

Drafting IRA Beneficiary "See-Through" Trust Provisions

Meeting Complex IRS Rules to Qualify a Trust as a Conduit Trust or an Accumulation Trust

WEDNESDAY, JULY 18, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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*Special Thanks to Owen Kaye, Esq., **Givner & Kaye**, Los Angeles for submission of materials

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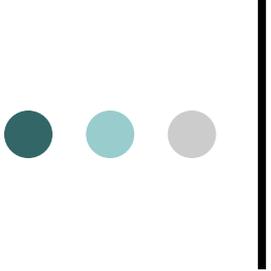
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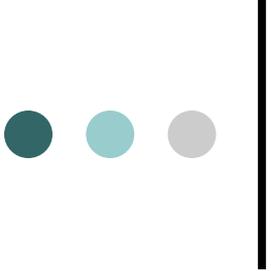
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Trust as Beneficiary of IRA





Can you have a Trust as a beneficiary?

YES! However, the Trust must meet five (5) requirements

Generally only *individuals* can be named as beneficiaries of an IRA. However if the Trust meets the following requirements it can be named as a beneficiary and take advantage of the “stretch-out.”

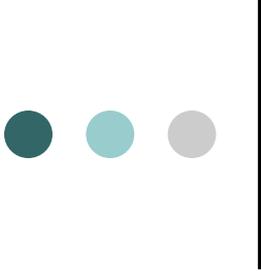
1. Trust must be valid under state law
2. Trust is irrevocable upon death of owner
3. Beneficiaries of the Trust are identifiable from trust instruction
4. Documentation requirement is satisfied
5. Designated Beneficiaries are individuals*

* Important when we want to determine the beneficiary whose life expectancy we will be using to determine the RMD.

If the trust meets the above requirements, then allowed to “look through” the named trust to the underlying beneficiaries and use their life expectancies.

Why Designate a Trust as Beneficiary?

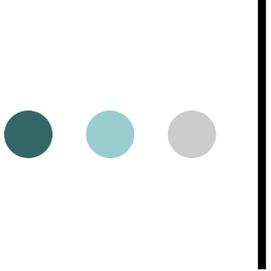
- The reasons are the same with IRAs and qualified plans as they are with other estate assets:
 - Minor beneficiaries (avoids guardianship);
 - Special need beneficiaries (avoids guardianship and can preserve Medicaid benefits);
 - Spendthrift beneficiaries;
 - Second or multiple marriages;
 - “Significant other” beneficiaries;
 - Beneficiaries with substance abuse problems;
 - Estate tax purposes (to preserve credit shelter or marital deduction).
 - Creditor protection of a beneficiary
 - Provide for only children/family and try to avoid issues in a divorce
 - Enforce stretch but also provide flexibility as needed



Paying IRAs to Trusts

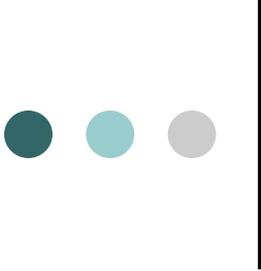
Benefits of Utilizing a Trust

- Spendthrift protection
- Creditor protection
- Divorce protection
- Special needs
- Investment management
- Estate planning
- “Dead-hand” control



Disadvantages of Naming a Trust

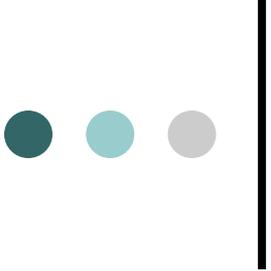
1. If Trust is not a “conduit” Trust and instead an “accumulation trust” then all monies not distributed from the trust are taxed at the trust level. A complex trust is taxed at 37%-39.6% when it has income over \$12,500.
2. Trustee, legal and administration fees
3. Income Tax return
4. Greater complexity



Paying IRAs to Trusts

Disadvantages of Utilizing a Trust

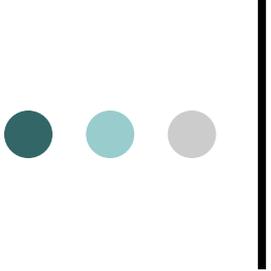
- Trust tax rates
- Legal and trustee fees
- Trust income tax returns
 - 1041
 - 1099
 - K-1
- Greater complexity



Pitfalls of Naming a Living Trust as an IRA Beneficiary (Living Trusts are Particular)

The Trust has a beneficiary that is not a designated beneficiary as a contingent beneficiary therefore not allowed to Stretch-out RMD.

Example: Trust provides that spouse is the primary beneficiary. The Trustee can make distributions to spouse for her health, education, maintenance and support and upon spouse's death the balance is to be distributed to a charity. The spouse and the charity are countable beneficiaries. Since the charity is not an individual, the Trust cannot stretch- out the RMDs over wife life expectancy.

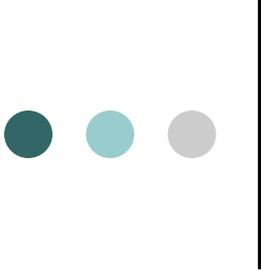


Pitfalls of Naming a Living Trust as an IRA Beneficiary

- To determine RMD you use the life expectancy of the oldest beneficiary. As a result, if you have a trust for the benefit of the grandchildren and if they are not alive to the grandmother then using the grandmother life expectancy unless conduit trust.
- The Trust to pay for debts or expenses of the participant's estate, including federal and state estate and death taxes after the beneficiary determination date. The estate may NOT be regarded as a designated beneficiary and therefore no stretch-out allowed since it is an individual.

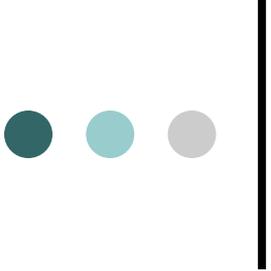
General power of appointment:

- Cannot expand the beneficiary designation because the individuals must be designated as of the date of the IRA owner's death.



Why would you want to have a Trust as a beneficiary of your IRA?

- i. Beneficiary is a spendthrift
- ii. Second spouse and children from a prior marriage
- iii. Creditor protection for beneficiary
- iv. Protection against spouse in a divorce
- v. Special Needs Trust to be eligible for government based funding
- vi. Beneficiary is a minor
- vii. Benefit from the “Stretch-out” over the beneficiary’s life expectancy
If you name the beneficiary as an outright beneficiary of the IRA then more likely than not (80%) the beneficiary will cash out the IRA and forgo the benefits
- viii. “Dead-hand” control
- ix. Estate tax planning



Naming a Trust as a Beneficiary

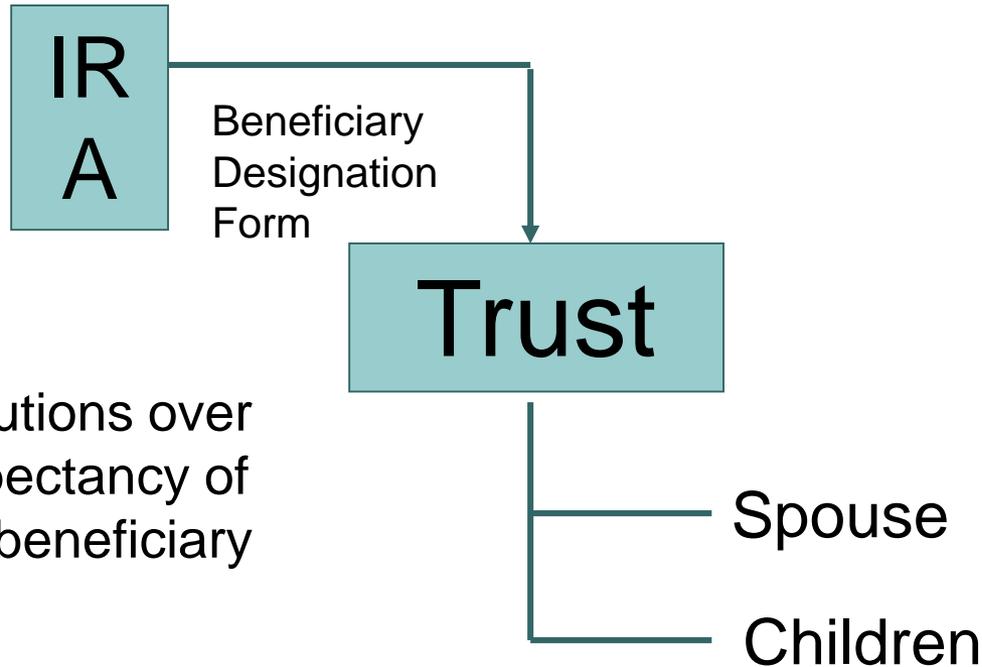
General Rule: Use the life expectancy of the oldest beneficiary

-Exception: creation of sub-trusts as separate accounts

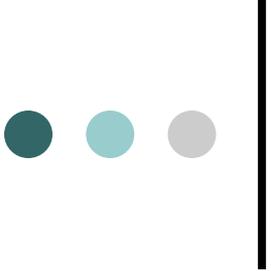
1. If you create sub-trusts for each beneficiary then allowed to use that beneficiary's life expectancy to determine RMD
2. The separate treatment can be advantageous for younger beneficiaries who can stretch out RMD over a longer period of time

Naming a Trust as a “Designated Beneficiary”

An IRA Can Be Payable to a Trust

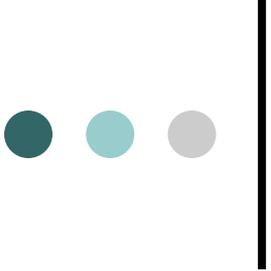


IRA distributions over the life expectancy of the oldest beneficiary of the trust



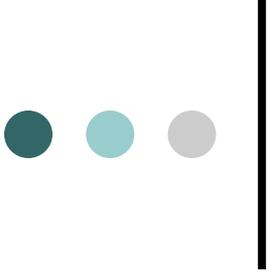
Trust as “Designated” Beneficiary:

- IRA owner must provide a list of the trust beneficiaries to the IRA custodian or Trustee has until October 31 of year after IRA owner’s death to provide trust document or list of beneficiaries, although to be practical the trustee or custodian should have the documentation prior to the September 30 determination date;
- Trust must be valid under State law;
- Trust must become irrevocable by its own terms upon the death of the IRA owner;
- Beneficiaries must be easily identifiable through the trust document.



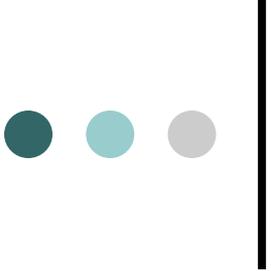
Trust Must be Valid Under State Law

1. Trust must be legally formed under state law- easily satisfied
2. Testamentary trust created pursuant to a Will is allowed
3. Treas. Reg. §1.401(a)(9)-4, Q&A 5(b)(1)



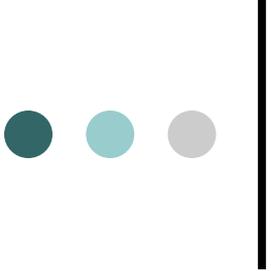
Trust is Irrevocable Upon Death of the Owner

Joint Living Trust may be difficult to satisfy as the IRS views the Trust as one trust (see PLR 200317044). Survivor's Trust is revocable.*



Documentation Requirement is Satisfied by October 31

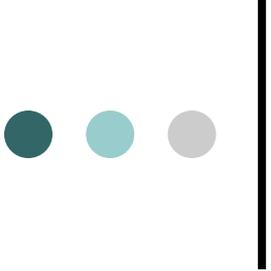
1. IRA owner or Trustee of beneficiary must provide IRA Trustee or custodian with:
 - a copy of the Trust by October 31st of the calendar year following the calendar year in which the IRA owner dies OR a list of all trust beneficiaries as of September 30th of the calendar year following the year in which the IRA owner dies, and agree to provide a copy of the trust instrument on demand
2. §1.401(a)(9)-4, Q&A 5(b)(4)
3. The documentation required to be furnished is set forth in Reg. §1.401(a)(9)-4; A-6(b)



Beneficiaries of the Trust are Identifiable from the Trust Instrument

The beneficiaries should be identified by name or identified as a member of a “class” of beneficiaries (i.e. my children or grandchildren)

Treasury Regulation §1.401(a)(9)-4, Q&A 5(b)(3)

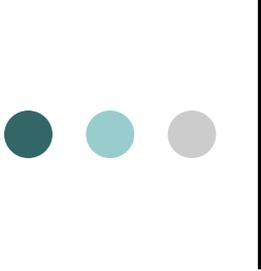


Rule of Thumb to determine Designated Beneficiary:

First, as explained by Natalie Choate:

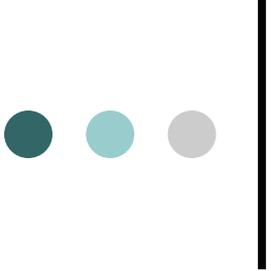
“... you test an accumulation trust by counting all successive beneficiaries down the “chain” of potential beneficiaries who could take under the trust, until you come to the beneficiary(ies) who or which will be entitled to receive the trust property immediately and outright upon the death of the prior beneficiaries. The “immediate outright” person, entity or group is (or are) the last beneficiaries in the “chain” that you need to consider... These tests are applied at the time of the participant’s death, “as if” the first trust beneficiary died immediate after the participant, and the next beneficiary in the chain died immediately after the first beneficiary, and so on until you reach the first “immediate outright” beneficiary, where you stop.”

Second, if the beneficiary is entitled to all distributions from the plan (i.e. the Trust is required to distribute all distribution from the plan to the beneficiary) then the other beneficiaries can be disregarded (i.e. conduit trust).



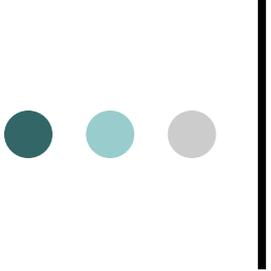
Other Considerations in Naming a Trust as Beneficiary:

- For treatment as separate shares, two requirements must be met:
 - The interests of the beneficiaries must be expressed as fractional or percentage interests as of the date of death of the IRA owner; and,
 - Separate accounts must be established by December 31st of the year after the IRA owner's death.
- This is important because without separate share treatment, the trust will be limited to using the life expectancy of the oldest beneficiary. If the goal was to pay the IRA to separate sub-trusts, this may be a trap for the unwary.



Designated Beneficiaries

1. Designated beneficiaries must be individuals.
2. If a charity, estate, LP, LLC or corporation is named as a beneficiary then there are no designated beneficiaries.
3. The designated beneficiaries are determined on **September 30th** of the calendar year following the calendar year of the IRA owner's death. Solution: separate accounts, cash out or disclaimer before the September 30th determination date.

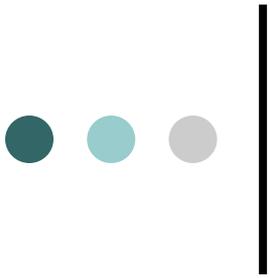


Separate accounts?

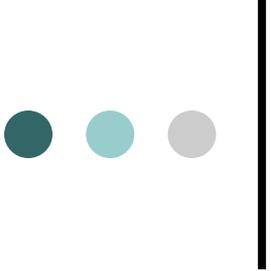
1. Is it sufficient to have the Trust provide that separate sub-accounts will be created for each child upon Grantor's death? PLR 200750019, and 200317041 held NO.

Example: Decedent died in 1999 before reaching the RMD. His Living Trust was named as the IRA beneficiary. The beneficiaries of his Trust were Decedent's Three (3) children. Upon the death of the Decedent, the provisions of the Trust directed the Trustee to divide the Trust into equal share. Each share constitute a separate trust and was administered as such. Holding: subtrusts created pursuant to the terms of a trust do not constitute separate accounts for purposes of §401(a)(9).

2. To create separate accounts/sub-trusts you must do so on the beneficiary designation or the plan documents during the IRA owner's lifetime.



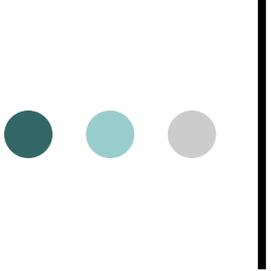
Separate accounts need to be established by the end of the calendar year following the participant's death. According to IRS representative's comment if a beneficiary is not an individual then it is advisable to establish a separate account for that beneficiary by the beneficiary determination date (September 30th).



Paying IRAs to Trusts

Separate Share Rule

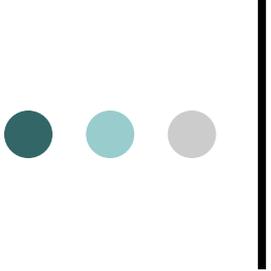
- Payable to single trust
- ↓
- No separate shares identified in the beneficiary designation form
- ↓
- IRA paid over oldest life expectancy



Paying IRAs to Trusts

Separate Share Rule

- IRA payable to multiple trusts
 - ↓
 - Each trust named in beneficiary designation form
 - ↓
 - IRA paid over each separate trust beneficiary's life expectancy

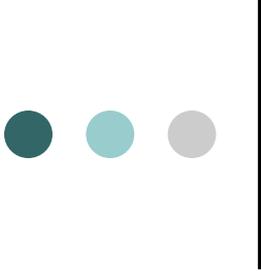


Paying IRAs to Trusts

Separate Share Rule

PLR 200537044

- Ruling 1: Each Beneficiary's Trust Share Qualified for Maximum Stretch-out.
 - Upon the death of the Settlor, the IRA stand-alone trust creates separate shares for each beneficiary (in this case, separate shares for 9 beneficiaries), each trust share “treated effective ab initio to the date of the Decedent's death” and each share functioned as a “separate and distinct trust” for the beneficiary.
 - The beneficiary designation form named each separate share as a primary beneficiary of the IRA.
 - Before the December 31st deadline, the IRA was divided into separate accounts for each share.
 - Held: Separate account treatment permitted; MRD of the IRA for each separate trust share measured by the lifetime of its sole beneficiary for whom the share was created.

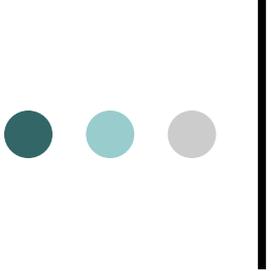


Paying IRAs to Trusts

Separate Share Rule

PLR 200537044

- Ruling 2: Allowance of One-Time “Toggle” Between Accumulation and Conduit Trust.
 - Each separate share in the IRA stand-alone trust had language structuring the separate share as a conduit trust.
 - The trust provided for an independent 3rd party, as “trust protector” to transform each sub-trust to an accumulation trust in the protector’s sole discretion by voiding the conduit provisions *ab initio*.
 - Trust Protector had the authority to limit the initial trust beneficiary *ab initio*.
 - After Participant’s date of death, Trust Protector exercised “toggle” and converted one share to an accumulation trust.
 - Held: Each share can use that the life expectancy of its initial beneficiary to measure the MRD for that share.

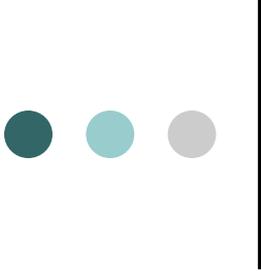


Paying IRAs to Trusts

Separate Share Rule

PLR 200537044

- Ruling 3: Payment of Expenses from IRA not considered an accumulation.
 - The trust provided that “Trust expenses may be deducted prior to any such payment to or for the benefit of the beneficiary of the trust share if the deduction does not disqualify the status of the trust as a conduit trust. This paragraph may be rendered void, *ab initio*, by the Trust Protector. . .”
 - Held: Each share can use that the life expectancy of its initial beneficiary to measure the MRD for that share.
 - Why? Even with the deduction for payment of trust expenses, no amounts distributed to the trust during the beneficiary’s lifetime would be accumulated in the trust, and thus would not be kept in the trust for the benefit of any future beneficiaries. Treas. Reg. § 1.401(a)(9)-5 Q&A 7(c)(3), Example 2.

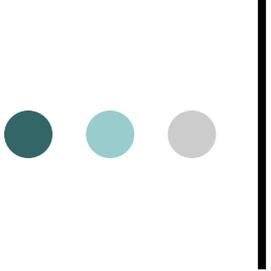


Paying IRAs to Trusts

Separate Share Rule

PLR 200537044

- Ruling 4: The trust assets will not be included in the estate of the primary beneficiary of a share upon that beneficiary's death.
 - Each trust share would accumulate the net income of the trust, and distributions of income and principal could distribute accumulated income and principal to the primary beneficiary for his or her health, education, maintenance and support only.
 - The document did not grant any beneficiary a general power of appointment over his or her share.
 - Held: The provisions of the trust could not result in estate inclusion for the estate of a primary beneficiary upon his death.



Designated Beneficiary is Key to Determining RMD

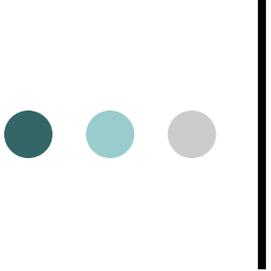
General Rules:

1. Designated beneficiary must be an individual. To determine the designated beneficiary of the Trust we “look-through” the Trust to its beneficiary.
2. Designated beneficiary is determined as of September 30th following the participant’s death.

Death of a Beneficiary: If a designated beneficiary dies during the period between the IRA owner’s death and September 30th, that period is still counted as a designated beneficiary for purposes of determining the RMD.

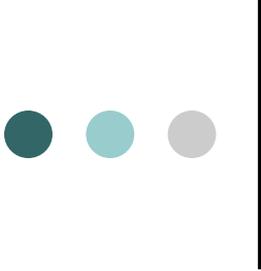
Treasury Regulation §1.401(a)(9)-4, Q&A-4(c).

3. If there are multiple beneficiaries as of the September 30th date and one beneficiary is not an individual (charity or estate) then participant is treated as not having any designated beneficiary. Treasury Regulation 1.401(a)(9)-5; Q&A-7(a)(2).



Determination of Designated Beneficiary of a Trust

1. General Rule: If a beneficiary's entitlement to a participant's IRA is contingent on an event other than death, then the contingent beneficiary is considered a designated beneficiary.
2. Exception: General rule does NOT apply to anyone who has a right to a benefit beyond a "mere potential successor" to the interest of one of the beneficiaries upon the beneficiary's death.



Treasury Regulation

1.401(a)(9)-5, A-7(c)

(c) Successor beneficiary--

(1) A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy under paragraph (a) of this A-7, or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death. Thus, for example, if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.

IRA

TRUST

Sister's measuring life for determining Required Minimum Distributions

Discretionary Distributions

Grandchild

Entire Trust outright upon Grandchildren reaching age 30

Grandchild

If Grandchildren die before reaching age 30

Sister
Age 67

Facts essentially the same as
PLR200228025

*Herman-Giddens, Gregory, *Leveraging IRA Trusts in Estate Planning*, May 31, 2012.

IRA

Trust

Other Assets

Enough to satisfy all other distributions, and terms of trust prohibited using IRA to pay any disqualifying expenses

Discretionary distributions until age 45, then outright

Child – Age 46

Discretionary distributions until age 45, then outright

Child – Age 50

Whoever, Whatever

Ages at participant's death preclude accumulation; thus, contingent beneficiaries are not "countable" Oldest Child is the determining applicable life expectancy PLR200708084

If child dies before reaching age 45

*Herman-Giddens, Gregory, *Leveraging IRA Trusts in Estate Planning*, May 31, 2012.

Paying IRAs to Trusts

Common Mistakes to Avoid in Selecting a Beneficiary

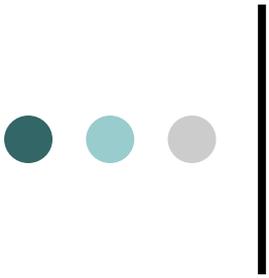
- Older or unidentifiable contingent beneficiary
- Estate as contingent beneficiary
- Powers of appointment
- Failure of beneficiaries clause
- Failure to provide trust document to custodian by October 31 of year following year of death
- Making lump sum distribution to trust
- General powers of appointment
- Tax issues
- Asset protection issues

Paying IRAs to Trusts

State Ramification of Trust

PLR 201021038

- Service ruled that the retroactive reformation of a trust would not be respected for purposes of section 401(a)(9) and the related regulations.
- The trustee reformed the trust pursuant to a state court order to remove charities under a limited power of appointment granted to first tier beneficiaries.
- The adverse ruling means the trust was not treated as a “designated beneficiary trust” (“DBT”) and that the trust beneficiary’s life expectancy could not be used for determining required minimum distributions.

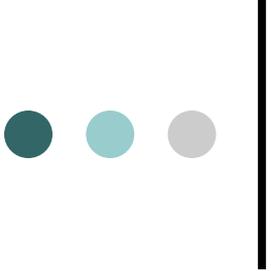


Conduit Trust VS Accumulation Trust

Paying IRAs to Trusts

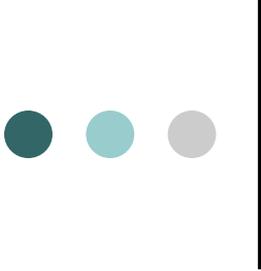
Conduit Trust

- A trust in which all distributions from the IRA are immediately distributed to the trust beneficiary(ies)
- Very limited asset protection
- Never use for Special Needs Beneficiary
- Does force the stretch treatment of payment, so no early liquidation of account



Conduit Trust

1. Trust **REQUIRES** that the trustee pay **ALL** amounts received from the plan to the beneficiary.
2. In such a case, the IRS considers the conduit trust beneficiary the sole beneficiary disregarding all potential successor beneficiaries.
 - a. Example: Trust for the benefit of the spouse and the Trustee must distribute all distributions from the plan to the spouse outright. The spouse is the sole designated beneficiary.
 - b. Many times the purpose of placing the IRA in Trust is to avoid having to pay the distribution out directly to the beneficiaries therefore a conduit trust may not be practical.



Accumulation Trust

(Stronger asset protection should always be considered when there is a Special Needs Beneficiary)

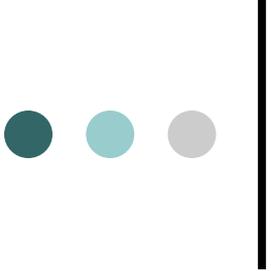
1. If a trust is not a conduit trust then it is an accumulation trust. The Trustee has the ability to accumulate distributions it receives from the plan.
2. Payment to a Trust qualifies as distribution for purposes of the RMD rules, therefore the trust is not required to redistribute the payments to a beneficiary. As a result, the Trustee can accumulate distribution until a certain age or need.
3. The Designated Beneficiary gets complicated, careful drafting is required to make certain you are maximizing the benefit of the “stretch-out.”

Paying IRAs to Trusts

Accumulation Trust

The key issue in analyzing an accumulation trust is to determine which beneficiaries are “countable.”

All beneficiaries are countable unless such beneficiary is deemed to be a “mere potential successor” beneficiary.

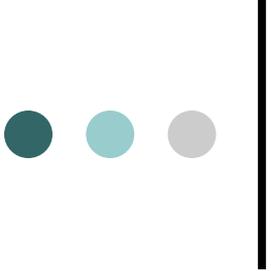


Example 1:

If wife has the right to all income during her lifetime and the children have the right to principal but only after the wife's death, with any principal distributed during the wife's life to be accumulated, both beneficiaries must be taken into account when determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.

a. Above example is an Accumulation Trust.

b. Yes, the wife is the oldest beneficiary so her life expectancy is used. However, she is not the sole beneficiary as such she cannot step into his shoes and start distributions when IRA owner would have turned 70 1/2 and spouse's life expectancy will not be redetermined each year as it would if the spouse had been the sole beneficiary.

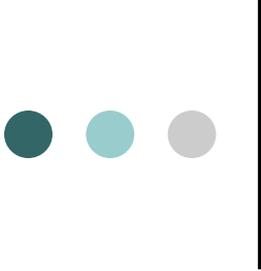


Example 2:

Income is payable to wife for her life and upon her death an outright distribution to the children. If the children are not alive, then to a charity. The wife and the children are designated beneficiaries but the charity is not a designated beneficiary since it is a “mere potential successor” because if the children survive they would receive it outright.

However, if the trust provided that the trust would continue in existence after the spouse’s death for the benefit of the then-living children, and at the death of the last child to die the assets were payable to the charitable organization, the charity would be considered a designated beneficiary.

This would not be true if this was a conduit trust, meaning that spouse was entitled to all distributions from the plan. No accumulation is allowed.



Toggling Conduit to Accumulation Trust

PLR Ruling 200537044: Allowance of One-Time “Toggle” from Conduit to Accumulation Trust

- Each separate share in the IRA standalone trust had language structuring the separate share as a conduit trust.
- The trust provided for an independent 3rd party as “trust protector” to transform each sub-trust to an accumulation trust in the protector’s sole discretion by voiding the conduit provisions ab initio.
- Trust Protector had the authority to limit the initial trust beneficiary ab initio.
- After Participant’s date of death, Trust Protector exercised “toggle” and converted one share to an accumulation trust.
- Held: Each share can use the life expectancy of its initial beneficiary to measure the MRD for that share.

*Herman-Giddens, Gregory, *Leveraging IRA Trusts in Estate Planning*, May 31, 2012.

How to Fix “Broken” Irrevocable Trusts

- What would cause an irrevocable trust to be in need of repair?
 - Events that could not be anticipated by the original Grantor, such as:
 - Change in family circumstances:
 - Births
 - Deaths
 - Marriages
 - Divorces
 - Special Needs Issues
 - Spendthrift Issues
 - Substance or alcohol abuse
 - Lack of beneficiary maturity at mandatory distribution ages

How to Fix “Broken” Irrevocable Trusts

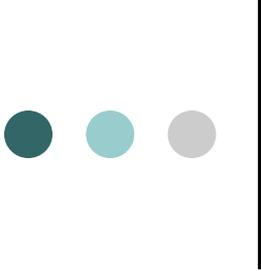
- Competing interest of beneficiaries that could not be foreseen;
- Falling out with or death of successor or current trustees;
- Trustee powers are too restrictive;
- Unfavorable state law governing trust;
- Inconvenient trust situs;
- Drafting errors in document that create ambiguities;
- Changes in tax law or unanticipated tax issues

How to Fix “Broken” Irrevocable Trusts

- How do we determine what options are available?
 - Look to the trust document:
 - Does the Trustee or Trust Protector have powers to correct the problem granted in the document?
 - Does anyone have a limited power of appointment over trust property that could effectively resolve the problem?
 - Does the trust document provide any express provisions for modification?

How to Fix “Broken” Irrevocable Trusts

- If no solutions are found in the trust document, consider:
 - Decanting
 - Judicial Modification
 - Non-Judicial Modification



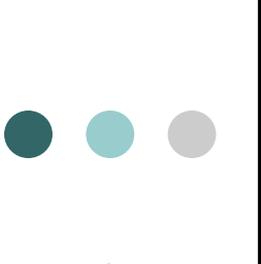
How to Fix a Beneficiary Designation

1. Disclaimer – must meet the requirements of IRC §2518 for a qualified disclaimer.
2. Cash out before September 30th
IRA owner left his IRA benefits to his revocable living trust. The beneficiaries of the Trust were children and a charity. Charity is not an individual therefore no designated beneficiary. If the Trust has other assets and the ability to distribute assets non-pro rata then the trustee can satisfy the charity's share without assets. If this is done before September 30th then the charity is not counted as a designated beneficiary.
3. Separate accounts.

Paying IRAs to Trusts

Reforming Beneficiary Designations

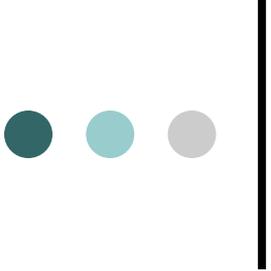
- PLR 200616039-41 - Daughter's life expectancy could be used. Even though no contingent beneficiaries were named, court reformed beneficiary designation to name daughters as contingent beneficiaries of IRA.
- IRS is currently rethinking this position.



Power of Appointment

- “If a remainder interest is subject to a power of appointment upon the death of the life beneficiary of the trust, all potential appointees, as well as those who would take in default of exercise of the power, are considered beneficiaries, unless they can be disregarded.
- For a conduit trust with a single beneficiary, the remainder beneficiaries are disregarded. If the single conduit beneficiary has been given a power of appointment, all members of the class of appointees will not be counted even if there are non-individuals, like charities, among the potential appointees.
- With an accumulation trust, remainder beneficiaries must be counted. If the accumulation trust wants to qualify for see-through trust status, all potential appointees, as well as all those who would take in default of the exercise of the power, must be (1) identifiable (2) individuals, who are (3) younger than the beneficiary whose life expectancy is the one the participant wants used as the applicable distribution period.

*Griffin, Linda Suzanne, Drafting “Leaky Faucet” (Conduit) Trusts and “Stopped Up Faucet” (Accumulation) Trusts, February 29, 2012.



Power of Appointment

1. Power to Appoint to Issue. A power of appointment given to a surviving spouse with the class of potential beneficiaries being the issue of the participant and his spouse would work. It is a clearly defined group of identifiable younger individuals. PLR 1999-03050.
2. Power to Appoint to Spouses of Issue. A power to appoint to someone's spouse is a classic example of creating a nonidentifiable beneficiary (unless it's limited to a specific spouse). Such a power of appointment would make the trust fail the see-through trust status.
3. Power to Appoint to Charity. A power of appointment given to a surviving spouse that would allow her to appoint the trust estate to the participant's issue and charities of the spouse's choice would make the trust fail the see-through rules because there is a potential that a non-individual could end up as a beneficiary of the plan benefits.”

*Griffin, Linda Suzanne, Drafting “Leaky Faucet” (Conduit) Trusts and “Stopped Up Faucet” (Accumulation) Trusts, February 29, 2012.



Are RMDs considered DNI?

- All items of IRD are considered DNI
- Retirement Plan distributions are considered IRD
- Therefore retirement plan distributions received by a trust are considered as DNI
- IRC Section 643(a), Reg. Section 1.663(c)-5, Examples 6 and 9
- However, this does not necessarily mean that a distribution carries out DNI



Six Hurdles to Overcome

Trust is entitled to an income tax deduction for retirement plan distributions it makes from DNI to beneficiary if following requirements are met:

1. The beneficiary must be entitled to receive the money – drafting important.



Six Hurdles to Overcome

2. DNI deduction is only available for gross income that is either required to be distributed or is actually distributed in same taxable year (or within 65 days of end of taxable year, if special election is made). Thus, if discretionary distributions, must make the distribution in time.



Six Hurdles to Overcome

3. If there are 2 or more beneficiaries and then have “substantially separate and independent shares” a distribution to one beneficiary will not carry out DNI that is allocated under the separate share rule to a different beneficiary.



Six Hurdles to Overcome

4. Transfer of the Retirement Plan, itself, does not carry out DNI.
5. The Trust generally does not get a DNI deduction for distributions to charity.
6. The DNI distribution is not available for distributions in fulfillment of a special sum or a pecuniary bequest, thus if bequest is to pay 10k to grandchild, that bequest does not carry out DNI.



Trust Accounting vs. Federal Income Tax

- An RMD general will be gross income for income tax purposes, but that same RMD may be principal or corpus for trust accounting purposes.
- RMDs and Trust accounting income are totally different and unrelated concepts.



Trust Accounting Vs. Federal Income Tax

Unless the Trust has own definition, then must look to state law to determine what part of RMD is considered income and what part is considered principal or corpus.

How to Draft

- If Conduit Trust, then must pay RMDs to beneficiary and distributions carry out DNI.
- If Accumulation Trust, then must be careful when drafting in order to make sure distribution carries out DNI.
- In order for Trust to get DNI deduction the Trust must give Trustee discretion to distribute principal (or at least that part of principal that is RMDs).

Drafting Solutions

- Draft so the definition of income does not matter, i.e., trustee shall pay such amounts of income or principal that the trustee deems desirable from time to time.
- Draft own definition of income, i.e., can state that all retirement plan distributions to trust are considered income (but if require all income to be paid out, then this could be problematic).
- Treat the retirement plan as a trust within a trust, typically done to qualify a marital trust which holds an IRA, require that the IRA pay to the trust greater of income of trust or RMD, and then require that trust distribute income of IRA to spouse.

Additional Drafting Tips and Examples

- **BENEFICIARY DESIGNATION IS CRUCIAL. IT IS AS IMPORTANT (IF NOT MORE SO) AS THE TRUST DRAFTING.** It is important to note that plans can define who may be listed as primary beneficiary so step 1 is to make sure the plan allows for Trust as beneficiary. This may effect your drafting.
- Institutional Requirements may create barriers (consider moving institutions).
- Proof that the Beneficiary Designation Form was “accepted” should be kept with the Will/Trust. For example, date-stamped receipt from administrator.

Additional Drafting Tips and Examples

- BENEFICIARY DESIGNATION SAMPLES:

- Primary: To Marge Simpson, spouse of Plan Participant.

Contingent: To the Trustee of the IRS Trust(s) **[to be]** created for the benefit of Bart and Lisa Simpson U/A dated July 4, 1976.

- Primary: To the Trustee of the Marital Trust created for the benefit of Marge Simpson under the Last Will & Testament of Homer Simpson.

Contingent: ALWAYS CHOOSE A CONTINGENT OR THE PLAN WILL CHOOSE ONE FOR YOU.

Additional Drafting Tips and Examples Continued

- PRACTICAL CONSIDERATIONS IN DRAFTING TRUST AS A BENEFICIARY:
 - VALUE OF ACCOUNT (COST/BENEFIT)
 - COMMUNITY PROPERTY RIGHTS
 - MOTIVES OF PLAN PARTICIPANT
 - NEEDS OF BENEFICIARIES
 - NUMBER AND AGES OF BENEFICIARIES
 - TRUSTEE SELECTION
 - BEWARE THE FAILURE OF BENEFICIARY CLAUSE WHEN DRAFTING ACCUMULATION TRUST.

Additional Drafting Tips and Examples Continued

- STAND ALONE TRUST OR COMBINED TRUST
 - STAND ALONE TRUST – A TRUST ESTABLISHED FOR THE SOLE PURPOSE OF RECEIVING QUALIFIED PLAN BENEFITS (CAN BE A TRUE STAND ALONE, OUTSIDE OF A TESTAMENTARY DOCUMENT OR A TRUST CREATED WITHIN A TESTAMENTARY DOCUMENT)
 - STAND ALONE TRUST SEEMINGLY LESS LIKELY TO BE ADMINISTERED INCORRECTLY.
 - SAMPLE STAND ALONE CONDUIT TRUST LANGUAGE ATTACHED AS EXHIBIT “A” BY DIANE J. KIEPE
 - SAMPLE STAND ALONE ACCUMULATION TRUST ATTACHED AS EXHIBIT “B” BY DIANE J. KIEPE.

Thank You

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