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PRACTICAL PLANNING IDEAS FOR DISTRIBUTIONS FROM IRAS AND QUALIFIED PLANS

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Many people today have large balances in individual retirement accounts ("IRAs") and tax-qualified plans. These assets are subject to complex income, estate, generation-skipping, and excise taxation that erode the value of a person's retirement benefits. Recently issued final regulations simplify the requirements for minimum distributions commencing at age 70½, and create opportunities for additional estate planning strategies when leaving retirement benefits to family and charities. The final regulations, however, leave many questions unanswered, including how the new rules apply to common estate planning techniques such as the use of trusts as beneficiaries.

Estate and financial planning professionals often pay special attention to preserve retirement benefits and to pass them on to family members and other loved ones in a tax efficient manner. This article is intended to assist tax practitioners when advising clients how to structure distributions from IRAs and tax-qualified plans and underscores the importance of beneficiary designations. It includes summaries of federal income, estate, excise, and generation-skipping transfer tax considerations. State tax issues are not addressed, although it should be noted that several states afford favorable income tax treatment to distributions from IRAs and tax-qualified plans. For example, the State of Illinois excludes from state income tax all distributions from IRAs and qualified plans. The article also includes a summary of the minimum distribution

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rules applicable to IRAs and to tax-qualified plans that express participants' benefits in the form of an account balance rather than a periodic annuity payable at retirement age.[1]

The article includes examples of common beneficiary designations, as well as a discussion of practical considerations applied when drafting beneficiary designations and post-mortem strategies incorporated into sophisticated estate plans or made available to correct problems after death. For example, an individual might name successive beneficiaries, thereby allowing the beneficiaries at least nine months after death to evaluate the alternatives and to select the most appropriate designation through the use of qualified disclaimers. This article is not intended to be, and should not be considered as, tax or legal advice. Conclusions about the state of the law under final regulations should be revisited in light of developments subsequent to the date of this article.

I. INCOME TAX CONSIDERATIONS

As a general rule, the recipient[2] of distributions from IRAs and tax-qualified plans is taxed on the value of amounts received during the year, at ordinary income tax rates.[3] The taxable amount typically is reported to the recipient, and to the Internal Revenue Service ("IRS"), on IRS Form 1099. In many cases, a distribution is subject to one or more adjustments identified by code on Form 1099. This section addresses those adjustments and exceptions to the taxation of distributions from IRAs and tax-qualified plans. As discussed later in the article, a beneficiary may be entitled to an income tax deduction for the portion of the net federal estate tax that is

1. The minimum distribution rules for tax-qualified plans are found in I.R.C. § 401(a)(9) (2000 & Supp. 2003) and applicable Treasury regulations, and for individual retirement accounts ("IRAs") are found in I.R.C. § 408 and applicable regulations (generally incorporating regulations issued pursuant to I.R.C. § 401(a)(9)). On April 17, 2002, the IRS issued final regulations applicable to defined contribution (individual account) plans and temporary regulations applicable to defined benefit plans and annuity contracts; the final and temporary regulations can be found at 67 Fed. Reg. 18988 (Apr. 17, 2002).

2. The recipient may be the IRA owner or plan participant, a beneficiary or an alternate payee under a qualified domestic relations order. An IRA owner or plan participant is taxed on the amount of any distribution to an alternate payee who is a child or dependent of the owner or participant. *See* I.R.C. §§ 402(e)(1)(A) (2000 & Supp. 2003) and 414(p)(12) (2000 & Supp. 2003). A divorced spouse entitled to benefits under a qualified domestic relations order is taxed as if he or she were the plan participant, and thus eligible for rollover treatment and certain other adjustments discussed below. *See* I.R.C. § 402(e)(1) (2000 & Supp. 2003).

3. I.R.C. § 72 (2000 & Supp. 2003); I.R.C. § 402 (2000 & Supp. 2003); I.R.C. § 408(d) (2000 & Supp. 2003).

attributable to the IRA or qualified plan benefits.[4]

A. Nondeductible Contributions

When a plan participant or an IRA owner makes after-tax contributions, the earnings grow tax-deferred and they are taxed at ordinary income rates at distribution. The contributions, however, are excluded from taxable income. The plan administrator of a qualified plan is required to report on IRS Form 1099 the gross and the taxable amounts of distributions made throughout the year. IRA custodians must also file IRS Form 1099 to report amounts distributed during the year, but the IRA custodian is not required to provide a breakdown of taxable and non-taxable amounts. This reporting is left to the IRA owner when he or she completes the federal income tax return.

In the case of a lump sum distribution, the calculation of taxable income is relatively easy. One simply subtracts the aggregate after-tax contributions from the total amount distributed. For installment payments or annuity payments, the excludable portion is calculated in accordance with Treasury Regulations. The worst tax result occurs in the case of installment payments made after the "annuity starting date," because distributions are treated as coming first from taxable income, with after-tax contributions taken into account only after all taxable amounts have been distributed.[5] The annuity starting date is the date when payments are both fixed and have commenced to be paid.[6]

For annuity payments made after the annuity starting date, the nontaxable portion is determined using the exclusion ratio for distributions from IRAs and the table set forth in Code Section 72(d) for distributions from tax-qualified plans.[7] Under the exclusion ratio, the non-taxable portion of each payment is calculated using the ratio that the total non-taxable contributions bear to the total account balance or total expected return determined as of the annuity starting date.[8] The pro rata recovery rule applies to installment payments or periodic distributions under both IRAs and qualified plans that are made before the

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4. I.R.C. § 691(c) (2000). *See also infra,* "Estate Tax Considerations" section below.

5. I.R.C. § 72(e)(2)(A) (2000 & Supp. 2003).

6. The "annuity starting date" is defined in the Internal Revenue Code to mean "the first day of the first period for which an amount is received as an annuity under a contract." I.R.C. § 72(c)(4) (2000 & Supp. 2003).

7. I.R.C. § 72(d)(1)(B) (2000 & Supp. 2003). I.R.C. § 72(d) and regulations issued thereunder prescribe the method for calculating the exclusion ratio.

8. I.R.C. § 72(b) (2000 & Supp. 2003). For tax-qualified plans with respect to annuity starting dates in 1998 or later, the expected return is determined using a table set forth in I.R.C. § 72(d).

annuity starting date.[9] The pro rata recovery rule is similar to the exclusion ratio, except that the ratio under the pro rata recovery rule is calculated at the time of each payment, whereas the exclusion ratio is generally fixed as of the annuity starting date.[10] Under both the exclusion ratio and the pro rata recovery method, once the total amount of after-tax contributions have been recovered, all subsequent distributions are fully includible in taxable income.

B. Roth IRAs

Distributions from a Roth IRA are generally tax-free. Like after-tax IRAs, contributions to a Roth IRA are not deductible for federal income tax purposes at the time the contribution is made, and thus are not subject to federal income tax at distribution. However, Roth IRAs offer several advantages over after-tax IRAs. Regardless of the circumstances of the distribution or the age of the owner, distributions from a Roth IRA are treated as coming first from tax-free contributions. Earnings in a Roth IRA are excluded from taxable income if both conditions are satisfied: (a) the distribution is made after the fifth tax year beginning with the tax year in which the owner made a contribution to the IRA; and (b) the distribution is made after age 59½, on account of death or disability, or to pay certain first-time home buyer expenses.[11] Roth IRAs are not subject to the lifetime minimum distribution rules, thereby allowing greater tax-deferred growth inside the IRA.[12]

C. Rollover Treatment

Only a plan participant, an IRA owner, a surviving spouse, or a divorced spouse who is an alternate payee under a qualified domestic relations order may defer income tax by rolling over the amounts received in a distribution.[13] No other person, including children, may elect rollover treatment. Since 2002, plan participants can roll over distributions from one type of qualified plan to another type of plan.[14] Also, a surviving spouse may roll over amounts received from an IRA or a qualified plan into another qualified plan or an IRA.[15]

Most types of distributions from IRAs and tax-qualified plans are eligible for rollover treatment when paid to a plan participant, an IRA owner, a surviving spouse, or a divorced spouse who is an

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9. *See* I.R.C. § 72(e)(1)(A) (2000 & Supp. 2003).
10. *See* I.R.C. § 72(e)(2)(B) (2000 & Supp. 2003).
11. I.R.C. § 408A(d) (2000 & Supp. 2003).
12. I.R.C. § 408A(c)(5) (2000 & Supp. 2003).
13. *See generally* I.R.C. § 402(c); 402(e)(1)(B) (2000 & Supp. 2003).
14. *See generally* I.R.C. § 402(c) (2000 & Supp. 2003).
15. *See* I.R.C. § 402(c)(9) (2000 & Supp. 2003).

alternate payee under a qualified domestic relations order.[16] However, the following forms of distributions are not eligible for rollover treatment:

- Distributions in the form of annuity payments.[17]
- Distributions made in installments over ten years or longer.
- Required minimum distribution for any year.
- Certain corrective distributions, loan defaults, and pass-through dividends paid on employer securities.
- Hardship withdrawals from a qualified plan.
- Other types of distributions as described in applicable regulations.[18]
- Life insurance policies may not be rolled over into an IRA.[19]

Example

If Don Smith irrevocably elects to receive his distribution from a qualified plan or IRA in the form of annual installments over ten years, he may not roll over the annual installment amounts as he receives them. On the other hand, if Don receives a distribution of his entire account balance under a qualified plan in a single payment, he may roll over all or part of the distribution, other than his required minimum distribution, if any.

D. Capital Gains/Ten-Year Income Averaging

A plan participant, but not an IRA owner, who reached age 50 before January 1, 1986, may elect 20 percent capital gains treatment for the pre-1974 portion and ten-year averaging for the post-1973 portion of the taxable amount of a lump sum distribution from a qualified plan (but not from an IRA). Ten-year averaging treats the distribution as received evenly over ten years, avoiding a possible increase in the participant's marginal income tax rate. The tax is calculated using IRS Form 4972.[20]

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16. *See* I.R.C. § 402(c) (2000 & Supp. 2003).

17. Amounts paid under an annuity contract purchased by a qualified plan and distributed to a participant are eligible for rollover treatment if the amount paid would otherwise constitute an eligible rollover distribution. *See* Treas. Reg. § 1.402(c)-2, A-10 (as amended in 2000).

18. The definition of "eligible rollover distribution" is found in I.R.C. § 402(c)(4) (2000 & Supp. 2003) and Treas. Reg. § 1.402(c)-2 (as amended in 2000).

19. I.R.C. § 408(a)(3) (2000 & Supp. 2003).

20. Before January 1, 2000, five-year income averaging was available for lump sum distributions. It was repealed by Section 1401 of the Small Business Job Protection Act of 1996, but ten-year income averaging is still available. *See* Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 110 Stat. 1755 (1996).

E. Net Unrealized Appreciation on Employer Securities

Favorable tax treatment is accorded to distributions from a tax-qualified plan (but not an IRA) that includes stocks, bonds, or debentures of the employer that sponsors the plan. In the case of a lump sum distribution from a qualified plan, the plan participant or beneficiary is not taxed at the time of the distribution on any net unrealized appreciation in such securities. In the case of a distribution other than in the form of a lump sum payment, the participant/beneficiary is not taxed on any net unrealized appreciation in securities purchased with the participant's own contributions.[21] Upon a subsequent sale, the net unrealized appreciation as of the date of distribution is taxed at long-term capital gains rates, and any appreciation after the date of distribution is taxed at capital gains rates based on the holding period following the date of distribution. The tax deferral is automatic and is available to a beneficiary of any age, including the plan participant's estate. However, the recipient can opt out of this tax treatment. The plan trustee will determine and report on Form 1099 the amount of any net unrealized appreciation.[22]

A lump sum distribution is defined as one or more distributions from a qualified plan made within a single taxable year of the entire balance of the participant's benefits.[23] The distribution must occur on account of the participant's death, disability, separation from service (other than self-employed persons), or after attaining age 59½.[24] All plans maintained by the same employer are treated as a single plan for these purposes.[25] Often, an employee who separates from service is entitled to an allocation for the year of separation, which is deposited into the plan the following year. The IRS has ruled that a distribution made in the year an employee separates from service can qualify as a lump sum distribution, even if an additional amount representing a contribution for the year of separation is credited and paid to the individual in the following year.[26]

F. Annuity Contracts

The distribution of a non-transferable annuity contract that meets certain requirements of the Internal Revenue Code is not a

21. *See* Treas. Reg. § 1.402(a)-1(b) (as amended in 1994) (stating the determination of net unrealized appreciation for distributions other than a lump sum distribution). *See also* IRS Notice 89-25, A-1.
22. I.R.C. § 402(e)(4) (2000 & Supp. 2003).
23. I.R.C. § 402(e)(4)(D)(i) (2000 & Supp. 2003).
24. *Id.*
25. I.R.C. § 402(e)(4)(D)(ii) (2000 & Supp. 2003).
26. *See* Rev. Rul. 56-558, 1956- 2 C.B. 290 (1956).

taxable event.[27] Under certain circumstances, the contract may be exchanged or converted into another qualified annuity without adverse tax consequences. Any distributions from the annuity contract, however, are taxable to the recipient in the year of distribution and may be eligible for rollover treatment, for example, if the annuity is surrendered.

G. Life Insurance

Life insurance held in a qualified plan[28] is taxed differently than other types of assets held in qualified plans. First, the participant must include in taxable income each year the term cost of coverage. The participant is deemed to receive a distribution equal to the premium cost of term insurance each year, as determined by the life insurance company or under IRS Tables. These deemed distributions are commonly called "PS-58" costs after the original IRS tables used to calculate the taxable value of life insurance coverage, and the deemed distributions are reported on the plan participant's W-2 Form. Second, upon distribution, the beneficiary is not taxed on the death benefit portion of the life insurance, but the cash value, if any, is taxable income to the beneficiary to the extent it exceeds the amounts previously taxed to the participant.[29] The tax, legal, and insurance communities have employed innovative strategies using life insurance to reduce or eliminate unfavorable income and estate tax consequences associated with retirement benefits.

II. ESTATE TAX CONSIDERATIONS

As a general rule, retirement benefits are includible in the gross estate of the IRA owner or plan participant for federal estate tax purposes.[30] The amount includible is the fair market value of the decedent's interest in the IRA or under the qualified plan. Under conventional theory, the amount reported on a decedent's estate tax return is equal to the aggregate account balances held in IRAs and individual account plans,[31] and the present value of pension plan benefits under defined benefit plans,[32] determined as

27. *See* I.R.C. § 72 (2000 & Supp. 2003).

28. IRAs are prohibited from owning life insurance contracts. I.R.C. § 408(a)(3) (2000 & Supp. 2003). Qualified plans are limited in the amount of life insurance that can be owned by the plan.

29. *See* I.R.C. § 72 (2000 & Supp. 2003). *See also* I.R.C. § 101(a) (2000 & Supp. 2003).

30. I.R.C. § 2039 (2000).

31. These types of plans are "defined contribution plans" as that term is defined in I.R.C. § 414(i) (2000 & Supp. 2003) and ERISA, Pub. L. No. 93-406, § 3(34), and are required to be identified in the summary plan description.

32. Defined benefit plans are defined in the Internal Revenue Code as any tax-qualified plan that is not a defined contribution plan and in ERISA as a pension plan within the meaning of ERISA § 3(2) that is not a defined

of the date of the person's death or the alternate valuation date.[33] In a recent technical advice memorandum,[34] the IRS rejected a taxpayer's argument that the value of a decedent's IRA should be discounted for estate tax purposes to reflect income taxes that become payable by the beneficiary, and for lack of marketability due to penalties on the transfer or assignment of the IRA by reason of Section 408(e) of the Internal Revenue Code. Unlike employer-provided life insurance benefits, a person generally may not make an irrevocable gift of qualified retirement benefits in order to remove them from his or her estate, because of the anti-alienation provisions of the Employee Retirement Income Security Act of 1974 (ERISA). Yet, some commentators have devised strategies that attempt to exclude from an individual's taxable estate retirement benefits under qualified plans.

A. Grandfather Rules

Before the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), certain retirement benefits under an IRA or a qualified plan were not subject to estate tax. The unlimited estate tax exemption under TEFRA continues to apply to individuals in pay status on December 31, 1982 who irrevocably designated the form of benefit payment before January 1, 1983.[35] TEFRA reduced the exclusion to $100,000, and the Deficit Reduction Act of 1984 ("DRA") eliminated the exclusion entirely. The DRA established a transition rule that applies the $100,000 exclusion to certain individuals who made an irrevocable designation of the form of benefit payment before July 1984 and who were in pay status on December 31, 1984. The Tax Reform Act of 1986 extended the transition rule to plan participants who separated from service before January 1, 1985 as long as they did not change the form of benefit before death.[36]

B. Income In Respect of A Decedent

Retirement benefits are "income in respect of a decedent" and, as such generate taxable income to the beneficiary (without

contribution plan. *See* I.R.C. § 414(j) (2000 & Supp. 2003); *see also* ERISA, Pub. L. No. 93-406, § 3(35).

33. The personal representative of a decedent's estate may elect to use the "alternate valuation date," which is the six month anniversary of death or the prior date of sale or any asset, if it will reduce the estate tax. I.R.C. § 2032 (2000).

34. *See* Tech. Adv. Mem. 200247001 (Nov. 22, 2002).

35. For more information, see Temp. Treas. Reg. § 20.2039-1T (1986) and IRS Notice 83-23, 1983-2 C.B. 418.

36. *See* Treas. Reg. § 1.401(a)(9)-8, A-13 -A-16 (2002) and Temp. Treas. Reg. § 20.2039-1T (2004).

adjustment to basis by reason of the decedent's death),[37] but also there is a deduction for a portion of any federal estate tax attributable to the retirement benefits. The combined federal estate and income taxes can be as high as 65-70%, even after taking into account the income tax deduction for federal estate taxes paid.[38] The income tax deduction is equal to the incremental federal estate tax owed as a result of inclusion of the IRA or qualified plan benefits in the decedent's gross estate.[39] Typically, the deduction is reported as an itemized deduction on the beneficiary's Schedule A to Form 1040 as "other miscellaneous deductions," although the deduction is not subject to the floor of 2 percent of adjusted gross income applicable to most miscellaneous itemized deductions.[40] If a beneficiary receives a lump sum distribution and elects special capital gains and ten-year income averaging treatment (See Income Tax Considerations in *Capital Gains/Ten-Year Income Averaging* above), then the net federal estate tax is subtracted from the lump sum payment when calculating the income tax on the lump sum distribution.

III. GENERATION-SKIPPING TRANSFER TAX CONSIDERATIONS

A generation-skipping transfer tax ("GST Tax") is imposed on transfers to persons assigned to a generation that is at least two generations below the transferor's generation, whether the transfers are outright, in trust, or in an arrangement similar to a trust, such as life estates, remainder interests, and annuities. A taxable event occurs upon a direct skip, a taxable distribution, and a taxable termination. The tax rate is the maximum estate tax rate in effect at the time of the transfer. Each person has a GST exemption of $1.5 in 2004-05, $2 million in 2006-08, and $3.5 million in 2009.[41] The beneficiary may be entitled to a deduction for federal GST Tax imposed on a direct skip or a taxable termination occurring as a result of the death of the transferor for the portion of the tax attributable to retirement benefits,[42] or an itemized deduction for

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37. I.R.C. § 1014(c) (2000 & Supp. 2003).

38. This assumes taxes are paid at marginal rates of 48% federal estate tax and 33% federal income tax; it uses a "back of the envelope" calculation of $100,000 in retirement benefits that results in estate tax of $48,000 and income tax of $17,000 ($100,000 minus $48,000 times 33%). Any state taxes will further erode the amounts realized by the beneficiary.

39. The deduction is allowed under I.R.C. § 691(c) (2000).

40. I.R.C. § 67(b)(7) (2000). *See* Instructions for Schedule A to Form 1040.

41. These increases are legislated by the Economic Growth and Tax Relief Reconciliation Act of 2001 and, unless extended or made permanent by subsequent legislation, are scheduled to sunset after 2010. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat 38.

42. I.R.C. § 691(c)(3) (2000).

federal and state GST Taxes imposed on income distributions.[43]

Because of the tax-deferred growth on retirement benefits and the income tax rules that result in taxation at the beneficiary level, retirement plans and IRAs are suitable for passing on to successive generations by naming as beneficiary either grandchildren or a trust for the benefit of grandchildren so long as distributions are not subject to GST Taxes. Retirement benefits distributed over the life expectancy of the grandchild, or of the oldest beneficiary in the case of a trust for grandchildren, will grow tax-deferred for generations. The strategy of allocating GST exemption to an IRA at death allows for leveraging the GST exemption.

IV. EXCISE TAX CONSIDERATIONS

The Internal Revenue Code contains numerous excise taxes, two of which often come into play in the context of retirement plan distributions. First, the tax code imposes a 50 percent penalty on any amount that should have been, but was not withdrawn or distributed as required by the minimum distribution rules discussed below.[44] Second, under new reporting requirements, IRA custodians, but not plan administrators, are required to calculate and report to IRA owners the minimum amount to be distributed each year.[45] For 2004 and later years, IRA custodians must report those amounts to the IRS as well as to the IRA owner, so it will be easier for the IRS to monitor compliance with the distribution rules.

In addition, the tax code imposes a 10 percent penalty on distributions made to an IRA owner or plan participant before he or she has attained age 59½, unless an exception applies.[46] The estate planning professional should be aware of these exceptions to the early distribution penalty, because they can play an important role in handling distributions after the death of an IRA owner or plan participant. For example, a widow or widower under age 59½ can receive distributions from accounts held in the name of the decedent without any penalty, but the penalty applies if those same amounts are rolled over into an IRA or another qualified plan and withdrawn before the widow or widower reaches age 59½. Exceptions to the ten percent penalty include:

- Distributions made on account of death or disability.
- Distributions that are part of a series of substantially equal periodic payments (not less frequently than annually)

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43. I.R.C. § 164(a) (2000).

44. I.R.C. § 4974 (2000).

45. IRA custodians should review IRS Notice 2002-27 and Notice 2003-3, which describe alternative methods for complying with the disclosure requirement.

46. *See* I.R.C. § 72(t) (2000 & Supp. 2003). The exceptions to the early distribution penalty are listed in I.R.C. § 72(t) for qualified plans and IRAs, and in I.R.C. § 72(q) for annuity contracts.

made for the life or life expectancy of the owner/participant or the joint lives or life expectancies of the owner/participant and his or her designated beneficiary.

- Distributions made to the owner/participant following separation from service after attaining age 55. This exception does not apply to distributions from IRAs or plans sponsored by self-employed persons.
- Distributions that do not exceed the owner/participant's deductible medical expenses for the year (i.e., in excess of 7.5 percent of the person's adjusted gross income for that year). This exception applies to IRA withdrawals made after 1996.
- Distributions of dividends from an Employee Stock Ownership Plan.
- Distributions from an IRA that do not exceed the IRA owner's qualified higher education expenses for the year.
- Distributions from an IRA while receiving unemployment compensation to the extent the IRA owner paid certain health insurance premiums in the year of the distribution.
- Distributions from an IRA that are qualified first-time home buyer distributions.
- Distributions made to an alternate payee pursuant to a qualified domestic relations order.

V. MINIMUM DISTRIBUTION RULES

Until recently, the minimum distribution rules were set forth in proposed regulations issued in 1987. The 1987 regulations were quite complex and unnecessarily restrictive. The IRS issued a new set of proposed regulations in 2001, and one year later the IRS came out with final regulations for distributions from IRAs and individual account plans and temporary regulations for distributions from defined benefit plans. The final regulations[47] are significantly less complicated than the 1987 proposed regulations, but they do require careful consideration, especially when naming trusts as beneficiaries or employing other sophisticated estate planning strategies. The final regulations are effective for distributions made on or after January 1, 2003.[48]

To help IRA owners comply with the minimum distribution rules, the final regulations require IRA custodians, but not plan administrators, to calculate and disclose to each IRA owner the minimum amount to be distributed for any year.[49] Starting in

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47. The final regulations are published in 67 Fed. Reg. 18988 (Apr. 17, 2002).

48. *Id.*

49. IRA custodians should review IRS Notice 2002-27 and Notice 2003-3, which

2004, IRA custodians must also report those amounts to the IRS, making it easier for the IRS to monitor compliance with the distribution rules. This section of the article discusses the application of minimum distribution rules to IRAs and individual account plans. In practice, the plan documents or IRA agreements may be more restrictive than the tax rules require, and the practitioner should obtain a copy of the IRA agreement or the summary plan description (and occasionally plan documents) to confirm the manner and timing of distributions. The minimum distribution rules set forth minimum amounts that must be distributed each year, but the rules do not prevent an IRA owner, plan participant, or beneficiary from withdrawing greater amounts if permitted by the terms of the governing instruments.

VI. DISTRIBUTIONS COMMENCING AFTER AGE 70½

After a person reaches his or her "required beginning date," the Internal Revenue Code requires that minimum amounts must be paid annually from an IRA (other than a Roth IRA) or a qualified plan. Roth IRAs are not subject to these lifetime distribution rules, but they are subject to the minimum distribution rules applicable after the owner's death. A transitional rule "grandfathers" certain distributions from qualified plans, if the form of the benefit payment and the beneficiary were designated in writing before January 1, 1984; this is known as a "TEFRA Section 242(b) election."[50]

A person may aggregate several IRAs and withdraw the required minimum distribution for all IRAs from one or more of them. This rule does not apply to qualified plans, to IRAs with different lifetime distribution periods, or to IRAs payable to a beneficiary. Of course, the minimum distribution rules do not prevent a person from withdrawing in excess of the required minimum distribution for any year.[51]

A. Definition of "Required Beginning Date"

A person's required beginning date might be different for tax-qualified plans and for IRAs. For Regular IRAs, the applicable date is April 1 of the calendar year following the calendar year in which the IRA owner reaches age 70½. The required beginning

describe alternative methods for complying with the disclosure requirement. This reporting requirement became effective as of January 1, 2003.

50. *See* Treas. Reg. § 1.401(a)(9)-8, A-13 through A-16 (2002).

51. Amounts withdrawn in excess of the required minimum distribution in one year are not applied against the following year's required distributions. However, the amount required to be distributed in the following year is reduced because the account balance at the end of the year is less than it would have been absent the withdrawal. *See* Treas. Reg. § 1.401(a)(9)-5, A-2 (2002).

date is the same under qualified plans, unless the person is employed past age 70½ and is not a "five percent owner"[52] of the employer that sponsors the plan, in which case the required beginning date for that person is April 1st of the calendar year following the calendar year in which the person retires. A person reaches 70½ on the sixth month anniversary of his or her 70th birthday. Thus, a person who is born January through June reaches age 70½ in the same calendar year in which he or she turns age 70; and a person who is born on or after July 1 is 70½ in the same calendar year in which he or she turns age 71.

Example
Assume Don Smith has both an IRA and an account under a tax-qualified plan, and he was born on July 1, 1933. Don turns age 70½ on January 1, 2004, and his required beginning date for his IRA is April 1, 2005. If Don is still employed on December 31, 2004 and he is not a five percent owner of the employer that sponsors the qualified plan at any time during 2004, his required beginning date for distributions from the qualified plan is April 1st following the calendar year in which he retires.

B. Timing and Amounts of Payments

Except for the first year, distributions must be made annually no later than December 31st of each calendar year. Technically, the first distribution is required for the calendar year in which the person turns age 70½ (or retirement for certain plan participants), but it can be deferred until April 1st of the following year (i.e., the required beginning date). When payment of the first year's distribution is deferred into the year containing the required beginning date, then two distributions are required for that year.

For IRAs and individual account plans, the amount to be distributed each calendar year is a fraction of the account balance as of December 31st of the prior year.[53] For example, one would use the account balance as of December 31, 2003 to determine the minimum distribution for calendar year 2004. The numerator of the fraction is always one, and the denominator is the number of years in the "distribution period."

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52. A "five percent owner" means a person who owns more than five percent of the outstanding stock (in number or voting power) or capital or profits of the plan sponsor. *See* I.R.C. §§ 401(a)(9)(C)(ii) (2000 & Supp. 2003) and 416(i)(1)(B) (2000 & Supp. 2003).

53. Under the final regulations, the year-end balance used to determine minimum distribution for the second year is no longer reduced by the amount deferred from the first year's distribution into the second year, which had been permitted by the 1987 proposed regulations. *See* Treas. Reg. §§ 1.401(a)(9)-5, A-1(c) and A-3 (2002). *See also* the preambles to the final regulations under the section heading "Calculation Simplification."

C. Uniform Lifetime Table and Exception

Under the final regulations, there is now a uniform schedule for most people of the same age called the "Uniform Lifetime Table," which is found at Table I at the end of this article.[54] The distribution period is determined based on a person's age on December 31st in the calendar year of distribution.[55] It is recalculated each year by looking to the table, so the person's retirement benefits are never fully depleted. The distribution period under the Uniform Lifetime Table is the equivalent of the joint life expectancy of an IRA owner and a beneficiary ten years his or her junior.

There is one important exception to the use of the Uniform Lifetime Table. If the person's spouse is the sole beneficiary *and* more than ten years younger, the couple's actual joint life expectancy is used to determine the distribution period. The joint life expectancy is determined each year using the Joint and Last Survivor Table found in the final regulations, applying both spouses' ages as of December 31st in that year.[56]

> *Example*
> Assume Amy's IRA account balance was $100,000 as of December 31, 2003, Amy is 70½ and 71 in 2004, and her husband is not more than ten years younger than Amy. Amy must withdraw $3,773.58 by April 1, 2005 (her required beginning date), which is roughly 3.8 percent of the December 31, 2003 account balance. If she defers her first distribution until 2005, she must receive two distributions during that year, with the second distribution made not later than December 31, 2005. The second year's distribution is calculated based on the IRA account balance as of December 31, 2004, without adjusting for the deferred distribution.

Under the 1987 regulations, it was often necessary to create separate IRAs when naming multiple beneficiaries, because the distribution period for lifetime distributions was always determined based on the joint life expectancy of the IRA owner and oldest beneficiary. Under the Uniform Lifetime Table, separate IRAs are no longer necessary unless a person wishes to name multiple beneficiaries that include a spouse more than ten years younger.[57]

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54. The "Uniform Lifetime Table" is found in Treas. Reg. § 1.401(a)(9)-9, A-2 (as amended in 2002).

55. The final regulations look to a person's age on his or her birthday in the year of distribution, which is the same as one's age on December 31 of that year. Treas. Reg. § 1.401(a)(9)-5, A-4 (2002).

56. The "Joint and Last Survivor Table" is found in Treas. Reg. § 1.401(a)(9)-9, A-3 (2002).

57. The final regulations have greatly simplified the minimum distribution rules by making several important changes from proposed regulations issued

Special care should be taken when naming a trust for the benefit of a spouse. For example, a typical marital deduction trust may qualify for the extended distribution period, but only if the trust is a "conduit trust" with respect to the spouse, i.e., the trust must provide that the spouse will receive or be entitled to receive all distributions paid by the IRA or qualified plan to the trust after the death of the IRA owner or plan participant.[58] In addition, the trust must meet the requirements for a qualified trust explained below, although a copy of the trust instrument or a certification must be given to the IRA custodian or the plan administrator by the required beginning date; the IRA owner or plan participant must agree to notify the custodian or administrator of future amendments to the trust. The conduit trust is discussed below in the section titled *Trust Design and Funding Issues.*

D. Comparison of Old versus New Distribution Periods

The table below compares distribution periods under the 1987 and 2002 regulations. For distribution periods under the 1987 rules, the author assumes that an IRA owner does not name a beneficiary or elect to recalculate his or her life expectancy. For distribution periods under the 2002 rules, the author assumes that the owner does not have a spouse who is more than ten years younger. The complete Uniform Lifetime Table is set out in Table I at the end of this article.

	Under 1987 Rules		Uniform Lifetime Table	
Age	Distribution Period	Approximate Percentage of IRA/QP Distributed	Distribution Period	Approximate Percentage of IRA/QP Distributed

in 1987. For example, for distributions starting at age 70½, there is a uniform distribution period for everyone of the same age, regardless of who is the named beneficiary, except that if the person's spouse is the sole beneficiary and more than ten years younger, the couple's actual joint life expectancy can be used to determine the distribution period. Also, an individual can change beneficiaries after age 70½ without adversely affecting the required minimum distributions payable during the individual's lifetime. The final regulations create a "gap" period that allows at least nine months after the death of an IRA owner or plan participant to perform additional planning or to correct defects in beneficiary designations.

58. The special treatment for spouses is conditioned on the spouse being the "sole beneficiary" of the IRA or plan account during the year of distribution. *See* Treas. Reg. § 1.401(a)(9)-5, A-4(b) (2002). To comply with this section, the trust might also provide that no person other than the spouse has any interest in the retirement benefits during the spouse's lifetime (after the death of the IRA owner or plan participant) similar to provisions applicable to a marital trust.

	Under 1987 Rules		Uniform Lifetime Table	
Age	Distribution Period	Approximate Percentage of IRA/QP Distributed	Distribution Period	Approximate Percentage of IRA/QP Distributed
70	16 years	6.25%	27.4	3.7%
71	15	6.66%	26.5	3.8%
72	14	7.14%	25.6	3.9%
73	13	7.69%	24.7	4.0%
74	12	8.33%	23.8	4.2%
75	11	9.09%	22.9	4.4%
76	10	10.00%	22.0	4.5%
77	9	11.11%	21.2	4.7%
78	8	12.50%	20.3	4.9%
79	7	14.28%	19.5	5.1%
80	6	16.66%	18.7	5.3%
81	5	20.00%	17.9	5.6%
82	4	25.00%	17.1	5.8%
83	3	33.33%	16.3	6.1%
84	2	50.00%	15.5	6.5%
85	1	100%	14.8	6.8%

Under the Uniform Lifetime Table, the minimum required payments are relatively low until age 90. For example, from 70 to 80, a person must withdraw between 3.7% and 5.3% of the retirement benefits' value each year. If earnings in the IRA or qualified plan are greater than 4-6 percent annually, the person's retirement benefits will grow in value despite the distributions. Even at age 90, the distribution period is 10.5 years, so the minimum distribution for that year is less than ten percent of the account balance at the end of the prior year.

VII. DISTRIBUTIONS COMMENCING AFTER DEATH

The rules for distributions after death apply to Roth IRAs, Regular IRAs and tax-qualified plans. The method and timing requirements for these distributions depend on whether the IRA owner or plan participant dies before or after the "required beginning date" (described above) and whether there is a designated beneficiary in place (described below). Under the minimum distribution rules, post-death distributions to a designated beneficiary begin in the year *following* death, and must continue each year until the IRA or plan account is completely distributed. Each year's distribution must be made by December 31 of the calendar year. For IRAs and individual account plans, the amount to be distributed each year typically is a fraction of the balance in the IRA or plan account as of December 31st of the prior year.

If a person dies after his or her required beginning date, the minimum required distribution for the year of death is determined as if the person had lived throughout that year, and is required to be distributed as part of the lifetime distributions.[59] Some practitioners have questioned whether the final year's distribution should be made to the estate of the decedent, because the decedent would have received the payment had he or she lived and the estate is the successor to the decedent.[60]

There are six possible scenarios for determining the distribution period following death:

1. *Death Before Required Beginning Date—No Designated Beneficiary.* If an individual dies before his or her required beginning date without a designated beneficiary, then the IRA or plan benefits must be paid out in full by December 31st of the calendar year containing the fifth anniversary of the individual's death.

> *Example*
> Assume that Mary dies on June 15, 2004, at age 65, without having named a beneficiary. The entire IRA must be distributed no later than December 31, 2009.

2. *Death Before Required Beginning Date—Surviving Spouse is Designated Beneficiary.* If an individual dies before the required beginning date and his or her spouse is the sole designated beneficiary, the spouse may either: (a) roll over the retirement benefits to an IRA in the surviving spouse's name or to another tax-qualified plan sponsored by the employer of the surviving spouse (if the plan permits such rollovers), or simply elect to treat the IRA as if the spouse were the original owner, which has the same effect as a rollover; or (b) elect to have distributions paid over his or her life expectancy, beginning either December 31 of the calendar year immediately following the calendar year in which the deceased spouse died, or December 31 of the calendar year in which

59. Treas. Reg. § 1.401(a)(9)-5, A-4(a) (2002).

60. This is an area of disagreement among tax practitioners. Because the regulations refer to "a beneficiary" rather than making reference to the designated beneficiary, attorneys have asserted that a decedent's estate is an appropriate beneficiary where the executor is responsible for ensuring payment of the final year's minimum distribution. *See* Treas. Reg. § 1.401(a)(9)-5, A-4(a) (2002). From a tax perspective, it may be beneficial to pay the final year's distribution to the estate and apply it against attorney and accountant fees properly chargeable to the estate. This is particularly true where there is a full estate tax marital deduction, and there is insufficient other income earned after death from which to offset such fees and expenses. IRA custodians may be agreeable to pay the final year's distribution to the decedent's estate consistent with the terms of the governing instruments or upon direction of the executor and beneficiary.

the deceased spouse would have attained age 70½, whichever is later.[61] If the surviving spouse dies after the IRA owner or plan participant but before distributions have begun to the spouse, the distribution rules apply as if the surviving spouse were the IRA owner or plan participant.

3. *Death Before Required Beginning Date—Someone Other Than Surviving Spouse is Designated Beneficiary.* If an individual dies before the required beginning date and someone other than his or her spouse is a designated beneficiary, then distributions are made over the beneficiary's life expectancy determined under the Single Life Table, using the designated beneficiary's age at his or her birthday in the year *following* the year of death, and reduced by one for each passing year. If there are multiple beneficiaries, or if there is a qualifying trust, the life expectancy of the oldest beneficiary is used, unless separate accounts are established so that each beneficiary can use his or her own life expectancy. A designated beneficiary may elect to apply the five-year rule described above; and if the beneficiary does not take a required minimum distribution by the end of the calendar year following the year of death, he or she is deemed to have elected the five-year rule.

4. *Death After Required Beginning Date—No Designated Beneficiary.* If a person dies after his or her required beginning date without having a designated beneficiary, then any remaining portion of the IRA or plan benefits can be distributed over the person's hypothetical remaining life expectancy under the Single Life Table, determined as of the year of death, and reduced by one for each passing year. The first distribution to the beneficiary is required to be made in the year following death.

> *Example*
> Assume that Mary dies on June 15, 2004, at age 75 without having named a beneficiary. Mary is a widow and her birthday occurs in March. Therefore, the IRA is distributed in annual installments over 12.4 years, beginning in 2005. This is calculated as follows: Mary is age 75 in the year of death with a hypothetical life expectancy of 13.4 years under Table II for 2004. The distribution period is Mary's hypothetical remaining life expectancy in the year of death reduced by one for each passing year, so the distribution period for 2005 is 12.4 (13.4 minus 1).

5. *Death After Required Beginning Date—Surviving Spouse is*

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61. This election will enable a surviving spouse who is under age 59½ to receive distributions without being subject to the 10% penalty tax on early distributions. After the surviving spouse reaches age 59½, he or she can then roll over the benefits into an IRA and continue to take out distributions without penalty. Of course, all distributions will be subject to income tax regardless of the spouse's age.

Designated Beneficiary. If a person dies after the required beginning date and his or her spouse is the sole designated beneficiary, then the distribution period is recalculated each year by looking to the surviving spouse's life expectancy under the Single Life Table. After the surviving spouse's death, the remaining distribution period is the spouse's hypothetical remaining life expectancy under the Single Life Table, determined as of the year of death, and reduced by one for each passing year. Of course, a surviving spouse who is named as outright beneficiary may roll over the retirement benefits to an IRA in the surviving spouse's name.

> *Example*
> Assume that Don dies on December 31, 2003, at age 75 having named his wife, Dana, as beneficiary of an IRA. Dana is age 68 in 2003, and she does not roll over the IRA account into another IRA in her name. Don's IRA is distributed in annual installments over Dana's life expectancy, calculated each year using the Single Life Table, beginning in 2004. For 2004, Dana's age is 69 and her life expectancy at age 69 is 17.8 years, so she must receive approximately 5.62% of the IRA balance as of December 31, 2003. For 2005, Dana is age 70 and her life expectancy is 17 years, and Dana must receive approximately 5.88% of the IRA balance as of December 31, 2004. After Dana's death, minimum distributions are made over her remaining life expectancy, determined under the Single Life Table for the year of death, and reduced by one for each passing year.

6. *Death After Required Beginning Date—Someone Other Than Surviving Spouse is Designated Beneficiary.* If a person dies after the required beginning date and someone other than his or her spouse is a designated beneficiary, then any remaining portion of the IRA or plan benefits can be distributed over the *longer* of (a) the oldest designated beneficiary's life expectancy under the Single Life Table, determined in the year following death, and reduced by one for each passing year, or (b) the decedent's remaining hypothetical life expectancy determined as of the year of death and reduced by one for each passing year.

> *Example*
> Assume that Don dies on December 31, 2003, at age 75 having named his son, Daniel, as beneficiary. Daniel is age 40 in 2003. The IRA is distributed in annual installments over 42.7 years, beginning in 2004. This is calculated as follows: Daniel is age 41 in 2004 and he has a life expectancy of 42.7 years under Table II for 2004. Daniel's life expectancy is reduced by one for each passing year, so the distribution period for 2005 is 41.7 (42.7 minus 1).

A. Who is a Designated Beneficiary?

Every IRA and individual account plan has a beneficiary, either expressly named by the account owner or by default under the terms of the governing instruments. The important question for purposes of the minimum distribution rules is whether the beneficiary is also a designated beneficiary. Under the final regulations, a designated beneficiary is limited to one or more individuals who are designated as beneficiary on the date of death and who remain as beneficiary on September 30 of the calendar year following the year of death.[62] If a trust meets certain requirements, the trust is disregarded and the trust beneficiaries are treated as being the beneficiaries of the retirement benefits, subject to certain restrictions and conditions set forth in the final regulations. A person's estate is not a designated beneficiary, nor is a charity or charitable trust.

The period between the date of death and the September 30 deadline can be used to correct defects in beneficiary designations, by way of distribution, qualified disclaimer, and creating separate accounts payable to different beneficiaries. However, the grace period cannot be used to add new beneficiaries who are not named at the IRA owner or plan participant's death.[63] As a result, people may wish to provide for various alternative dispositions through contingent beneficiary designations, thereby allowing the beneficiaries at least nine months in which to select the best means of preserving the retirement benefits and passing on wealth.

Example

Assume that Don dies on June 15, 2003. The dates for determining whether Don has a designated beneficiary are June 15, 2003 and September 30, 2004. If Don named his wife, his son, and a charity as equal beneficiaries and if the beneficiaries properly divide the IRA into separate accounts before September 30, 2004, then Don's wife and child can take their minimum distributions over their respective life expectancies, and the charity is free to withdraw its share immediately. Don's wife may also elect special treatment as discussed above.

In the case of multiple designated beneficiaries, the life expectancy of the oldest beneficiary is used to determine the distribution period.[64] For example, it is permissible to name a class of beneficiaries, such as children, descendants, and the like,

62. Treas. Reg. § 1.401(a)(9)-4, A-4(a) (2002).

63. An individual beneficiary who is alive on the plan participant/IRA owner's date of death but who dies before the following September 30th continues to be treated as the designated beneficiary for purposes of determining the distribution period, absent a qualified disclaimer. Treas. Reg. § 1.401(a)(9)-4, A-4(c) (2002).

64. Treas. Reg. § 1.401(a)(9)-5, A-7 (2002).

and the decedent is treated as having a designated beneficiary if it is possible to identify the member of the class with the shortest life expectancy.[65] If a decedent's IRA or account is divided into separate accounts, then the minimum distribution rules apply separately with respect to each separate account.

B. Separate Accounts

Separate accounts can be established during a person's lifetime or after death, but not later than December 31 of the calendar year following the calendar year in which death occurs. Each separate account must reflect the separate interest of the beneficiary as of the date of death. In other words, all post-death investment gains and losses, contributions, and forfeitures for the period prior to the establishment of the separate accounts must be allocated on a pro rata basis among all accounts. Generally, the separate account should be expressed as a fraction or percentage of the IRA or plan account to take into account adjustment for earnings and losses after death until division of the separate accounts. Once established, each beneficiary may have the right to direct investment of, and withdrawal from, his or her separate account. The final regulations contain some, but by no means complete, guidance on the application of the separate account rules.[66] Each separate account should be titled in the name of the decedent for the benefit of a sub-trust, using the decedent's social security number as the primary number on the sub-account.[67] However, the beneficiary's social security number can also be provided to the IRA custodian or plan administrator.

There is ambiguity under the final regulations concerning the application of the separate account rules. The final regulations state that the separate account rules apply to calendar years beginning *after* the separate accounts are established. Read literally, if separate accounts are established in the calendar year following death, then the separate account rules do not apply for that year and the distribution period is based on the life expectancy of the oldest beneficiary of the combined accounts. However, two examples in the same section in the regulations appear to reach a different result.[68] To the extent feasible, the separate accounts should be established in the year of death.

65. Treas. Reg. § 1.401(a)(9)-4, A-1 (2002).

66. The separate account rules are found in Treas. Reg. § 1.401(a)(9)-8, A-2 and -3 (2002).

67. *Compare* Priv. Ltr. Rul. 200228023 (Apr. 15, 2002) *with* Priv. Ltr. Rul. 200228025 (Apr. 18, 2002) *and* Priv. Ltr. Rul. 200248031 (Apr. 17, 2002).

68. Treas. Reg. § 1.401(a)(9)-8, A-2(a)(2) (2002).

C. Trust as Beneficiary

In many areas of the country, tax professionals commonly recommend the use of trusts as an integral part of a person's estate plan. Revocable trusts are designed to provide for the prompt and cost-efficient disposition of one's assets and to accomplish a person's tax and financial goals. Trusts also serve as alternatives to the use of guardianships or custodial accounts for beneficiaries who are minors. Naming a trust as beneficiary of retirement benefits can be an effective estate planning strategy, but it requires careful consideration because the final regulations are often unduly restrictive or silent on how to apply the new rules to various uses of trusts as beneficiaries. On the positive side, the preambles to the final regulations confirm the IRS's position that an election by a revocable trust to be treated as an estate[69] does not cause the trust to be treated as an estate for purposes of the minimum distribution rules.

A trust is not a "designated beneficiary." However, if the following requirements are met, the beneficiaries of the trust are treated as having been named as beneficiaries of the retirement benefits:

1. The trust must be valid under state law (or would be but for the fact that there is no corpus when created);
2. The trust must be irrevocable or become irrevocable upon death under the terms of the trust instrument;
3. The beneficiaries of the trust must be identifiable from the trust instrument; and
4. The beneficiaries or their representatives must provide to the plan administrator or the IRA custodian either a copy of the trust instrument or a certification that complies with the provisions of Treas. Reg. § 1.401(a)(9)-4, Q&A-6. The trust copy or certification must be provided no later than October 31 of the year following the year of death.[70]

If the requirements described above are met, the beneficiaries of the trust are treated as being the beneficiaries of the IRA or qualified plan benefits for purposes of determining (i) whether the decedent has a designated beneficiary in place, and (ii) what life expectancy is used in determining the distribution period. Although not completely clear under the final regulations, for the trust beneficiaries to qualify as "designated beneficiaries," the requirements in (a), (b), and (c) should be satisfied as of the decedent's date of death—and remain so until September 30 of the calendar year following the year of death.

69. I.R.C. § 645 (2000) allows a revocable trust to elect to be treated as an estate for federal income tax purposes.
70. Treas. Reg. § 1.401(a)(9)-4, A-5 and A-6 (2002).

D. Trust Design and Funding Issues

The final regulations contain important limitations, and some traps, when trusts are named as beneficiaries of IRAs and individual account plans. As a result, financial and estate planners should review trust instruments in light of the final regulations when advising their clients about naming trusts in beneficiary designations. At the end of this article are examples of beneficiary designations where trusts are included in the designation.

Where a trust divides into sub-trusts at the death of the IRA owner or plan participant, it is generally recommended to name the sub-trusts in the beneficiary designation to take advantage of the separate account rules, although as yet there is no ruling to support this position.[71] If retirement benefits are payable to a master trust that immediately divides into sub-trusts, the separate account rules are not available to the sub-trusts.[72] The master trust should use a fractional formula for the division, such as a fractional marital deduction formula, to avoid premature recognition of income that occurs when income in respect of a decedent is used to fund a pecuniary bequest.[73] As a result, many tax professionals employ fractional formulas for funding marital and credit shelter trusts, generation-skipping trusts, and trusts for the benefit of a class of individuals, such as children or grandchildren. Because only individuals can be designated beneficiaries, a decedent will not have a designated beneficiary if entities other than individuals, such as charities, are beneficiaries under the trust. One way to avoid this result is provide in the trust instrument that retirement benefits will not be used to fund distributions to non-individual beneficiaries. Absent such protective language in the trust instrument, the trustee should ensure that any trust beneficiaries who are not individuals receive their distributive share before the September 30 deadline. Also, the trust should not have primary responsibility for paying estate taxes, debts, or expenses of administration if one cannot be certain that all such payments will be completed by the September 30 deadline.[74] This can be accomplished by drafting the trust

71. In a series of private letter rulings issued in 2003, the IRS held that the separate account rules did not apply in a situation where the beneficiary designation directed benefits to a trust that subdivided into sub-trusts at the IRA owner's death, even though the beneficiary designation also provided that the trustee could establish sub-accounts for each sub-trust. *See* Priv. Ltr. Rul. 200317041 (Dec. 19, 2002); Priv. Ltr. Rul. 200317043 (Dec. 19, 2002); Priv. Ltr. Rul. 200317044 (Dec. 19, 2002).

72. *See supra* note 71. *See* Treas. Reg. § 1.401(a)(9)-4, A-5(c) (2002).

73. *See* I.R.C. § 691(a)(2) (2000); Treas. Reg. § 1.691(a)-4 (2002).

74. *See* Priv. Ltr. Rul. 200010055 (Dec. 14, 1999); Priv. Ltr. Rul. 9809059

instrument to prohibit, to the extent feasible, use of retirement benefits to pay claims against the estate, expenses of administration, taxes, and the like.

In the case of multiple beneficiaries of a trust, the life expectancy of the oldest trust beneficiary is used to determine the distribution period. For example, in the case of a trust for the benefit of a class of people, such as children or grandchildren, where the trustee has authority to spray income and principal among the class members, the life expectancy of the oldest spray beneficiary is used to determine the distribution period. The separate account rules (discussed above) do not apply to beneficiaries of a trust with respect to retirement benefits payable to the trust.[75] The IRA owner or plan participant who desires to have benefits paid to sub-trusts after death should specifically name the separate sub-trusts as takers in the beneficiary designation form, and it may be necessary to create the sub-trusts prior to death to take advantage of the separate account rules.[76]

1. Conduit Trusts

If a trust is a conduit trust, then the IRS looks only to the current beneficiaries to determine whether the decedent has a designated beneficiary, and contingent remaindermen and successor beneficiaries are ignored. A conduit trust is a trust where the trust beneficiary must receive or be entitled to receive all distributions paid by the IRA or qualified plan to the trust, including, but not limited to, each year's required minimum distribution. A description of a conduit trust is found in the final regulations.[77] The author believes that amounts distributed from the IRA or a qualified plan can be accumulated by the trustee and still result in the trust being treated as a conduit trust, if the beneficiary has a right of withdrawal or a lifetime right to appoint trust property to himself or herself.

A trust is not a conduit trust if the trustee has the power to retain all or any part of a distribution for the benefit of contingent or residuary trust beneficiaries.[78] If a trust is not a conduit trust,

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(Dec. 4, 1999).

75. Treas. Reg. § 1.401(a)(9)-4, A-5(c) (2002). *See* Priv. Ltr. Rul. 200317041 (Dec. 19, 2002); Priv. Ltr. Rul. 200317043 (Dec. 19, 2002); Priv. Ltr. Rul. 200317044 (Dec. 19, 2002).

76. *See supra* note 71.

77. *See* Treas. Reg. § 1.401(a)(9)-7, A-7, Ex. 2 (2002) (describing a marital trust where the trustee is required to pay out to the spouse all amounts received from a qualified plan). Example 1 in the regulations describes a marital trust that allows the trustee to accumulate distributions and fails to be a conduit trust.

78. *Compare* Examples 1 and 2 in Treas. Reg. § 1.401(a)(9)-5, A-7 (2002) (comparing a Q-TIP Trust that allows discretionary distribution of principal

then according to the final regulations, the IRS will look to contingent and residuary beneficiaries to determine whether the individual has a designated beneficiary and, if so, to determine the distribution period based on the oldest trust beneficiary's life expectancy. This rule can result in the decedent having no designated beneficiary where charities are named as default beneficiaries.

2. Spray Trusts

A spray trust is not a conduit trust if the trustee has the power to accumulate all or any part of a distribution received from the IRA or qualified plan during a calendar year. In the typical spray trust, the trustee has authority to make discretionary distributions among a class of beneficiaries, but is not required to make any distributions. Where a spray trust is intended to be a designated beneficiary, the trust might either (i) provide for mandatory distributions of amounts received by the trust to current beneficiaries who qualify as designated beneficiaries, or (ii) restrict contingent and residuary beneficiaries to individuals who are ascertainable at the settlor's death and younger than the intended oldest designated beneficiary. For example, the trustee should not have authority to make distributions to spouses generally, because spouses can be any age. However, allowing distributions to spouses under a specified age would not pose a problem.

It is not clear from the final regulations whether granting powers of appointment under a trust that is not a conduit trust will result in the potential takers under the power to be treated as contingent beneficiaries for purposes of the minimum distribution rules. The author believes that potential takers are viewed as contingent beneficiaries because they potentially take ahead of those named in the instrument as contingent beneficiaries. For example, assume that Don creates a spray trust at his death for the benefit of his daughter and he gives her the power to appoint the trust property to charities at her death, but if no appointment is made then the trust property passes to Don's descendants. In such cases the charities could take ahead of the descendants and the author fails to see why the descendants, but not the charities, would be viewed as contingent beneficiaries. In a typical situation, Don might give his daughter the ability to appoint to both descendants and charities, but if a charity is a potential appointee, then the same concern is present.

To avoid the problem, the trust instrument might prohibit

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and a Q-TIP Trust that requires payment to the spouse of all amounts received from a qualified plan). *See also* Priv. Ltr. Rul. 200228025 (Apr. 18, 2002).

exercise of a power of appointment over retirement benefits or restrict the universe of appointees of retirement benefits to a class of persons younger than the powerholder.[79] In the alternative, when successor or alternate beneficiaries include a charity or persons older than the powerholder, a trust might require that all distributions must be passed through the trust each year to the current beneficiaries, i.e., a conduit trust.

3. "See-Through" Trusts

A trust that is not a conduit trust may nonetheless be divided into sub-trusts, each payable to a different beneficiary. Each separate sub-trust constitutes a portion of the decedent's account balance which reflects the beneficiary's interest in the IRA or plan account. A beneficiary can have the right to direct the investment of his or her separate sub-account and the right to withdraw funds from the sub-account at any time. However, the distributions from all sub-trusts must be made over the life expectancy of the oldest beneficiary of any of the sub-trusts.

The IRS has issued numerous private letter rulings approving this arrangement, referring to the sub-trusts as "see-through" trusts. The private letter rulings offer guidance on how to structure the sub-trusts and draft beneficiary designations.[80] Briefly, the division into sub-accounts should be made before December 31 of the calendar year following the year of death, and each sub-account should be titled in the name of the decedent for the benefit of a sub-trust. For example, the decedent's social security number should be the primary number on the sub-account, although the taxpayer identification number for the sub-trust can be provided to the IRA custodian or plan administrator. Each sub-account should be funded with the sub-trust's separate interest in the retirement benefits, which reflects accounting for allocation of investment gains and losses, and contributions and forfeitures, on a pro rata basis among all sub-trusts. In the private letter rulings, the taxpayer followed the separate accounting rules for creation of separate accounts following death.

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79. The class of permissible takers should be limited to those individuals who are younger than the person whose age is used to determine the distribution period. In the case of a single beneficiary under a conduit trust, that person is the person who holds the power of appointment. In the case of a "see-through" trust discussed below, the distribution period may be determined based on another beneficiary's age.

80. Priv. Ltr. Rul. 200235038–200235041 (June 4, 2002). *See also* Priv. Ltr. Rul. 200211047 (Dec. 17, 2001), *modified by*, Priv. Ltr. Rul. 200229048 (Apr. 23, 2002).

VIII. POST-MORTEM PLANNING

Post-mortem planning is often an important component of an individual's estate plan. For example, many practitioners recommend the use of multiple contingent beneficiary designations, relying on methods of "cash out," disclaimer, separate accounts, and even renunciation as an affirmative strategy to pass retirement benefits to the appropriate beneficiary. Of course, post-mortem planning might also be available to cure unexpected problems.

The following is a timeline of events following the death of an IRA owner or plan participant:

Date of Death	1/1	9/30 DB is fixed*	10/31 Certification given to IRA custodian or Plan administrator	12/31 Separate accounts are established

*Note that a disclaimer must be made within nine months after the date of death to be a qualified disclaimer.

Under the final regulations, the date for determining the designated beneficiary is September 30 of the calendar year following the year of death. As a result, individuals or entities named as beneficiaries by the decedent are not considered when determining the designated beneficiary if they are "cashed out" by the September 30 deadline. This can be an effective strategy when a decedent has named charities or older persons, such as parents or siblings, to receive a portion of retirement benefits along with children.

If the "cash out" approach is not available, the creation of separate accounts may be appropriate. The goal is to divide the decedent's IRA or plan account into separate accounts that are permitted to satisfy the minimum distribution rules independently. The separate account rules contained in the final regulations and described above must be satisfied. Once established, each beneficiary may have the right to direct investment of, and withdrawal from, his or her separate account.

In the event of a qualified disclaimer under the Internal Revenue Code,[81] the person disclaiming is not taken into account in determining who is a designated beneficiary.[82] A disclaimer may be made by individual beneficiaries and also by an executor or

81. I.R.C. § 2518 (2000).

82. Treas. Reg. § 1.401(a)(9)-4(a) (2002). *See also* General Couns. Mem. 39858 (Sept. 9, 1991).

trustee if authorized by the will or trust instrument or applicable law. The preambles to the final regulations make it clear that any disclaimer must be a qualified disclaimer, so the disclaimer must be made within nine months after the death of the decedent. In some situations, a surviving spouse's renunciation may create the ability to take advantage of a tax-free rollover. The IRS has allowed a surviving spouse who elected against a decedent's will to roll over her elective share of IRAs payable to the estate into an IRA in the spouse's name.[83]

IX. BENEFICIARY DESIGNATIONS

Whom a person names as his or her beneficiary is an important part of the estate and financial plan. It not only governs who receives the benefits upon death, but it can also affect the method, timing, and tax consequences of distributions. In light of the final regulations, advisors may wish to review their clients' current estate plans and to consider whether to change the beneficiary designations to a more tax-efficient structure. Typical IRA beneficiary designations and the tax consequences associated with them are discussed below.

Proposed regulations issued in 2001 offered considerable latitude in planning for post-mortem distributions because the designated beneficiary was determined based on the takers as of December 31 of the calendar year following the calendar year of death. The final regulations are more restrictive, requiring that a designated beneficiary must be named as a beneficiary on the date of death and remain as a beneficiary on September 30 of the calendar year following the year of death. As a result, people may wish to name multiple contingent beneficiaries.

Another consideration is the extent to which the beneficiary should have control over the investment and distribution of the IRA or qualified plan account. The beneficiary designation might contain authorities granted to, and limitations placed on, the beneficiary. IRA agreements often provide substantial flexibility in how to structure distributions. On the other hand, qualified plan documents are typically rigid in the distribution options available to a beneficiary, and in many instances they will mandate lump sum distributions to non-spouse beneficiaries. As a result, financial advisors often encourage their clients to make in-service withdrawals from qualified plans prior to retirement, and transfer or roll over the benefits into IRAs.

A. *Spouse as Outright Beneficiary*

Many people feel most comfortable naming their spouses as

83. *See* Priv. Ltr. Rul. 200150036 (Aug. 10, 2001).

outright beneficiaries. That way, the surviving spouse has complete control over the investment and the timing of IRA distributions and the surviving spouse can select the method and timing of payment under qualified plans. If the spouse is more than ten years younger, the distribution period during the lifetime of both spouses is extended beyond the period prescribed by the Uniform Lifetime Table.

If a surviving spouse has the right to receive retirement benefits paid in the form of a lump sum payment, the minimum distribution rules are satisfied, and the retirement benefits qualify for a federal estate tax marital deduction. The surviving spouse can elect to roll over the retirement benefits and defer distributions if he or she is under age 70½ or start a new distribution period based on his or her own age under the Uniform Lifetime Table if the spouse is over age 70½. Following a rollover, no minimum distribution is required until the surviving spouse reaches age 70½. If the spouse is already over age 70½, then distributions must begin in the year following the rollover. If payments are made to the surviving spouse in installments, then the beneficiary designation should ensure that the installment payments satisfy the minimum distribution rules and carry out all income of the IRA in order to qualify for the marital deduction, similar to the treatment of a QTIP trust as beneficiary.

Absent a rollover, if the decedent dies before the required beginning date, the surviving spouse can elect to treat the retirement benefits as his or her own benefits, and defer distributions after death until December 31 of the calendar year immediately following the calendar year in which the deceased spouse died, or December 31 of the calendar year in which the deceased spouse would have attained age 70½, whichever is later. If the decedent dies after the required beginning date, the distribution period is recalculated each year using the surviving spouse's life expectancy under the Single Life Table. After the surviving spouse's death, the remaining distribution period is the spouse's hypothetical remaining life expectancy under the Single Life Table, determined as of the year of death and reduced by one for each passing year.

B. Right of Withdrawal Trust

If a surviving spouse has an unrestricted right to withdraw all of the income and principal of a trust at any time, the trust qualifies for the marital deduction for federal estate tax purposes and, for purposes of the minimum distribution rules, the spouse is treated as the sole beneficiary of the retirement benefits and the trust should qualify as a "conduit trust." Accordingly, if the decedent dies after the required beginning date, the distribution period is recalculated each year using the surviving spouse's life expectancy under the Single Life Table. After the surviving spouse's death, the remaining distribution period is the spouse's hypothetical remaining life expectancy under the Single Life Table, determined as of the year of the spouse's death and reduced by one for each passing year. If the decedent dies before the required beginning date, the required minimum distributions must begin no later than the end of the calendar year in which the decedent would have attained age 70½.[84]

The IRS has not yet addressed whether, under final regulations, a surviving spouse may roll over a distribution from an IRA or a qualified plan to a marital trust in which the surviving spouse has an unlimited right of withdrawal. The IRS had issued several private letter rulings under the 1987 proposed regulations permitting a surviving spouse to roll over amounts payable to an estate or a trust under which the surviving spouse had an unconditional right to receive the retirement benefits.[85] In two recent rulings applying the final regulations, the IRS permitted a surviving spouse to roll over amounts held by an IRA payable to the decedent's estate in which the surviving spouse was sole representative of the estate and sole residuary beneficiary.[86] In two other rulings applying the final regulations, the IRS allowed a surviving spouse to roll over amounts payable to a "revocable joint trust" in which the surviving spouse had the right to revoke the trust, in whole or in part, and distribute the trust corpus to himself or herself.[87]

C. QTIP Trust as Beneficiary

Naming a QTIP trust as beneficiary of retirement benefits is common in second marriage situations and for tax planning purposes. The retirement benefits may be payable directly to the QTIP trust with the marital deduction formula specified in the beneficiary designation. Otherwise the master trust should use a fractional marital deduction formula. The executor might consider whether to allocate GST exemption to the trust.

The QTIP trust must be structured to satisfy both the

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84. *See* Treas. Reg. § 1.401(a)(9)-5, A-7, Ex. 2 (2002).

85. *See, e.g.*, Priv. Ltr. Rul. 9836029 (June 9, 1998); Priv. Ltr. Rul. 9623056 (Mar. 12, 1996); Priv. Ltr. Rul. 9608036 (Nov. 29, 1995); Priv. Ltr. Rul. 9416039 (Jan. 26, 1994).

86. *See* Priv. Ltr. Rul. 200344024 (Aug. 6, 2003) (testate estate) and Priv. Ltr. Rul. 200324059 (June 13, 2003) (intestate estate); *see also* Priv. Ltr. Rul. 200236052 (June 18, 2002) (applying 2001 proposed regulations and allowing a rollover of retirement benefits paid to a surviving spouse as executrix and sole residuary beneficiary of the estate).

87. *See* Priv. Ltr. Rul. 200245055 (Aug. 12, 2002); Priv. Ltr. Rul. 200221051 (Feb. 26, 2002).

minimum distribution rules and the requirements for the federal estate tax marital deduction. A common approach is to draft the beneficiary designation to provide for annual distributions from an IRA equal to the larger of: (a) annual trust accounting income, or (b) annual required minimum distributions. In Revenue Ruling 2000-2, the IRS held that retirement benefits can qualify for a federal estate tax marital deduction if the surviving spouse does not automatically receive, but has the right to compel, distribution of all income of the IRA.[88] This ruling allows for accumulation of income in the QTIP trust, although care must be taken because of gift tax and generation-skipping transfer tax considerations.

If the trustee is required to pay out all distributions received by the trust to the surviving spouse, then the trust is a conduit trust and the spouse is considered to be the sole designated beneficiary.[89] On the other hand, if the trustee has the right to retain any portion of a distribution, then contingent and residuary beneficiaries are considered in determining whether the decedent had a designated beneficiary and, if so, which beneficiary has the shortest life expectancy.[90] In order to use the spouse's life expectancy, the trust instrument should prohibit payment of retirement benefits at the death of the spouse to charities, other non-individual beneficiaries, or individuals who are older than the spouse. Also, the trust instrument can grant a power of appointment in favor of the spouse, but potential appointees must be limited to individuals, or to trusts for the benefit of individuals, who are younger than the spouse.[91] Out of an abundance of caution and if feasible, the trust might prohibit payment of estate tax at the spouse's death from the retirement benefits, to prevent the spouse's estate being considered a beneficiary under the QTIP Trust.

D. *Credit Shelter Trust as Beneficiary*

The federal estate tax exemption is $1.5 million in 2004-05, $2 million in 2006-08, and $3.5 million in 2009.[92] As the exemption increases, a greater number of people are placed in a position to consider using retirement benefits to fund credit shelter trusts. Some practitioners view IRAs and plan benefits as "wasting assets," and generally try to avoid using retirement benefits to fund a credit shelter trust. However, IRAs and other retirement benefits may be the best asset available to fund an individual's

88. Rev. Rul. 2000-2, 2000-1 C.B. 305 (Jan. 18, 2000).
89. *See* Treas. Reg. § 1.401(a)(9)-5, A-7, Ex. 2 (2002).
90. *See* Treas. Reg. § 1.401(a)(9)-5, A-7, Ex. 1 (2002).
91. *See* Priv. Ltr. Rul. 200235038-41 (June 4, 2002) for guidance on how to structure the terms of the trust.
92. *See supra* note 41.

credit shelter trust. To avoid recognition of income upon funding the credit shelter trust, the retirement benefits should be payable directly to the credit shelter trust—or the master trust should employ a fractional formula to fund the marital and credit shelter trusts. If a pecuniary marital deduction formula is used, then no part of the retirement benefits should be applied to fund the marital trust.

The credit shelter trust may need to be modified with respect to common trust features. For example, the trust instrument should prohibit retirement benefits from being used to pay obligations of the estate or of the decedent (such as administration expenses, taxes, and claims). If the trustee has the right to accumulate principal and income, then the trust instrument should prohibit retirement benefits from being paid to older beneficiaries or applied to fund charitable dispositions at termination of the income beneficiaries' interest under the trust. The trust instrument can utilize a power of appointment, but unless the trust is a conduit trust, potential appointees must be limited to individuals, or to trusts for the benefit of individuals, who are younger than the powerholder.

E. Estate as Beneficiary

Practitioners recommend against having one's estate as beneficiary of retirement benefits. Payment to an estate may occur by an affirmative election or by the default under the terms of the IRA or plan document in situations where the decedent either does not name a beneficiary or the named beneficiary predeceases the IRA owner/plan participant.

As a general rule, an estate is not a designated beneficiary.[93] The final regulations provide explicitly that a decedent's interest passing to an individual under a will, or under applicable state law, does not make that individual a designated beneficiary.[94] Thus, retirement benefits payable to an estate must be distributed within five years, if the decedent dies before the required beginning date. If the decedent dies after the required beginning date, then payments must be made annually, with the distribution period starting at the decedent's life expectancy for the year of death, calculated using the Single Life Table (Table II), and reduced by one for each passing year.

Historically, the IRS has allowed a surviving spouse to roll over distributions from an IRA payable to an estate in which the surviving spouse is both sole executor and sole (residuary)

93. Treas. Reg. § 1.401(a)(9)-4, A-3 (2002).
94. Treas. Reg. § 1.401(a)(9)-4, A-1 (2002).

beneficiary.[95] The IRS has reached the same conclusion under the final regulations in at least two private letter rulings involving a tax-qualified plan[96] and a tax-sheltered annuity.[97] Further support can be found in the preambles to the final regulations, which state that if a surviving spouse actually receives a distribution from an IRA that belonged to the deceased spouse, the surviving spouse is permitted to roll the distribution over within 60 days into an IRA in the surviving spouse's name.

F. Charities and Charitable Trusts

Because of the high combined estate and income tax rates, a charity, donor advised fund, or charitable foundation may be an attractive beneficiary for a person who is motivated by charitable desires. If properly structured, the retirement benefits will pass to the charity or charities free of estate and income taxes.[98] Under the old 1987 proposed regulations, a person who named a charity as beneficiary was punished by means of a shortened distribution period for lifetime distributions commencing at age 70½. The final regulations have eliminated this penalty by allowing use of the Uniform Lifetime Table, unless the person is married with a spouse more than ten years younger. If the charity is "cashed out" before the September 30 deadline, or separate accounts are established, the charity is not considered in determining the distribution period for non-charitable beneficiaries. The charitable trust is exempt from income tax, so there is no reason from a tax perspective to delay funding the charitable trust with payments directly made from an IRA or a qualified plan.

Typically, the donor names the charity or charitable trust in the beneficiary designation, rather than having the retirement benefits pass to the charitable entity through the probate estate or a trust. This approach will avoid triggering recognition of income in respect of a decedent when the amounts are paid to, or set aside for the benefit of, the charitable entity. For example, retirement benefits should not be used to fund an estate or trust's pecuniary gift of installment payments to a charity.

A split-interest charitable trust may be an attractive

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95. *See, e.g.,* Priv. Ltr. Rul. 200236052 (June 18, 2002); Priv. Ltr. Rul. 200305030 (Nov. 4, 2002); Priv. Ltr. Rul. 200304038 (Oct. 29, 2002).

96. Priv. Ltr. Rul. 200344024 (Aug. 6, 2003).

97. Priv. Ltr. Rul. 200325008 (Dec. 8, 2002). Tax-sheltered annuities are subject to the minimum distributions rules by reason of I.R.C. § 403(b)(10) (2000 & Supp. 2003), and distributions from the annuities are eligible for rollover treatment under I.R.C. § 403(b)(8)(b) (2000 & Supp. 2003).

98. Retirement benefits payable at death to a charity qualify for federal income and estate tax deductions under Code Sections 2055 (estate tax) and 642(c) (estate income tax).

beneficiary for a person who is motivated by charitable desires but wants to have some part of the retirement benefits payable to a non-charitable beneficiary. The estate is entitled to a federal estate tax charitable deduction for a portion of the retirement benefits passing to the charitable trust.[99] If the surviving spouse is the sole non-charitable beneficiary, a split-interest trust may qualify for both charitable and marital deductions.[100] The charity is not subject to income tax on distributions to the charity, and the non-charitable trust beneficiary is taxed on payments when made by the trust under a tier system approach set forth in the Internal Revenue Code.[101] The IRS has ruled that the taxable portion of distributions from an IRA or qualified plan constitute income in respect of a decedent and "first tier" income, offset by any deduction for federal estate tax attributable to the income in respect of a decedent.[102]

A split-interest trust can take several forms, such as a charitable remainder annuity trust (CRAT) or a charitable remainder unitrust (CRUT). The CRAT pays a fixed annuity (not less than 5 percent) to non-charitable beneficiaries for life or for a term not to exceed 20 years; the annuity amount is established at the inception of the trust. The CRUT pays a fixed percentage of the net value of the trust assets valued annually payable to one or more non-charitable beneficiaries for life or for a term not to exceed 20 years. The CRUT can be designed so that the payments to the non-charitable beneficiaries are limited to the lesser of the net income of the trust or the stated unitrust percentage, and the deficiency can be made up in later years when the trust income exceeds the stated percentage (often called a "net income with make-up unitrust" or "NIMCRUT"). The use of a NIMCRUT may be appropriate in the qualified plan context if a lump sum distribution is not available but the minimum distributions are sufficient to pay out the trust income and—over time—will be enough to pay the stated unitrust amount. If the surviving spouse is the sole non-charitable beneficiary, it may be advantageous to combine a charitable remainder trust with a marital deduction trust.

G. Children and Grandchildren as Beneficiaries

If the children are all adults, it may be advantageous simply to name them as the beneficiaries. In the case of IRAs, the children can direct the investment and the timing of distributions

99. I.R.C. § 2055(e)(2) (2000).
100. *See* I.R.C. § 2056(b)(8) (2000).
101. I.R.C. § 664(b) (2000 & Supp. 2003).
102. *See* Priv. Ltr. Rul. 199901023 (Oct. 8, 1998).

from the IRA. A per stirpes designation will provide for a deceased child's share to pass to his or her children, but may result in the need for a guardianship. Alternatively, the beneficiary designation might provide for division and distributions directly to a separate trust for each child and take advantage of the separate account rules if each child is treated as the sole designated beneficiary of his or her trust. With care in drafting the beneficiary designation or trust instrument, the children can have the ability to name successive beneficiaries of, or a power of appointment over, the retirement benefits. The children or trusts are subject to income taxation as benefits are paid to them.

The advantage of naming grandchildren or a trust for the benefit of grandchildren as beneficiary is that the IRA or qualified plan benefits can be paid over the life expectancy of the grandchild or of the oldest grandchild in the case of a grandchildren's trust. Thus, the retirement benefits can grow tax-deferred for generations. In such cases, the executor or trustee should allocate generation-skipping transfer tax exemption to the IRA or qualified plan benefits.

X. SAMPLE BENEFICIARY DESIGNATIONS

Provided below are examples of beneficiary designations for individual retirement accounts and, in certain cases, tax-qualified plans. The examples are intended to serve as the starting point when drafting beneficiary designations. This article is not intended as tax or legal advice, and the examples below should not be relied upon when drafting beneficiary designations.

A. Distribution to Charity and Spouse

$10,000 [5%] to XYZ charity and the balance to my wife, if she survives me.

B. Multiple Beneficiary Designations for Distribution to Spouse, Family Trust, Children and Grandchildren

To my wife if she survives me, except that if my wife disclaims any portion or all of the account, such portion shall be payable to the acting trustee of the [Credit Shelter Trust].

If my wife does not survive me, in equal shares to my children, [names], who survive me or who do not survive me but leave a descendant who survives me, provided that (a) the share of a deceased child of mine shall be divided *per stirpes* among that child's descendants who survive me, and (b) if any child or other descendant of mine is an income beneficiary of a trust created by me which is in existence at the time of the distribution, then the share provided for that child or descendant shall instead be paid to the trustee of such trust. In making such division and distribution, the IRA custodian may rely upon a written certification by my legal representative or, if none, the trustee of [master trust].

Alternative:

Primary Beneficiary: My wife, if she survives me.

Contingent Beneficiary #1: [Credit Shelter Trust]

Contingent Beneficiary #2: My descendants who survive me, *per stirpes*, except that if a descendant of mine is the income beneficiary of a trust created by me which is in existence at the time of the distribution, then the share provided for that descendant shall instead be paid to the trustee of such trust. In making such division and distribution, the IRA custodian may rely upon a written certification by my legal representative or, if none, the trustee of [master trust].

Note: Wife disclaims only enough to fund credit shelter trust, using formula disclaimer. In some cases, it might be appropriate for the trustee of the credit shelter trust to disclaim the retirement benefits, so that the benefits are payable directly to the children, or each child's trust, to take advantage of the separate account rules.

C. Division and Distribution to Credit Shelter/Marital Trust

If my [spouse] survives me, a fraction of the IRA shall be payable to the Credit Shelter Trust created under the [master trust], the numerator of which is the largest amount that, when added to other amounts allocated to the Credit Shelter Trust as a result of my death (including by disclaimer), would not result in or increase the federal estate tax payable by reason of my death, and the denominator is the federal estate tax value of the IRA. In determining the amount of the numerator, the credit for state death taxes shall be considered only to the extent those taxes are not thereby incurred or increased. The balance of the IRA shall be payable to the Marital Trust. In making such division and payments, the IRA custodian may rely upon a written certification by my legal representative, or if none, the trustee of [master trust], as to the fraction to be paid to each beneficiary. [Include other marital deduction provisions, additional provisions in case the spouse does not survive, and other provisions relating to the limitations on investment or methods of distribution, as appropriate.]

D. Division and Distribution to Children or Children's Trusts

In equal shares as follows: one share to each child of mine who survives me and one share to be divided equally among the then living children of a deceased child of mine, except that if a child or grandchild of mine is an income beneficiary of a trust created by me which is in existence at the time of the distribution, then the share otherwise distributable to such person shall instead be paid to the trustee of such trust. In making any payment to a trust, the

IRA custodian may rely upon a written certification of the trustee of such trust.

Alternative:

In equal shares [percentages or fractional division] to each [child's trust] created under the [master trust] in existence at the time of the distribution. [Expand if exempt and non-exempt generation-skipping trusts are created for each child.] In making such division and payments, the IRA custodian may rely upon a written certification by my legal representative, or if none, the trustee of [master trust], as to the share to be paid to each beneficiary.

XI. CONCLUSION

Retirement benefits often constitute a significant portion of the net worth of individuals who utilize the services of estate and financial planning professionals. This form of wealth is subject to complex income, estate, and other taxes, as well as required minimum distributions during one's lifetime and following death. This article offers guidance to practitioners by providing a summary of those rules and insight into the application of the rules to common estate planning techniques.

TABLE I – UNIFORM LIFETIME TABLE[103]

The Uniform Lifetime Table generally is to be used for determining the required minimum distributions to an individual after his or her required beginning date (other than an individual who names his or her spouse as sole beneficiary *and* the spouse is more than ten years younger):

AGE	DISTRIBUTION PERIOD	APPROXIMATE PERCENTAGE OF IRA/QP
70	27.4	3.7%
71	26.5	3.8%
72	25.6	3.9%
73	24.7	4.0%
74	23.8	4.2%
75	22.9	4.4%
76	22.0	4.5%
77	21.2	4.6%
78	20.3	4.9%
79	19.5	5.1%
80	18.7	5.3%
81	17.9	5.6%
82	17.1	5.8%
83	16.3	6.1%
84	15.5	6.5%
85	14.8	6.8%
86	14.1	7.1%
87	13.4	7.5%
88	12.7	7.9%
89	12.0	8.3%
90	11.4	8.8%
91-99	10.8-6.7	9.4-15%
100-109	6.3-3.4	16-29%
110-114	3.1-2.1	32-48%
115 and older	1.9	52+%

103. Treas. Reg. § 1.401(a)(9)-9 (2002).

TABLE II - SINGLE LIFE TABLE[104]

The Single Life Table is to be used for determining the distribution period for distributions to an individual after the death of an IRA owner or a participant in a defined contribution plan.

DECEDENT/ BENEFICIARY'S AGE	BENEFICIARY'S DISTRIBUTION PERIOD	APPROXIMATE PERCENTAGE OF IRA/QP
5	77.7	1.29%
6	76.7	1.30%
7	75.8	1.32%
8	74.8	1.34%
9	73.8	1.36%
10	72.8	1.37%
11	71.8	1.39%
12	70.8	1.41%
13	69.9	1.43%
14	68.9	1.45%
15	67.9	1.47%
16	66.9	1.49%
17	66.0	1.52%
18	65.0	1.54%
19	64.0	1.56%
20	63.0	1.59%
21	62.1	1.61%
22	61.1	1.64%
23	60.1	1.66%
24	59.1	1.69%
25	58.2	1.72%
26	57.2	1.75%
27	56.2	1.78%
28	55.3	1.81%
29	54.3	1.84%
30	53.3	1.88%
31	52.4	1.91%
32	51.4	1.95%
33	50.4	1.98%
34	49.4	2.02%
35	48.5	2.06%
36	47.5	2.11%
37	46.6	2.15%

104. Treas. Reg. § 1.401(a)(9)-9 (2002).

DECEDENT/ BENEFICIARY'S AGE	BENEFICIARY'S DISTRIBUTION PERIOD	APPROXIMATE PERCENTAGE OF IRA/QP
38	45.6	2.19%
39	44.6	2.24%
40	43.6	2.29%
41	42.7	2.34%
42	41.7	2.40%
43	40.7	2.46%
44	39.8	2.51%
45	38.7	2.58%
46	37.9	2.64%
47	37.0	2.70%
48	36.0	2.78%
49	35.1	2.85%
50	34.2	2.92%
51	33.3	3.00%
52	32.3	3.10%
53	31.4	3.18%
54	30.5	3.28%
55	29.6	3.38%
56	28.7	3.48%
57	27.9	3.58%
58	27.0	3.70%
59	26.1	3.83%
60	25.2	3.97%
61	24.4	4.10%
62	23.5	4.26%
63	22.7	4.41%
64	21.8	4.59%
65	21.0	4.76%
66	20.2	4.95%
67	19.4	5.15%
68	18.6	5.38%
69	17.8	5.62%
70	17.0	5.88%
71	16.3	6.13%
72	15.5	6.45%
73	14.8	6.76%
74	14.1	7.09%
75	13.4	7.46%
76	12.7	7.87%
77	12.1	8.26%

DECEDENT/ BENEFICIARY'S AGE	BENEFICIARY'S DISTRIBUTION PERIOD	APPROXIMATE PERCENTAGE OF IRA/QP
78	11.4	8.77%
79	10.8	9.26%
80	10.2	9.80%
81	9.7	10.31%
82	9.1	10.99%
83	8.6	11.63%
84	8.1	12.35%
85	7.6	13.16%
86	7.1	14.08%
87	6.7	14.93%
88	6.3	15.87%
89	5.9	16.95%
90	5.5	18.18%
91	5.2	19.23%
92	4.9	20.41%
93	4.6	21.74%
94	4.3	23.26%
95	4.1	24.39%
96	3.8	26.32%
97	3.6	27.78%
98	3.4	29.41%
99	3.1	32.26%
100	2.9	34.48%
101	2.7	37.04%
102	2.5	40.00%
103	2.3	43.48%
104	2.1	47.62%
105	1.9	52.63%
106	1.7	58.82%
107	1.5	66.67%
108	1.4	71.43%
109	1.2	83.33%
110	1.1	90.91%
111	1.0	100.00%