transfers. Furthermore, a direct transfer of IRA assets from one IRA to another does not generate tax reporting and is not subject to federal income tax withholding.**

Other things to keep in mind:

- **Internal issues in institutions that might arise if the surviving spouse wants to change the name on the account.**

- **The standard of review for abatement of excess accumulation penalties has changed from "good faith error" to "reasonable error".**

- **Trustees and custodians will be facing new liability and responsibilities with the new proposed reporting requirements and under the elective share.**

- **There is a good bit of confusion in the professional community.**

- **No matter what, the IRA document is a contract and the contract rules.**

Drafting Checklist
See Forms at Appendix H At J- 60

Drafting Checklist

(Taken in part from Natalie Choate's Book
"Life and Death Planning for Retirement Benefits")

1. Impress on the client that the "Designation of Beneficiary Form" is just as important a legal document as a will or trust. Often, more of the client's assets are controlled by this form than by his will.

2. Read the applicable sections of the "Account Agreement" estab1ishing the client's IRA or Roth IRA, to make sure the beneficiary designation and payout method the client desires are permitted.

3. There are certain issues in the disposition of death benefits that need to be considered and covered. While some IRA providers now cover these matters in their printed IRA documents, others do not. If these matters are not covered in the IRA agreement , then they can be covered in the beneficiary designation form:

   A. Who chooses the form of death benefits, the client-participant or the beneficiary?

   B. On the death of the Participant, the primary beneficiary is entitled to the benefits. If the beneficiary does not withdraw them immediately, what happens to the benefits that are still in the IRA when the primary beneficiary dies? Will they pass to a new beneficiary designated by the primary beneficiary? Do they now belong to the primary beneficiary's estate, so they pass under his or her will?

   C. In the case of an IRA (or Roth IRA), can the beneficiary transfer the benefits to another IRA (or Roth IRA) still in the name of the deceased Participant?

4. Problems frequently arise with IRA providers when practitioners submit beneficiary designation forms that place unsuitable duties on the IRA provider. Most IRAs are custodial accounts, under which the IRA provider's duties are

limited to custodial and tax reporting services, and the provider's fees are nominal. Administrators of most company retirement plans also are not set up to monitor and administer employees' retirement benefit accounts individually. There are IRA providers who offer "individual retirement trusts" (IRTs), which are identical in all tax attributes to IRAs, but are structured as trusts rather than custodial accounts. The IRT provider is the trustee of the IRT, and as such often provides a higher level of services than the typical IRA account contemplates. The IRT provider's fees would also typically be higher if it is providing trust services rather than just custodial services. Unless the client's particular IRA or IRT provider is set up to provide individual services customized for that client (with appropriate charges), the provider cannot be expected to do much more than send out benefit checks in specified proportions to beneficiaries whose names, addresses and Social Security numbers are listed in the beneficiary designation form. Here are some "do's and don't's" for avoiding problems with the plan or IRA administrator:

A. <u>Don't require the administrator to make legal judgements</u>. A form that says "I leave the benefits to X unless he disclaims the benefits by means of a qualified disclaimer within the meaning of § 2518," appears to require the plan administrator to determine whether the disclaimer is qualified under §2518 before it can decide who to pay the benefits to.

B. <u>Don't require the administrator to carry out the function of an executor or trustee</u> - For example if you say "I designate my son as beneficiary, to receive only the minimum required distribution each year," you are requiring the plan administrator to control the beneficiary's withdrawals. Most IRAs have no mechanism for restricting the beneficiary's withdrawals. If you want to restrict the beneficiary's withdrawals or make them conditional in any way ("beneficiary can withdraw funds as needed for education " "beneficiary can withdraw funds so long as she has not remarried") you must either (i) leave the benefits to a trust (so the trustee can enforce the conditions);or (ii)find an IRA provider that offers accounts which allow restricted withdrawal provisions (and probably charges accordingly).

C. <u>Don't require the administrator to determine amounts dependent on external facts</u>. If it is necessary to include, in your beneficiary designation form, a formula that is dependent on external facts (for example, "I leave my grandchild an amount equal to my remaining GST exemption," or "I leave to the marital trust the minimum amount necessary to eliminate federal estate taxes"), then do this in a way that does not make the IRA provider responsible to apply the formula. Provide that a beneficiary or fiduciary will certify the facts to the IRA provider, who can rely absolutely on such certification.

D. Do avoid redundant or contradictory lists of definitions and payout options. If the plan document already has suitable and clear definitions of "primary beneficiary," "death benefit," "the account" and other terms, using a different set of definitions may just create confusion.

5. Consider whether you wish to alter the applicable presumptions in case of simultaneous death.

6. If the disposition is intended to qualify for the marital deduction, include language to that effect.

7. Consider the extent to which you need to define any terms such as "issue per stirpes," or "income"; and/or specify which state's law shall be used to interpret terms you use in the form. It is highly likely that the IRA agreement specifies that the law of the Sponsor's state of incorporation will be used. Because that may well not be the state in which your client lives (or dies), there is a potential for problems if the client's chosen disposition depends on a definition which varies from state to state. Although you cannot change the governing law of the plan, a statement that the language of the beneficiary designation will be interpreted according to the laws of a particular state should be accepted in the sense that it will lead to the correct determination of the client's intent.

8. Follow the required formalities of execution. Most IRAs are simply custodial accounts. As such, they may be considered "probate" assets of Participant's estate in some states. Some states do not recognize a disposition of certain forms of retirement benefits unless executed with the formalities of a will.

9. The choice of a contingent beneficiary should not be overlooked. For example:

A. If benefits are being made payable to a trust, to take advantage of Participant's unified credit while providing life benefits for the surviving spouse, consider naming the trust as primary beneficiary only if the spouse survives. Consider naming the children (assuming that is Participant's choice as contingent beneficiary) directly as contingent beneficiaries if the spouse does not survive, to avoid the complications of running benefits through a trust.

B. Consider whether different contingent beneficiaries should be named depending on whether the primary beneficiary actually dies before Participant, or merely disclaims the benefits.

10. Whenever a trust is named as beneficiary, be sure to file the required documentation

11. It is strongly advised to include complete contact information for the beneficiaries, or they and the IRA provider may never find each other; and also to require the administrator to provide information to the participant's executor.

12. Finally, do not focus on taxes and minimum distributions to the exclusion of basic drafting issues. If the spouse is named as beneficiary, is that only if he or she is married to Participant at time of death?...or does divorce revoke the designation of spouse? If any beneficiary predeceases Participant, does his or her share pass instead to the surviving beneficiaries, or to his or her own issue, or to someone else?

A Few Words about Florida's New Elective Share Statute:

- **The new elective share statute provides that the spouse can elect to take 30% of the "elective estate", which has now been expanded to include death benefits payable under qualified and non-qualified retirement plans.**

- **This includes amounts payable by reason of the decedent's death under any public or private pension, retirement, or deferred compensation plan, or similar arrangement.**

- **A transfer is excluded from the elective estate if it is made with the written consent of the surviving spouse. This includes ERISA spousal waivers.**

- **Subject to a priority system, all direct recipients of property included are liable for contribution toward satisfaction any remaining unsatisfied balance of the elective share, with the liability being proportional to the proportional part of the elective estate received.**

- **Unless there is an extension, the elective share election must be filed by the earlier of six months from receipt of the notice of administration or two years after the decedent=s date of death.**

The Issues Presented by Florida's new Elective Share Statute:

- **State law versus Federal law - this involves the Supremacy clause of the Constitution and will be a question of whether ERISA will trump the probate code in regard to qualified plans.**

- **What if an IRA beneficiary takes distribution before an election is made and has already taken on the tax liability? How will this be corrected?**

- **In regard to waivers, is the spouse made aware when signing an ERISA waiver for a qualified plan that this will preempt elective share election of this asset even when rolled into an IRA?**

- **How does someone account for IRAs that contain both rollover monies that have had an ERISA waiver and regular contributions? Some will be elective share and some will not. Seems counter to EGGTRA intent.**

- **Since the spouse is not classified as a beneficiary of the IRA, is not named directly and IRAs are not subject to probate, would the spouse be considered a creditor? Florida statutes specifically protect IRAs from creditors.**

***For a more detailed discussion of these issues, please see Kristen Lynch's Florida Bar Journal Article from the June 2002 issue entitled "Marriage, Minimum Distributions and Mayhem: A Discussion of IRAs under Florida's New Elective Share Statute.**

Florida's Uniform Principal and Income Act

738.602 Deferred compensation, annuities, and similar payments.--

See Appendix I at J - 98

*****Remember: Distribution itself is still subject to income tax regardless of whether it is trust account income or principal.**

Florida's New Exemption Statute 222.21 Exemption of pension money and certain tax exempt funds or account

See Appendix J at J - 99

Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPA") enacted on April 20, 2005, generally effective October 17, 2005.

- **Exempts retirement funds to the extent the funds are in a fund or an account exempt pursuant to IRC § 401, 403, 408, 408A, 414, 457 and 501(a);**

- **IRA accounts are exempt up to $1,000,000 (unlimited for rollover account). Thus, important to keep rollover accounts separate from IRAs funded with annual contributions.**

- **Because Florida is an "opt out" state it is unclear whether the $1,000,000 cap is applicable.**

- **In Re Robin Bruce McNabb, 2005 Bankr. Lexis 1231. 2005 LVL 1525101 (Bankr D. Ariz)**

FLORIDA CASES

Most cited case is:
<u>Cooper v. Muccitelli</u> (661 So.2d 52)
Fla. App. 2 Dist., 1995
Fla., 1996 (682 So.2d 77) Hillsborough County, FL

This was actually a case involving life insurance proceeds. Spouses had divorced and then husband died without changing beneficiary designation. Question was certified to the Florida Supreme Court regarding their holding that without specific reference in a property settlement to life insurance proceeds, the beneficiary of the proceeds is determined by looking only to the insurance contract. The Supreme Court examined their dissolution terms as well as the insurance documentation. They determined that the husband was free to name anyone he chose as beneficiary of the insurance policy and that the instructions were clear as to how to accomplish a change. He did nothing, therefore the wife remained the beneficiary. The Court said "The analysis that the general

language in the separation agreement trumps the specific language in the policy would place the insurance carrier in an impossible position . . .the carrier could never be certain whom to pay in such a situation without going to court, in spite of what the policy said or how clearly it was worded."

<u>Leonard v. Crocker</u> (661 So.2d 1244)
Fla.App. 3 Dist., 1995 Dade County, FL

Personal representative of estate brought suit seeking to recover proceeds of Individual Retirement Account (IRA), alleging that designation of decedent's child as beneficiary lapsed upon child's adoption. The Circuit Court, Dade County, Michael Salmon, awarded account proceeds to adopted daughter. Personal representative appealed. The District Court of Appeal held that designation which identified beneficiary by birth date and social security number did not lapse upon beneficiary's subsequent adoption and name change. Affirmed.

<u>Goter v. Brown</u> (682 So.2d 155)
Fla.App. 4 Dist.,1996 Palm Beach County, FL

Whether IRA beneficiary designation controls or conflicting will controls depends on document - what is procedure?
Dispute arose in probate action over proceeds of individual retirement account (IRA) brokerage account between person designated as beneficiary in IRA documents and beneficiary of bequest of all of decedent's "financial securities held in brokerage accounts". The 15th Judicial Circuit Court, Palm Beach County, Gary L. Vonhof, ruled that will provision was ineffective to countermand designated beneficiary in IRA documents. Appeal was taken. The District Court of Appeal, Farmer, held that will effectively changed IRA beneficiary designation, and (2) beneficiary change provision of IRA account agreement would not be considered when presented for first time on motion for rehearing. The Court said it would have decided differently if the evidence had been presented in the first place. The Circuit Court held that the IRAs went to the decedent's sister, who was named on the IRA beneficiary form and the same desire was expressed in the will. The Appeals Court held that the IRA should go to the beneficiary under the will because the will was more recent and the Paine Webber documentation that was in front of the Court simply stated that Paine Webber "may conclusively rely upon, and shall be protected in acting upon, any written or oral order from the Customer or any notice, request, consent,

certificate or other instrument or paper believes by it to be genuine and to have been properly executed, so long as it acts in good faith in taking or omitting to take any action in reliance thereon." The Appeals Court awarded the IRA to the will beneficiary. Upon motion for rehearing, the sister and counsel produced a "missing" second page to the IRA beneficiary designation that spelled out the appropriate formal procedure for changing beneficiaries. Documentation of this was never raised or presented in the trial court.

<u>Vaughan v. Vaughan</u> (741 So.2d 1221)
Fla. App. 2 Dist., 1999 Sarasota, FL

Settlement agreement in divorce that specifically refers to IRA proceeds will supercede conflicting beneficiary designation.

Decedent's daughter sought declaratory relief to determine distribution of proceeds of decedent's life insurance policy and his individual retirement account (IRA). Decedent's former wife filed a counterclaim contending that she was entitled to the entire proceeds of the insurance policy and to the IRA funds free of any claims of the daughter. The Circuit Court, Sarasota County, Lee E. Haworth, entered summary judgment for former wife. Daughter appealed. The District Court of Appeal, Salcines, J., held that: (1) former wife was entitled to proceeds of $250,000 life insurance policy, but (2) daughter, and not former wife, was entitled to proceeds remaining in the IRA.
Affirmed in part and reversed and remanded in part.

<u>In re Estate of Dellinger</u> (760 So.2d 1016)
Fla. App. 4 Dist., 2000 Palm Beach County, FL

Divorced - IRA not referenced in the settlement - husband dies with wife still named as beneficiary - IRA document controls

In action between former wife, who was named beneficiary of former husband's individual retirement account (IRA), and personal representative of former husband's estate to determine entitlement to proceeds of IRA, the Fifteenth Judicial Circuit Court, Palm Beach County, John D. Wessel, entered judgment for estate, and former wife appealed. The District Court of Appeal, Glickstein, Hugh S., Senior Judge, held that former wife was entitled to IRA proceeds because separation agreement did not include proceeds.
Reversed.

Luszcz v. Lavoie (787 So.2d 245)
Fla.App. 2 Dist., 2001 Sarasota, FL

Divorce - settlement did not call for change of beneficiary on IRA - no release of claims - husband takes all - recedes from Vaughan

"An IRA is a contract with an institution that involves a third-party beneficiary designation. The rights of a spouse who has been named a beneficiary of an IRA arise from that contract, not from the marital relationship."

Personal representative of ex-wife's estate brought contempt action against ex-husband, seeking repayment to estate of funds husband received as beneficiary of wife's individual retirement account (IRA). The Circuit Court, Sarasota County, Becky A. Titus, denied contempt motion. Personal representative appealed. The District Court of Appeal, en banc, Whatley, held that ex-husband was entitled as beneficiary to ex-wife's entire IRA account.
Affirmed.

CASES ELSEWHERE

Rousey v. Jacoway (2005 - 1 USTC ¶ 50, 258, 155 S. Ct. 1561 (2005))
U.S. Supreme Court

Mr. and Mrs. Rousey wanted to exempt IRA assets from Chapter 7 bankruptcy estate. Under § 522(d)(10)(E) prior to BAPA debtor could eliminate from the estate the right to receive payments from a stock bonus, pension, profit sharing, annuity or similar plan if such right was on account of illness disability, death, age or length of service. The Bankruptcy Court determined that the IRA was not a "similar account" because the participant had unlimited access and the payments were not on account of age. The Court of Appeals for the Eighth Circuit affirmed. The Supreme Court reversed finding IRAs were "similar" plans and because of the 10% penalty if a participant withdraws prior to age 59 ½ the distribution were based on age.

Egelhoff v. Egelhoff (121 S.Ct. 1322)
U.S.Wash., 2001 U.S. Supreme Court
Supremacy - pre-emption - divorce originated in Washington State

Children from intestate's first marriage sued intestate's second wife, whose marriage to intestate had been dissolved shortly before his death, claiming

entitlement to life insurance proceeds and pension plan benefits. The Superior Court, Pierce County, Karen Strombom and Frederick Hayes, granted summary judgment to wife, and children appealed. The Court of Appeals, <u>93 Wash.App. 314, 968 P.2d 924</u>, reversed. Petition for review was granted, and the Washington Supreme Court, Smith, J., <u>139 Wash.2d 557, 989 P.2d 80</u>, affirmed. Certioriari was granted. The Supreme Court, Justice Thomas, held that Washington statute providing for automatic revocation, upon divorce, of any designation of spouse as beneficiary of non-probate asset was pre-empted, as it applied to ERISA benefit plans, as state law "related to" ERISA plans, which directly conflicted with ERISA requirement that plans be administered, and benefits be paid, in accordance with plan documents.
Reversed and remanded.

Justice Thomas: "...petitioner argues that the Washington statute has an impermissible connection with ERISA plans. We agree. The statute binds the ERISA plan administrators to a particular choice of rules for determining beneficiary status. The administrators must pay benefits to the beneficiaries chosen by state law, rather than to those identified in the plan documents. The statute thus implicates an area of core ERISA concern."

<u>Weaver v. Keen</u> (43 S.W.3d 537)
Tex.App. - Waco, 2001 Texas

After Egelhoff - distinguished because there was a signed waiver relating to the pension plans as part of divorce settlement. Decedent had remarried but had failed to change beneficiary designation.

Contingent beneficiary under two ERISA-qualified pension plans brought action against deceased employee's former wife, who was the named primary beneficiary, and the plan's administrators to recover plan's proceeds paid to former wife. Administrators interpleaded the remaining benefits. Thereafter, contingent beneficiary died and independent executrix of both her estate and employee's estate continued the suit. The County Court at Law No. 4, Dallas County, W. Bruce Woody, entered judgment in favor of former wife and awarded her attorney fees. Executrix appealed. The Court of Appeals, Vance, held that: (1) executrix had standing; and (2) under state designation of statute adopted as federal common law, employee's divorce automatically terminated designation of former wife as primary beneficiary on his pension plans, and thus, contingent beneficiary was entitled to the proceeds.

Reversed and remanded.

Keen v. Weaver (2003 WL 21467100)
Supreme Court of Texas Texas

In part two of the previous case, the Supreme Court of Texas decided that a waiver that was included in the divorce decree waived the employee's spouse's interest in the ERISA plan in question. The wife was represented by counsel, and the agreement expressly waived her rights in the plans and listed them by name. Affirmed.

PaineWebber Inc. v. East (768 A.2d 1029)
Md. App. (748 A.2d 1082), 2000
Maryland Supreme Court, 2001(755 A.2d 1139) Maryland

Decedent died and still had ex-wife named as beneficiary on IRA even though he had remarried. New spouse claimed that ex-spouse had waived her rights in the settlement agreement and that when decedent executed a new document after the divorce and left it blank, it was his intent that the default provision of PaineWebber that the estate become the beneficiary would take effect. Trial Court granted summary judgment to the New Spouse. Ex-spouse then appealed to the Court of Special Appeals. The Appeals Court awarded the IRA to the ex-spouse and then petitioned for a writ of certiorari. The Supreme Court affirmed based on the premise that the beneficiary designation naming the ex-spouse was the only beneficiary designation that seemed to be executed and that her right to be a beneficiary were not waived in the settlement agreement.

CHARITIES
Doctrine of Cy Pres

Alzheimer=s Case (747 N.E.2d 843)
Ohio App. 1 Dist., 2000 Ohio

Decedent left one fifth of his IRA to "Alzheimer's Disease Research". The custodian filed a complaint with the Probate Court seeking a declaratory judgment. Decedent had previously gifted monies to several different Alzheimer's organizations locally. Applying the Cy Pres doctrine, which allows an equitable substitution if the original charitable purpose has become impossible, inexpedient or impracticable to fulfill, the court ordered that each of

three charities that were a party to the action receive one third of the monies designated for "Alzheimer's Research Center".

ELECTIVE SHARE

<u>Briggs v. Hemstreet-Briggs</u> (701 N.Y. S.2d 178)
N.Y.App.Div. 2000 New York

Spouse had filed for elective share and had been involved in several conferences with the decedent=s daughter, the executor, regarding the net estate. Both were under a duty to disclose "net estate" assets. The wife learned several months into the process that she was the beneficiary of an IRA worth $215,855. This, plus the amount stipulated to by the executor for one-third of the statutory amount of the "known" estate, amounted to more than 50% of the gross taxable estate. Supreme Court Appelate Division held that the surviving spouse had a duty to disclose the IRA and held that she was only entitled to the stipulated amount not including the IRA and ordered that the IRA proceeds, together with interest, be paid to the estate. ???? Did not address the fact that it is not a probate asset.

CREDITOR ISSUES and ATTACHMENT

<u>In the Matter of the Trust U/A Jeffry H. Gallet</u> (2003 WL 21295166)
New York Surrogates Court, 2003 New York, New York

The trustee of this trust petitioned the court because there were debts owed by the trust that exceeded the available assets other than a retirement plan, a thrift plan, and an IRA. The trustee was looking for guidance because the trust document gave the trustee discretionary power to pay estate debts if the probate estate was insufficient. The court held that since the available assets were exempt from creditors during the life of the decedent, they were not subject to creditor's claims merely because they were payable to the decedent's trust.

<u>Lawler v. SunTrust Securities, Inc</u>.(740 So.2d 592)
Fla.App. 5 Dist.,1999 Brevard County, FL
The IRS rules . . .

Taxpayer brought action against custodian of self-directed individual retirement account (IRA), after custodian complied with a notice of levy filed by the Internal Revenue Service (IRS). The Circuit Court, Brevard County, Bruce W. Jacobus,

granted custodian=s motion for summary judgment, and taxpayer appealed. The District Court of Appeal, W. Sharp, held that custodian was required to comply with notice of levy filed by IRS, and was therefore immune from taxpayer's suit. Affirmed.

<u>In re Goldenberg #1</u> (218 F. 3d 1264)
C.A.11 (Fla.), 2000 Broward County, FL

IRAs remain exempt from creditors

Patient who had obtained judgment of more than $4 million against surgeon, after first moving for relief from automatic stay imposed on his Chapter 7 filing, objected to two of exemptions claimed by surgeon in effort to remove roughly all of assets he owned from reach of creditors. The United States Bankruptcy Court for the Southern District of Florida entered order overruling patient=s objections, and patient appealed. The District Court, No. 97-06203-CV-WDF, Wilkie D. Ferguson, Jr., affirmed in part and reversed in part. On further appeal, the Court of Appeals, Anderson, Circuit Judge, held that surgeon who filed for Chapter 7 relief at start of jury deliberations in medical malpractice case could not be denied Florida state law exemption in the $2,546,319 in funds on deposit in his individual retirement accounts (IRAs), on theory that allowing debtor to use this exemption to remove roughly two-thirds of his assets from reach of creditors was imposition upon creditors.
Affirmed in part; question certified.

<u>In re Goldenberg</u> #2 (253 F.3d 1271)
C.A.11 (Fla.), 2001 Broward County, FL

Cash surrender value of annuity contracts is exempt from attachment, garnishment or legal process.

. . . Following decision by Florida Supreme Court, Wells, Chief Judge, on certified questions, <u>2001 WL 469074</u>, the Court of Appeals, Anderson, Chief Judge, held that cash surrender value of debtor-physician's annuity contracts was exempt from claims of creditors, under Florida statute exempting, from attachment, garnishment or legal process, the proceeds of any annuity contract. Decision of district court on remaining issue reversed and remanded.

In re Green (268 B.R.628)
Bkrtcy.M.D. Fla., 2001 Orlando, FL

Bankruptcy case in which Chapter 7 debtors waited 18 months to amend their schedules to disclose 9 IRA accounts worth several hundred thousand dollars and several insurance accounts after initially concealing their existence; debtors made their exemptions in bad faith and had liberally accessed these accounts both pre and post petition. The court held that creditors were prejudiced and therefore IRAs were not exempt.

CONTRACTUAL AGREEMENT

Wolff v. Holmes (2003 WL 21206173)
Cal.App. 2 Dist. Los Angeles, California

The two daughters of the decedent knew that it was their father's intent to split everything equally between them. The daughters did not always get along. Based on some inequities that surfaced in their father's estate after he died, the daughters signed an agreement that, among other things, his two IRAs would be split between them regardless of the beneficiary designation. The court ruled this to be an enforceable contract as opposed to a gift and required a new trial to determine the distribution of funds after the distribution of the IRAs and payment of taxes.

UNTIMELY ROLLOVER - New Rules?

In re Williams (269 B.R. 68)
Bkrtcy M.D. Fla., 2001 Tampa, FL

Bankruptcy case in which debtor received lump sum distribution from qualified plan less 20% withholding last week in December. Check was dated December 21, 1997 and debtor did not cash check but held check until March 3, 1998 when he deposited it in a new IRA. Court held that they had no authority to modify the 60 day rollover time period.

SELF-DIRECTED

Paszamant v. Retirement Accts., Inc. (776 So.2d 1049)
Fla.App. 5 Dist., 2001 Orange County, FL

Self-directed IRAs - no duty of custodian to monitor investments - <u>read</u> <u>contract</u>

Investors in self-directed Individual Retirement Accounts (IRAs) brought negligence claims against IRA custodian, relating to the failure of the mortgagee, from whom IRA investors purchased interest in mortgages, to record the documents assigning the interests in the mortgages, before the mortgagee filed before bankruptcy. . .

DEATH & TAXES

<u>Carlin v. Director</u> (19 N.J.Tax 545)
N.J. Tax, 2001 New Jersey

Taxpayer appealed assessment by the Division of Taxation of transfer inheritance tax on IRA inherited from his sister. The Tax Court held that the value of the IRA could not be reduced by its tax liability.

NOTE that this is not too dissimilar from TAM 20247001 issued 11/25/2002 stating that there is no justifiable discount for estate tax on IRAs to adjust for the income tax liability.

<u>In Re Estate of Roberts</u> (762 N.E.2d 1001)
Ohio, 2002 Ohio

Tax Commission of Ohio appealed from a judgment of the Miami County Court of Common Please, Probate Division, which held that an IRA owned by a retiree at the time of his death should be excluded from his gross estate. The Court of Appeals reversed. On discretionary appeal, the Supreme Court held that the value of the gross estate includes the value of a rollover IRA. Affirmed.

MALPRACTICE

<u>Powers v. Hayes</u> (776 A.2d 374)
Vermont Supreme Court, 2001 Vermont

Father was going in for surgery and prior to surgery went to long time estate planning attorney and told her he wanted to leave everything to his daughter. Attorney changed will but failed to change or even suggest to change IRA beneficiary designation even though she knew of its existence. Father died shortly after surgery and daughter, who is also Administrator of father=s estate,

brought suit for negligence because IRA was left to former girlfriend of father. Lower court granted summary judgment in favor of attorney based on contention there was a genuine issue of fact regarding negligence of attorney but that plaintiff could not prove that the negligence was the proximate cause of the plaintiff=s harm. Supreme Court of Vermont disagreed and said that there was enough circumstantial evidence that father had the intent to change the beneficiary designation and had made a "reasonable effort" to do so. Based on his attempt to act on his intent, it is sufficient to avoid summary judgment.

Johnson v. Wiegers (46 P.3d 562)
Kansas App., 2002 Kansas

Wife dies. Husband, individually and as executor, sues the attorney for negligence and breach of fiduciary duty. Husband had been the beneficiary of wife's IRA until wife's daughter from a previous marriage had her attorney meet with her mother. First change was to give husband a life interest with balance to three children from a prior marriage upon his death. Second change eliminated husband altogether and left monies to one daughter. Husband challenged wife's competence to sign beneficiary designation forms and the trial court jury found that daughter had exercised undue influence. Also found that the attorney did not give mother independent advice. Husband was reinstated as 100% beneficiary of IRA. Husband then sued on behalf of the estate. Although the attorney had not given independent advice to decedent, Appeals Court held that the estate was not damaged because the IRA was outside the probate estate.

Lavitt v. Meisler (35 Conn. L. Rptr. 133)
Sup. Ct. of Connecticut, July 2003 Connecticut

This suit was brought by the estate and children of the decedent, Mr. Lavitt, based on a breach of duty to third party beneficiaries. Mr. Lavitt had asked his attorney to modify his will after his second marriage and his attorney apparently failed to identify the fact that there were no beneficiaries designated on Mr. Lavitt's IRA account. The plaintiffs alleged negligence, breach of contract, and breach of fiduciary duty. This count was struck from the complaint based on a lack of privity between the beneficiaries and the attorney, and any potential malpractice was not directly attributable to the drafting of the will.

INCAPACITY ISSUES

<u>Goeke v. Goeke</u> (613 So.2d 1345)
Fla.App. 2 Dist., 1993 Palm Beach County, FL

Twin sons of incapacitated man fighting over one son as guardian attempting to open new IRAs in name of father and designate only himself as beneficiary. Twin number one alleges that Twin number two, as guardian, does not have that authority. Florida Appeals Court disagreed and said that for various reasons, a guardian, with court approval, does have statutory power to establish and modify IRA trusts or IRA custodial accounts for the ward. "While an IRA is clearly not a trust for all aspects of Florida Law, for the purposes of Section 744.441 we conclude that statutory powers permit a guardian to create and modify such accounts, when appropriate for and in the best interest of the ward". The Appeals Court affirmed the trial court decision that Twin number two had authority but remanded it for further proceedings based on the fact that the guardian's attorney erroneously convinced the court that the guardian could not list his brother as a beneficiary on those accounts. Nice try!

<u>SunTrust Bank, Middle Georgia, N.A v. Harper</u> (551 S.E.2d 419)
Ga.App., 2001 Macon, Georgia

Incapacity issue - father was adjudicated incapacitated and son was named as Guardian. Issue arose when son had father change beneficiary designation on IRA to name him alone, rather than estate or him and his two nephews. Issue before the court was whether it required contractual capacity, which he lacked, or testamentary capacity which had not been taken from him in adjudication of incapacity. Trial court ruled that it was testamentary capacity and that beneficiary designation stood, Appeals Court differed and said it was a contract.

RECENT PRIVATE LETTER RULINGS ("PLR") AND REVENUE RULING

<u>PLR 200449040, 200449041, 200449042.</u> Decedent dies before age 70 ½. Valid trust is beneficiary of IRA. Surviving spouse ("S") is trustee. Percentage to be distributed to S, (without trust) percentage to daughter 1 ("D1") (oldest) and daughter 2 ("D2"). No portion of the IRA is to be used to pay decedent's debts S, D1 and D2 want to divide IRA into separate IRAs. S IRA will be rolled over by S.

1. **S can defer distributions until S reaches age 70 ½ and if distribution made before September 30 following year of decedent's death, then S is not considered a "designated beneficiary."**

2. **D1 and D2 can take distributions over D1 life expectancy.**

<u>PLR 200450057.</u> Decedent dies while participant in profit sharing retirement plan. Pursuant to plan, surviving spouse ("S") must receive account 5 years after decedent's death. S creates an inherited IRA and transfers balance of plan to inherited IRA. S gets distributions prior to S being 59½.

1. **Direct transfer from plan to inherited rollover IRA excluded from S income**

2. **Distributions to S not subject to 10% penalty**

<u>PLR 200453015.</u> S employed by Co 1 and Co 2. S owns more than 5% of C 2 but not of C 1. Five percent owners must receive Required minimum distribution by April 1 of the year they reach age 70 ½. Less than 5% owners Required minimum distribution is April 1 after the later of the date of retirement or reach age 70 ½ in 2004, Required minimum distribution is requested by 04/01/05. S takes Required minimum distribution in 2004 and rollover account in Co 2 to Co 1.

1. **Rollover is okay**

2. **S does not have to take distributions from Co 1 (including the rollover) until the later of retirement or when S reaches age 70 ½.**

<u>PLR 200513032</u>. Trust created by S and Y as trustee. Discretionary income and principal to S's wife. If wife predeceases S then at S's death, S's three children are beneficiaries. Trust is beneficiary of IRA. Wife dies before S. Then S dies. Trustee completed forms to "transfer" IRA to the trust. No withholding taxes. Trustee thought the transfer was a "rollover" so no taxes were due. After Trustee received 1099-R Trustee requests funds that had been distributed be placed in inherited IRA in name of deceased S to qualify as rollover.

1. **Inherited IRAs cannot complete rollover transfers, must be trustee to trustee transfer**

2. Sixty day rule does not apply

PLR 200522012. S has IRA and a Family Trust and Marital Trust. IRA primary beneficiary is Wife with first contingent beneficiary as Marital Trust and second contingent beneficiary as Family Trust. S dies. Wife executes fractional formula disclaimer making the fractional amount payable to Family Trust. Income and principal to wife or children and testamentary SPOA in favor of decedent's issue. Power was disclaimed. If SPOA not used, then to children. Language in trust stating estate and inheritance taxes paid. Trust was reformed stating that no retirement assets (after September 30 of the year following date of death) could be used for such payments.

1. Disclaimers was valid

2. Family Trust was a qualified beneficiary

3. Distributions to Family Trust taken over life expectancy of wife.

PLR 200530032. Decedent had 2 IRAs with M as beneficiary. M withdrew entire balance and ultimately transferred to a trust in which M's spouse was grantor. Trust provides all income to M, and principal to M for health, maintenance and support. M is elderly, English is not native language, no consultation with accountant.

1. Requests waiver

2. No waiver of 60 day rollover

PLR 200528031 - 200528035. Decedent dies in 2001, age 64 owned IRA and 403(b) annuity. Survived by spouse ("S") and 5 nieces and nephews. IRA is left 50% to Trust T and 50% to subtrust U created under Trust T. Fifty percent to Trust T allocated to subtrust V prior to 09/30 deadline. 403(b) annuity left to T which distributed in part to U and V. U was created for S. V created for nieces and nephews. They would receive benefits at age 21; all were 21.

1. Each individual timely named as beneficiary of V.

2. Each individual timely named as beneficiary of 403(b) annuity allocated to V.

3. **Each individual could make trustee to trustee transfer of their share of IRA to new IRA in name of decedent for benefit of V, payable to each individual.**

4. **Each individual could make trustee to trustee transfer of their share of 403(b) to a new 403(b) in name of decedent for benefit of V, payable to each individual.**

5. **Oldest life expectancy of S and nieces and nephews must be used.**

6. **Life expectancy of S could be used for 403(b).**

<u>Revenue Ruling 2005-36. 2005-26 IRB.</u> Designated beneficiary receives required minimum distribution in year of participant's death. Designated beneficiary disclaims within 9 months. Valid disclaimer as long as disclaimer only disclaims amount <u>not</u> received plus its proportionate income.

<u>HOT TOPICS</u>

Self Directed IRAs for Real Estate
(See Steve Lemberg's Employee Benefits & Retirement Planning Email Newsletter - Archive Message #314)

1. **Tax advantages lost if real estate in IRA.**

2. **Owner's commingling funds may cause IRA disqualification.**

3. **IRA owned LLC managing property may create traps for the unwary.**

4. **Need to avoid prohibited transactions, unrelated business taxable income, conflict of interest transactions and dealing with disqualified persons.**

5. **Assignment of income issues.**

Possible Legislation re: Revocation of Spouse as Beneficiary if Divorce.