Massachusetts Association of Accountants

Trust Planning for Retirement Benefits... To Do or Not To Do!?!

Tuesday, May 17, 2016
9:00 AM - 12:30 PM

Prepared and Presented by

Leo J. Cushing, Esq., CPA, LLM
Luke C. Bean, Esq., LL.M.

9:00 – 9:20	Introduction and Overview; *Leo J. Cushing, Esq., CPA, LLM*
9:20 – 9:35	Portability; *Luke C. Bean, Esq., LL.M.*
9:35 – 9:50	IRC § 691(c) and the Real Cost of Retirement Planning; *Leo J. Cushing, Esq., CPA, LLM*
9:50 – 10:20	Distribution Rules in General; Required Minimum Distributions, Begin Date, Surviving Spouse, Single Life Tables and the Unisex Table; *Luke C. Bean, Esq., LL.M.*
10:20- 10:30	Introduction to IRAs Payable to Trusts; General Rules; *Leo J. Cushing, Esq., CPA, LLM*
10:30-10:45	Break
10:45-11:10	Conduit v. Accumulation Trusts and the Look-Through Rule; *Luke C. Bean, Esq., LL.M.*
11:10 - 11:30	Income Taxation and Fiduciary Income Tax Issues; the Definition of Trust Accounting Income and the Treatment of IRA Distributions as Principal Under the Uniform Principal and Income Act; How to Get Principal into DNI; Leo *J. Cushing, Esq., CPA, LLM*
11:30-11:50	Making IRA Benefits Payable to a QTIP Trust; the QTIP Rules and the Minimum Distribution Rules; Looking Through the IRA to Determine Trust Accounting Income; *Luke C. Bean, Esq., LL.M.*
11:50-12:15	Consider Using a Joint Trust to Plan for Estates That Have Large Retirement Plan Benefits; Combining Powers of Appointment with Step-Up in Basis and Portability; *Leo J. Cushing, Esq., CPA, LLM*
12:15-12:30	Question and Answer

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I. Introduction & Overview

Estate planning for retirement benefits has presented one of the more challenging aspects of planning whether in the case of a married couple or in the case of a single person. Unlike after-tax assets, pre-tax retirement benefits are subject both to the estate tax upon death, and to income taxes as the funds are withdrawn. In addition, the estate tax is due and payable in full within nine months after the date of death and the income taxes are due as the funds are withdrawn.

In the case of large retirement benefits, perhaps life insurance should be considered to provide funding to pay the estate tax liability. Once this problem is resolved, the planner must then turn to minimizing income taxes by stretching out the payments over the longest term possible. Overlying all of these issues is the fact that, prior to portability, a surviving spouse was not permitted to use the estate tax exemption that was available to the first spouse upon the death of the first spouse to die and, for this reason, techniques were developed whereby retirement plans could be made payable directly to marital deduction type trusts, including QTIP trusts.

Portability has lessened the need to implement these techniques except for cases involving asset protection, second spouses, and spendthrift concerns. Also, Massachusetts does not recognize portability. For this reason and for the reasons discussed below, in many cases involving a married couple, it would be better to simply leave the IRA/retirement accounts to the surviving spouse directly and find other assets with which to utilize the couple's estate tax exemptions.

<u>Planning Note</u>: In PLR 200637033 the IRS allowed a rollover to a spousal IRA even though the IRA was payable to the decedent's estate since the spouse was the sole beneficiary of the estate.

The IRA rollover rules are straight forward and the minimum distribution rules are favorable in the case of an IRA rollover to a surviving spouse. Portability, however, is not a perfect solution and, in order to take advantage of portability, an estate tax return must be filed even if an estate tax return was not required to be filed because the decedent's estate fell below the $5,450,000 federal estate tax exemption amount (or whatever filing threshold remains after lifetime gifting).

While the IRS has been quick to provide relief for failure to file such returns and make a portability election, this relief is only applicable if no federal estate tax return was required to be filed in the first place. (IRC § 9100 Relief)

If the decedent's estate exceeded the threshold amount and an estate tax return was required to be filed, no relief is permitted and the tax consequences can be devastating.

II. <u>691(c) Deduction</u>

Unlike after-tax assets which will receive a step up in basis upon death under IRC § 1014, retirement benefits do not receive any such step-up in basis. These assets are known as income in respect of a decedent and, while no step-up in basis is permitted, the recipient of the benefits will be entitled to an income tax deduction attributable to the <u>federal estate tax</u> imposed on the retirement account.

Here, with the federal exemption amount at $5,450,000 and a marital deduction, often times there is no 691(c) deduction available because no federal estate tax was incurred.

The computation itself is quite simple. First, compute the federal estate tax with the IRA benefits and then the federal estate tax without the IRA benefits and the difference is considered your 691(c) deduction.

There is an open question as to how this should be deducted but, in the case of an individual, it is an itemized deduction and, in the case of an estate or trust, it would be a so-called above-the-line deduction not subject to any 2% rule. There are various ways to report the deduction which are as follow.

The following formulas are used with the "pro-rata" deduction rule being the most popular:

(1) "Cost Recovery" or "FIFO" – a presumption that every distribution comes first from IRD until the entire amount has been distributed.

(2) "Pro-Rata Deduction Rule" – the deduction is based upon the following: estate tax attributable to the IRA over the total IRA balance at the date of death (unless alternate valuation date is used). That percentage is applied to each payment received to determine the itemized deduction, and

(3) "LIFO" – a presumption that every distribution comes first from that year's investment income and the excess is the original IRD.

Example:

Assume $3,000,000 total estate with $1,600,000 in IRA benefits and a 50% estate tax with no remaining unified credit.

(1) the total estate tax is $1,500,000

(2) the total estate without the IRA is $700,000

(3) the estate tax attributable to IRA is $800,000

(4) the pro-rata amount of the estate tax attributable to the IRA is 53.3% ($800,000 divided by $1,500,000)

	Child 1	Child 2	Child 3
1st Year of RMD	$30,000	$30,000	$30,000
% of IRD	53%	53%	53%
Itemized Deduction	$15,900	$15,900	$15,900

III. Charitable Options

Inasmuch as IRA benefits generate approximately $0.30 on the dollar for the recipient in the case of non-charitable beneficiaries, many IRAs are simply left to charitable foundations, such as colleges, universities, and private foundations and the wealth is replaced by a life insurance policy. If the IRA is made payable directly to a foundation, there is neither an estate tax nor an income tax and the charity will receive the amount 100% on the dollar.

It is important that the IRA shall not be made payable generally to the decedent's revocable trust, which breaks down into a pecuniary marital share and a so-called family share. The reason for this relates to CCA 200644020 IRC 691(a)(2) which provides that there would be an immediate recognition of income to the extent that the IRA benefits can under any circumstances be used to fund a pecuniary share. In the event IRA benefits are payable to a trust, it is important that the trust be a fractional share rather than a pecuniary share and, if a pecuniary share is utilized, the IRA benefits should be made payable to the QTIP portion where a marital deduction election can be made post-mortem, depending upon circumstances at that time.

(insert examples from Regulations)

IV. The Minimum Distribution Rules

A. Introduction

On January 11, 2001, Proposed Regulations for minimum distributions from retirement plans were published by the Internal Revenue Service. On April 17, 2002, the Regulations became final.

The Final Regulations apply to all stock bonus, pension and profit-sharing plans qualified under the Internal Revenue Code of 1986 as amended (the "IRC") §401(a), annuity contracts under IRC §403(a), annuity contracts or custodial accounts under IRC §403(b), IRAs under IRC §408, Roth IRAs under IRC § 408(A) and certain deemed compensation plans under IRC §457. The Final Regulations apply for determining required minimum distributions ("RMDs") for calendar years beginning on or after January 1, 2003, even if the employee died prior to January 1, 2003.

B. Simpler required minimum distributions during life of participant

Under prior practice, a plan participant must begin taking distributions from a retirement plan at age 70 ½ but can elect to defer the first distribution until April 1 of the year following the year in which the employee attained age 70 ½. Under the Final Regulations, an employee is still required to begin withdrawing distributions from a retirement plan on or before his or her required beginning date ("RBD"). (The RBD is April 1 of the year following the year in which the taxpayer attains age 70 ½ unless the employee has not retired and participant does not own more than 5% of employer.)

The Regulations published a new table to determine required minimum distributions (RMDs) based on the former minimum distribution incidental benefit table. This table is based on the fiction that the employee (or IRA owner) is 10 years older than the beneficiary and that both lives are recalculated each year. The "Uniform Table" is attached as Exhibit A.

Planning Note: A 50% excise tax is imposed as a penalty for failure to take RMD based on the amount by which the RMD exceeds the actual distributions during the year.

C. RMDs During Participant's Life

The employee determines his or her RMD in two steps as follows: First, the employee must find his or her current age from the Uniform Table and the applicable distribution period for that age, as of the end of the distribution year. Second, the employee must divide his or her account balance in the plan determined as of the most recent valuation date in the prior calendar year by the applicable distribution period (also known as the Applicable Divisor) associated

with his or her current age and thereafter is recalculated each year using the Applicable Divisor for the participant's attained age.

Example: X, individual at age 72, has an IRA account balance of $1,000,000. The distribution period (applicable divisor) for a 72 year old is 25.6 years. Therefore, X's RMD is $39,063 ($1,000,000 ÷ 25.6). This result is not dependent either on the identity of the beneficiary or on the employee even having a designated beneficiary. The next year, at age 73, the employee uses the Applicable Divisor for the attained age of 73.

D. RMDs After Death

a. Except in the case of a spouse who rolls the account over to a spousal IRA, RMDs for all other designated beneficiaries (DBs) are determined using the new Single Life Table. The Single Life Table is attached as Exhibit B.

b. Spouse as designated beneficiary. If an employee dies and his or her spouse is the sole designated beneficiary as of September 30 of the calendar year following the year of the employee's death and distributions had not begun for the deceased spouse and the spouse does not roll over the benefits to a spousal IRA, the Single Life (Expectancy) Table applies. Under this rule, payments may be extended over the spouse's life expectancy recalculated each year using the Single Life Table. Regs. 1.401(a)(9)-5, A-5(c)(2). In most cases, a spouse would be better served to roll the IRA into his or her own IRA and use the new Uniform Table to take advantage of a joint life expectancy using the age of the spouse and that of a person ten years younger.

Example:		*RMD Under Uniform Table*	*RMD Under Single Life Table*
Age of Spouse	72	25.6	15.5
Account Balance	$1,000,000	$ 39,063	$ 64,516

c. Surviving spouse dies before rollover to spousal IRA

If the spouse dies without having rolled over the benefit, distributions can continue to the spouse's beneficiaries over the spouse's remaining life expectancy not recalculated. The spouse's remaining life expectancy is determined using the Single Life Table and the spouse's age as of the calendar year of the spouse's death. In subsequent years, the applicable distribution period is reduced by one for each calendar year that has elapsed since the calendar year immediately following the calendar year of the spouse's death. Regs. 1.401(a)(9)-5, A-5(c)(2)

d. Spouse dies after rollover to spousal IRA

On the other hand, if the IRA had been rolled over, minimum distributions to the designated beneficiaries are based on the remaining life expectancy of the beneficiaries using the Single Life Table.

Example: Spouse dies at age 78 and account is payable to daughter age 40. If account had been rolled over, the RMD for the year of death to spouse would be $ $49,261 ($1,000,000 ÷20.3). The following year, the daughter would be required to withdraw only $23,419, assuming an account balance of $1,000,000 on December 31 of the year of mother's death ($1,000,000 ÷ 42.7). If the account had not been rolled over the following year, the daughters would be required to withdraw $87,719 ($1,000,000 ÷ (11.4).

e. Non-Spouse as designated beneficiary. If a non-spouse, such as a child, is the designated beneficiary, payments may extend over a period not extending beyond the child's life expectancy. The child's life expectancy is determined using the Single Life Table and the child's age as of his or her birthday in the calendar year immediately following the calendar year of the employee's death. In subsequent calendar years, the applicable distribution period is reduced by one for each calendar year that has elapsed since the calendar year immediately following the calendar year of the employee's death.

E. Timing of RMDs

(a) Spouse as beneficiary-death before RMD - no rollover to spousal IRA

The first distribution must be made on or before the later of December 31 of the calendar year following the employee's death or December 31 of the calendar year in which the employee would have attained age 70 ½. If the spouse is not the sole beneficiary, distributions must commence on or before December 31 of the calendar year following the year of employee's death. (This will be the case if a trust is named as the designated beneficiary, even if the spouse is the sole beneficiary of the trust as in the case of a QTIP trust.)

F. Determining Applicable Divisor in Year Employee Attains Age 70 ½
Regs. 1.401(a)(9)-5

An employee who is born in the first half of the year will attain age 70 ½ in the same year. The employee who is born in the second half of the year will attain age 70 ½ in the following year. Since the Applicable Divisor is determined by the employee's attained age in the year in which the employee attains age 70 ½, the Applicable Divisors will differ. For those born in the first half of the year, the attained age will be 70 while for those born in the second half of the year, the attained age will be 71. On the other hand, for those born in the second half of the year, the RBD will be extended for one additional year.

Example:

1. X is born March 1, 1933. X will attain age 70 ½ on September 1, 2003. The RBD will be April 1, 2004 and the Applicable Divisor will be 27.4 based on an attained age of 70. If the account balance was $1,000,000 as of December 31, 2002, the April 1, 2004 RMD would be $36,496 ($1,000,000 ÷ 27.4). A second distribution will be required on or before December 31, 2005 based on a Divisor of 26.5. This amount will be $36,359 [($1,000,000 - $36,496) ÷ 26.5].

2. Y is born July 1, 1933. Y will attain age 70 ½ on January 1, 2004. The RBD will be April 1, 2005. The Applicable Divisor will be 26.5 based on an attained age of 71. If the account balance was $1,000,000 on December 31, 2003 (not 2002), the RMD would be $37,736 ($1,000,000 ÷ 26.5). A second distribution will be required on or before December 31, 2005 based on an Applicable Divisor of 25.6. This amount will be $37,588 [($1,000,000 - $37,736) ÷ 25.6].

Planning Note: The benefit used in determining the RMD for a distribution year is the account balance as of the last valuation date in the calendar year immediately preceding that calendar year, less amounts that may not have been distributed but were required to be distributed. Regs. 1.401(a)(9)-5, A-3(a) and (b). The calendar year for which a minimum distribution is required is a distribution calendar year. Regs. 1.401(a)(9)-5, A-1(b). If an employer's RBD is April 1 of the calendar year following the calendar year the employee attained age 70 ½, the employee's first distribution year is the year the employee attains age 70 ½.

G. Determination of designated beneficiary. The timing of the determination of the designated beneficiary has changed under the new regulations

Old Rule: The designated beneficiary must be determined as of the required beginning date or, if earlier, as of the employee's death.

New Rule: The designated beneficiary must be determined as of the "applicable date." The "applicable date" is September 30 of the year following the calendar year of the employee's death. Any person who was a beneficiary as of the date of the employee's death, but is not a beneficiary as of the applicable date, because the person disclaims or dies prior to the applicable date, is not taken into account in determining the employee's designated beneficiary. Clear and unambiguous beneficiary designations are absolutely critical. Regs. 1.401(a)(9)-4, A-4(a).

Planning Note: The applicable date rule does not affect the identity of the beneficiary entitled to the benefit, it only affects the identity of the person whose life is a measuring period for purposes of RMDs.

H. No designated beneficiary by September 30

(a) If the employee dies, before the required beginning date, distributions of plan benefits must be made to the estate under the 5-year rule. This means that all plan benefits must be distributed no later than the last day of the fifth year containing the anniversary of the employee's death. No minimum distributions are required.

(b) If the employee dies after the required beginning date, distributions can continue over the deceased employee's remaining life expectancy. The deceased employee's remaining life expectancy is determined using the Single Life Table and the employee's age in the calendar year of the employee's death. In subsequent years, the applicable distribution period is reduced by one for each calendar year that has elapsed since the calendar year of the death.

Planning Note: The distribution period is likely to be longer for death after the RBD than for death prior to the RBD if there is no designated beneficiary.

I. Naming a trust as beneficiary

The Final Regulations allow an underlying beneficiary of a trust to be an employee's designated beneficiary for purposes of determining RMDs when the trust is named as the beneficiary of a retirement plan, provided that certain requirements are met. One of these requirements is that documentation of the underlying beneficiaries of the trust must be provided in a timely manner to the plan administrator. The deadline under these proposed regulations for providing the beneficiary documentation is October 31 of the year following the year of the employee's death. If one of the trust's beneficiaries is a charity (or estate) the trust will have no Designated Beneficiary.

V. Trusts as Beneficiaries

A. General Rules: If a trust meets the following rules, benefits can be "stretched" beyond the five year default rule.

1. Trust must be valid under state law. Regs. 1.401(a)(9)-4; Q&A 5(b)(1)

2. Trust is irrevocable upon death of owner. Regs. 1.401(a)(9)-4; Q&A 5(b)(2)

3. Beneficiaries of the trust are identifiable from trust instrument. Regs. 1.401(a)(9)-4; Q&A 5(b)(3)

4. Documentation requirement is satisfied. Regs. 1.401(a)(9)-4; Q&A 5(b)(4)

5. Designated Beneficiaries "DB" are individuals*

If the trust meets the above requirements, then the trustee is allowed to "look through" the trust to the underlying beneficiaries and use their life expectancies.

<u>Planning Note</u>: A trust executed under a Will is valid under state law. Regs. 1.401(a)(9)-4; Q&A 5(b)(1)

<u>Planning Note</u>:

1. **IRA owner or Trustee or beneficiary must provide IRA Trustee or custodian with: a copy of the Trust by October 31 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 Regs 1.401(a)(9)-4; Q&A 5(b)(4)**

<u>Planning Note</u>:

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 <u>September 30th</u> 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.**

i. <u>How to determine the RMD if a trust is named as a beneficiary</u>

A. General Rule: Use the life expectancy of the oldest beneficiary as of the end of the distribution year using the single life table and then subtract 1 for each subsequent year. Regs 1.401(a)(9)-5-A-4(a).(6); A-5(c)

- Exception: create of subtrusts as separate accounts

1. If you create subtrusts for each beneficiary, then you are 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.

3. Is it not sufficient to have the Trust provide that separate sub-accounts will be created for each child upon Grantor's death PLR 200750019 and 200317041.

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

Example: Decedent died in 1999 before reaching 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 shares. Each share constituted 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). In such a case, you must use the age of the oldest beneficiary to determine the RMD.

4. To create separate accounts/subtrusts, you must do so on the beneficiary designation or the plan documents during the IRA owner's lifetime.

<u>Planning Note</u>: Create separate trusts for each child and name each trust as a % beneficiary of the IRA. See PLR 200537044

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.

<u>Planning Note</u>: Separate accounts need to be established by the end of the calendar year following the participant's death and, 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).

B. September 30 of year following participant's death – General Rules:

1. Designated beneficiary must be an individual. To determine the designated beneficiary of the Trust you must "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).

C. Mere potential successor "beneficiaries" are disregarded.

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."

D. Conduit v. Accumulation Trusts

1. Conduit Trust

a. Trust REQUIRES that the trustee pay ALL amounts received from the plan to the beneficiary.

<u>Planning Note</u>:
(1) not just the RMD must be paid
(2) no asset protection

b. In such a case, the IRS considers the conduit trust beneficiary the sole beneficiary disregarding all potential successor beneficiaries.

Example Conduit Trust:

.01 As to any distributions from an individual retirement account, qualified retirement plan or annuity contract or custodial account described in Section 403(b) of the Internal Revenue Code, of which this trust is a beneficiary, such

amount withdrawn shall immediately, or within a reasonable amount of time after withdrawal from the plan, be distributed to a then living beneficiary not withstanding any provision contained herein to the contrary. Further, the Trustee is directed to withdraw from the plan such amounts as is necessary to meet the required minimum distribution amounts as set forth in any applicable Internal Revenue Code provision or supporting regulation. This is intended to be a conduit trust.

<u>Planning Note</u>: In most cases, the purpose of placing the IRA in trust is to avoid having to pay the distribution out directly to the beneficiaries and therefore a conduit trust may not be practical.

2. Accumulation Trust

    a. 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.

    b. 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.

    c. May not be eligible for minimum distributions but controversy .

3. Sample Private Letter Rulings

In PLR 201021038, even though state court reformed trust after Donor's death, IRS determined there was no designated beneficiary and thus the trust could not use the beneficiary's life expectancy.

- Surviving spouse named Bypass trust beneficiary of his IRA
- The bypass share beneficiary (surviving spouse) had lifetime LPOA
- The distribution provided for two shares to be paid outright and two shares to be held in trust, with income and principal payable for HEMS for such beneficiary and giving such beneficiary a lifetime and testamentary LPOA (including charities)
- The trust had been amended to add a section providing that any retirement plan payable to the trust should be stretched out to minimize income taxes
- On second death, bypass and other shares consolidated to be distributed under terms of trust
- Trustees of the bypass trust filed for declaratory judgment in state court to modify the trust to comply with IRS regulations & state court issued an order so modifying
- Modified trust provided for conduit trust (before modification, was accumulation trust)

- "Generally, the reformation of a trust instrument is not effective to change the tax consequences of a completed transaction" as the Tax Court has repeatedly refused to recognize state court reformation as retroactive for federal tax purposes.
- IRS generally only recognizes state order if for a reformation specifically allowed by IRC

PLR 200537044 - 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 third party as a "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.

PLR 200228025

As trust could accumulate IRA distributions (trustee's discretion to pay out), the contingent beneficiaries is considered in determining the beneficiary with the shortest life expectancy.

- Donor had four IRA accounts, named trust as beneficiary on all of them
- Primary beneficiaries of trust were Donor's two minor grandchildren, with shares held in trust for HEMS until age 30, then may withdraw entire share, and if either beneficiary predeceases final payment, that share goes to the other
- If both beneficiaries die before age 30, trust distributed to contingent beneficiaries (much older)
- Trust provides for last expenses and that IRA funds can't be used for such expenses, same for debts if enough non-IRA assets
- No issue of non-individual beneficiaries
- The trustee's discretion is a contingency beyond the death of a prior beneficiary and IRA distributions may be accumulated, so the contingent beneficiaries must be considered in determining the beneficiary with the shortest life expectancy

PLR 2007080884

- Decedent died before age 70½, survived by children and sister.

- Trust named beneficiary of IRA. Trust is valid under state law and became irrevocable on death.
- Trust distribution is specific bequests, then funds two subtrusts (one for each child), held in trust until each child attain 45, then distribute to said child. Both children were 45 or older at decedent's date of death. Other funds in the trust were enough to satisfy the bequests and estate taxes (and, in fact, did).
- IRA funds were used, in accordance with state law, to fund the subtrusts for the two children.
- Distributions intended to satisfy 401(a)(9) and 408(a)(6) have been made each year based on the older child's life expectancy.
- Determined trust is a qualified "see-through trust".
- As the trustee did not have the discretion to allocate IRA funds to anything other than the two subtrusts under state law, and the two children are the only beneficiaries under those two trusts, and further that distributions are to be made directly as both are over age 45 (meaning no accumulation is possible), the two children are the designated beneficiaries and the shorter life span of them will be used.

4. 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.

5. Post Mortem Planning for Defective Beneficiary Designation:

    a. Disclaimer - must meet the requirements of IRC § 2518 for a qualified disclaimer.

6. SEC. 2518. DISCLAIMERS.

[Sec. 2518(a)]

(a) General rule – For purposes of this subtitle, if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been transferred to such person.

[Sec. 2518(b)]

(b) Qualified disclaimer defined – For purposes of subsection (a), the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if –

(1) such refusal is in writing,
(2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of –
    (A) the date on which the transfer creating the interest in such person is made, or
    (B) the day on which such person attains age 21,
(3) such person has not accepted the interest or any of its benefits, and
(4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either –
    (A) to the spouse of the decedent, or
    (B) to a person other than the person making the disclaimer.

7. Cash out problem beneficiary 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 church's share without assets. If this is done before September 30th, then the charity is not counted as a designated beneficiary.

VI. Fiduciary Income Tax Consequences

A. Estate and Non-Grantor Trust Ordinary Income Tax Rates - 2015

2001 Bush-Era Tax Cuts	**American Taxpayer Relief Act of 2012**
15%	15%
25%	25%
28%	28%
33%	33%
35%	39.6%

B. Estate and Non-Grantor Trust Ordinary Income Tax Rates & Brackets - 2015

$0 - $2,500	15%
$2,501 - $5,900	25%
$5,901 - $9,050	28%
$9,051 - $12,300	33%
$12,301 and above	39.6%

C. Individual Ordinary Income Tax Brackets – 2015

- ○ Single Taxpayer 39.6% on Taxable Income over $413,200
- ○ Married Taxpayer Jointly 39.6% on Taxable Income over $464,850

D. New 3.8% Tax on Net Investment Income

A 3.8% tax applicable to the lessor of (1) the taxpayer's net investment income, or (2) modified adjusted gross income in excess of certain threshold amounts ($200,000 if single taxpayer and $250,000 for married filing jointly, but $12,300 for estates and non-grantor trusts for 2015).

(1) What is included in Net Investment Income?

- ● interest
- ● dividends
- ● capital gains
- ● rents
- ● royalties
- ● gain on sale of personal residence
- ● income from passive activities

(2) What is not included in Net Investment Income?

- ● wages
- ● unemployment compensation
- ● social security
- ● alimony
- ● tax-exempt interest
- ● self employment income
- ● IRA distributions

E. Trust Accounting Income and IRA Distributions

a) Example:

Trust provides that all income is made payable to the surviving spouse. Principal is payable to the spouse in the trustee's sole and absolute discretion. Trust is the beneficiary of a $1,000,000 IRA. Surviving spouse is age 65 and the trust is eligible for minimum distributions by taking into account the life of the surviving spouse. The surviving spouse has a 20 year life expectancy so that the distribution is $50,000.

How much of this amount is trust income and needs to be paid to the surviving spouse and how much is principal, if any?

b) Section 18 of the Uniform Principal and Income Act provides the following:

> (1) If a payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment.
>
> (2) If no part of a payment is characterized as interest, a dividend or an equivalent payment, and all or part of the payment is required to be made, a trustee shall allocate to income 10 per cent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not required to be made if it is made because the trustee exercises a right of withdrawal.

c) How is the 90% taxed: In an Office of Chief Counsel Memorandum Number 200644016, Release Date 11/3/2006, the Internal Revenue Service addressed the problem of so-called Income in Respect of a Decedent (IRD) such as an IRA distribution which is included in taxable income but allocated to corpus under state law when it actually is distributed to a beneficiary. The issue as framed by the IRS was as follows:

<u>ISSUE</u>

Are items of ordinary income in respect of a decedent (IRD) within the meaning of § 691 received by an estate and which are properly included in the estate's gross income included in the estate's distributable net income (DNI) under § 643(a) and used to determine the estate's income distribution deduction under § 661?

<u>CONCLUSION</u>

In general, ordinary IRD items received by an estate which are properly included in the estate's gross income are included in DNI and used to determine the income distribution deduction.

FACTS

The facts submitted to our office indicate that a number of estates and trusts are under examination with a similar set of relevant facts. Because we have been informed that most of the pending cases involve estates, we will refer only to estates in this memorandum, but the same analysis applies to trusts. The estate has received an item of ordinary IRD which is properly included in its gross income (although allocated to corpus under applicable state law) and makes a distribution of cash to beneficiaries in the same taxable year (or, if the relevant election has been made, within the sixty-five day period described in § 663(b)). Common examples of such ordinary IRD items would include amounts received from individual retirement accounts (IRAs) and qualified or non-qualified deferred compensation plans. The estate completes its Form 1041, U.S. Income Tax Return for Estates & Trusts, including the IRD received in its DNI and claiming an income distribution deduction based on that inclusion.

LAW AND ANALYSIS

Section 643(a) generally defines the term "DNI" as the taxable income of the estate computed with certain modifications.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of an estate, for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the DNI of the estate.

Section 691(a)(1) provides that the amount of all items of gross IRD which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a) causes items of IRD received by an estate to enter into its gross income, and thus its taxable income, unless removed by some other provision.

DNI under § 643(a) is defined as taxable income with certain modifications, none of which are relevant under the facts described above. Therefore, under the circumstances described above, DNI will generally include the IRD items received if those items were properly included in the gross income of the trust. The income distribution deduction of the estate under § 661(a) will be limited by the DNI so calculated. The beneficiary who receives a distribution from the estate will include the IRD received in that beneficiary's gross income subject to the rules of § 662.

VII. Minimum Distributions and the QTIP Marital Deduction

a. IRC § 2056(b)(7)

Election with respect to life estate for surviving spouse –

(A) In general – In the case of qualified terminable interest property –
  (i) for purposes of subsection (a), such property shall be treated as passing to the surviving spouse, and
  (ii) for purposes of paragraph (1)(A), no part of such property shall be treated as passing to any person other than the surviving spouse.

(B) Qualified terminable interest property defined – For purposes of this paragraph –
  (i) In general – The term "qualified terminable interest property" means property –
    I. which passes from the decedent,
    II. in which the surviving spouse has a qualifying income interest for life, and
    III. to which an election under this paragraph applies.
  (ii) Qualifying income interest for life – The surviving spouse has a qualifying income interest for life if –
    I. the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and
    II. no person has a power to appoint any part of the property to any person other than the surviving spouse.

  Subclause (II) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

  (iii) Property includes interest therein – The term "property" includes an interest in property.

  (iv) Specific portion treated as separate property – A specific portion of property shall be treated as separate property.

b. Rev. Rul. 2006-26

ISSUE

If a marital trust described in Situations 1, 2, or 3 is the named beneficiary of a decedent's individual retirement account (IRA) or other qualified retirement plan described in section

4974(c) that is a defined contribution plan, under what circumstances is the surviving spouse considered to have a qualifying income interest for life in the IRA (or qualified retirement plan) and in the trust for purposes of an election to treat both the IRA and the trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code?

FACTS

A dies in 2004, at age 68, survived by spouse, B. Prior to death, A established an IRA described in § 408(a). A's will creates a testamentary marital trust (Trust) that is funded with assets in A's probate estate. As of A's death, Trust is irrevocable and is valid under applicable local law. Prior to death, A named Trust as the beneficiary of all amounts payable from the IRA after A's death. The IRA is properly included in A's gross estate for federal estate tax purposes. The IRA is currently invested in productive assets and B has the right (directly or through the trustee of Trust) to compel the investment of the IRA in assets productive of a reasonable income. The IRA document does not prohibit the withdrawal from the IRA of amounts in excess of the annual required minimum distribution amount under § 408(a)(6). The executor of A's estate elects under § 2056(b)(7) to treat both the IRA and Trust as QTIP.

Under Trust's terms, all income is payable annually to B for B's life, and no person has the power to appoint any part of the Trust principal to any person other than B during B's lifetime. B has the right to compel the trustee to invest the Trust principal in assets productive of a reasonable income. On B's death, the Trust principal is to be distributed to A's children, who are younger than B. Under the trust instrument, no person other than B and A's children has a beneficial interest in Trust (including any contingent beneficial interest). Further, as in Rev. Rul. 2000-2, 2000-1 C.B. 305, under Trust's terms, B has the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to all the income of the IRA for the year and to distribute that income to B. If B exercises this power, the trustee is obligated under Trust's terms to withdraw the greater of all of the income of the IRA or the annual required minimum distribution amount under § 408(a)(6), and distribute currently to B at least the income of the IRA. The Trust instrument provides that any excess of the required minimum distribution amount over the income of the IRA for that year is to be added to Trust's principal. If B does not exercise the power to compel a withdrawal from the IRA for a particular year, the trustee must withdraw from the IRA only the required minimum distribution amount under § 408(a)(6) for that year.

The trustee of Trust provides to the IRA trustee a copy of A's will (Trust's governing instrument) before October 31, 2005, in accordance with A-6(b) of § 1.401(a)(9)-4 of the Income Tax regulations. Because the requirements of A-4 and A-5 of § 1.401(a)(9)-4 of the Income Tax regulations are satisfied and there are no beneficiaries or potential beneficiaries that are not individuals, the beneficiaries of the trust may be treated as designated beneficiaries of the IRA. In accordance with § 408(a)(6) and the terms of the IRA instrument, the trustee of Trust elects to receive annual required minimum distributions using the exception to the five year rule in § 401(a)(9)(B)(iii) for distributions over a distribution period equal to a designated beneficiary's life expectancy. Because amounts may be accumulated in Trust for the benefit of A's children, B is not treated as the sole beneficiary and, thus, the special rule for a surviving spouse in § 401(a)(9)(B)(iv) is not applicable. Accordingly, the trustee of Trust elects to have the annual required minimum distributions from the IRA to Trust begin in 2005, the year immediately

following the year of A's death. The amount of the annual required minimum distribution from the IRA for each year is calculated by dividing the account balance of the IRA as of December 31 of the immediately preceding year by the remaining distribution period. Because B's life expectancy is the shortest of all of the potential beneficiaries of Trust's interest in the IRA (including remainder beneficiaries), the distribution period for purposes of § 401(a)(9)(B)(iii) is B's life expectancy, based on the Single Life Table in A-1 of § 1.401(a)(9)-9, using B's age as of B's birthday in 2005, reduced by one for each calendar year that elapses after 2005. On B's death, the required minimum distributions with respect to any undistributed balance of the IRA will continue to be calculated in the same manner and be distributed to Trust over the remaining distribution period.

Situation 1—Authorized Adjustments Between Income and Principal. The facts and the terms of Trust are as described above. Trust is governed by the laws of State X. State X has adopted a version of the Uniform Principal and Income Act (UPIA) including a provision similar to section 104(a) of the UPIA providing that, in certain circumstances, the trustee is authorized to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries. More specifically, State X has adopted a provision providing that adjustments between income and principal may be made, as under section 104(a) of the UPIA, when trust assets are invested under State X's prudent investor standard, the amount to be distributed to a beneficiary is described by reference to the trust's income, and the trust cannot be administered impartially after applying State X's statutory rules regarding the allocation of receipts and disbursements to income and principal. In addition, State X's statute incorporates a provision similar to section 409(c) of the UPIA providing that, when a payment is made from an IRA to a trust: (i) if no part of the payment is characterized as interest, a dividend, or an equivalent payment, and all or part of the payment is required to be distributed currently to the beneficiary, the trustee must allocate 10 percent of the required payment to income and the balance to principal; and (ii) if no part of the payment made is required to be distributed from the trust or if the payment received by the trust is the entire amount to which the trustee is contractually entitled, the trustee must allocate the entire payment to principal. State X's statute further provides that, similar to section 409(d) of the UPIA, if in order to obtain an estate tax marital deduction for a trust a trustee must allocate more of a payment to income, the trustee is required to allocate to income the additional amount necessary to obtain the marital deduction.

For each calendar year, the trustee determines the total return of the assets held directly in Trust, exclusive of the IRA, and then determines the respective portion of the total return that is to be allocated to principal and to income under State X's version of section 104(a) of the UPIA in a manner that fulfills the trustee's duty of impartiality between the income and remainder beneficiaries. The amount allocated to income is distributed to B as income beneficiary of Trust, in accordance with the terms of the Trust instrument. Similarly, for each calendar year the trustee of Trust determines the total return of the assets held in the IRA and then determines the respective portion of the total return that would be allocated to principal and to income under State X's version of section 104(a) of the UPIA in a manner that fulfills a fiduciary's duty of impartiality. This allocation is made without regard to, and independent of, the trustee's determination with respect to Trust income and principal. If B exercises the withdrawal power, Trustee withdraws from the IRA the amount allocated to income (or the required minimum distribution amount under § 408(a)(6), if greater), and distributes to B the amount allocated to income of the IRA.

Situation 2—Unitrust Income Determination. The facts, and the terms of Trust, are as described above. Trust is governed by the laws of State Y. Under State Y law, if the trust instrument specifically provides or the interested parties consent, the income of the trust means a unitrust amount of 4 percent of the fair market value of the trust assets valued annually. In accordance with procedures prescribed by the State Y statute, all interested parties authorize the trustee to administer Trust and to determine withdrawals from the IRA in accordance with this provision. The trustee determines an amount equal to 4 percent of the fair market value of the IRA assets and an amount equal to 4 percent of the fair market value of Trust's assets, exclusive of the IRA, as of the appropriate valuation date. In accordance with the terms of Trust, trustee distributes the amount equal to 4 percent of the Trust assets, exclusive of the IRA, to B, annually. In addition, if B exercises the withdrawal power, Trustee withdraws from the IRA the greater of the required minimum distribution amount under § 408(a)(6) or the amount equal to 4 percent of the value of the IRA assets, and distributes to B at least the amount equal to 4 percent of the value of the IRA assets.

Situation 3—"Traditional" Definition of Income. The facts, and the terms of Trust, are as described above. Trust is governed by the laws of State Z. State Z has not enacted the UPIA, and therefore does not have provisions comparable to sections 104(a) and 409(c) and (d) of the UPIA. Thus, in determining the amount of IRA income B can compel the trustee to withdraw from the IRA, the trustee applies the law of State Z regarding the allocation of receipts and disbursements to income and principal, with no power to allocate between income and principal. As in Situations 1 and 2, the income of Trust is determined without regard to the IRA, and the income of the IRA is separately determined based on the assets of the IRA.

LAW AND ANALYSIS

Section 2056(a) provides that the value of the taxable estate is, except as limited by § 2056(b), determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes from the decedent to the surviving spouse, to the extent that interest is included in the value of decedent's gross estate.

Under § 2056(b)(1), if an interest passing to the surviving spouse will terminate or fail, no deduction is allowed with respect to the interest if an interest in the property passes or has passed from the decedent to any person other than the surviving spouse (or the estate of the spouse), that may be possessed or enjoyed by such other person after termination of the spouse's interest.

Section 2056(b)(7) provides that QTIP, for purposes of § 2056(a), is treated as passing to the surviving spouse and no part of the property is treated as passing to any person other than the surviving spouse. Section 2056(b)(7)(B)(i) defines QTIP as property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7) applies. Under § 2056(b)(7)(B)(ii), the surviving spouse has a qualifying income interest for life if, inter alia, the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals.

Section 20.2056(b)-7(d)(2) provides that the principles of § 20.2056(b)-5(f), relating to whether the spouse is entitled for life to all of the income from the property, apply in determining whether

the surviving spouse is entitled for life to all of the income from the property for purposes of § 2056(b)(7).

Section 20.2056(b)-5(f)(1) provides that, if an interest is transferred in trust, the surviving spouse is entitled for life to all of the income from the entire interest if the effect of the trust is to give the surviving spouse substantially that degree of beneficial enjoyment of the trust property during the surviving spouse's life that the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. In addition, the surviving spouse is entitled for life to all of the income from the property if the spouse is entitled to income as determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of § 1.643(b)-1.

Section 20.2056(b)-5(f)(8) provides that the terms "entitled for life" and "payable annually or at more frequent intervals" require that under the terms of the trust the income referred to must be currently (at least annually) distributable to the spouse or that the spouse must have such command over the income that it is virtually the spouse's. Thus, the surviving spouse will be entitled for life to all of the income from the trust, payable annually, if, under the terms of the trust instrument, the spouse has the right exercisable annually (or at more frequent intervals) to require distribution to the spouse of the trust income and, to the extent that right is not exercised, the trust income is to be accumulated and added to principal.

Generally, § 1.643(b)-1 provides that, for purposes of various provisions of the Code relating to the income taxation of estates and trusts, the term "income" means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Under § 1.643(b)-1, trust provisions that depart fundamentally from traditional principles of income and principal generally will not be recognized. Under these traditional principles, items such as dividends, interest, and rents are generally allocated to income and proceeds from the sale or exchange of trust assets are generally allocated to principal.

However, under § 1.643(b)-1, the allocation of an amount between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3 percent and no more than 5 percent of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust. Similarly, under § 1.643(b)-1, a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust.

Rev. Rul. 2000-2, 2000-1 C.B. 305, concludes that a surviving spouse has a qualifying income interest for life under § 2056(b)(7)(B)(ii) in an IRA and in a marital trust named as the beneficiary of that IRA if the spouse has the power, exercisable annually, to compel the trustee to withdraw the income earned on the IRA assets and to distribute that income (along with the income earned on the trust assets other than the IRA) to the spouse. Therefore, assuming all other

requirements of § 2056(b)(7) are satisfied, and provided the executor makes the election for both the IRA and the trust, the IRA and the trust will qualify for the marital deduction under § 2056(b)(7). The revenue ruling also concludes that the result would be the same if the terms of the trust require the trustee to withdraw an amount equal to the income earned on the IRA assets and to distribute that amount (along with the income earned on the trust assets other than the IRA) to the spouse.

In Situation 1, under section 104(a) of the UPIA as enacted by State X, the trustee of Trust allocates the total return of the assets held directly in Trust (i.e., assets other than those held in the IRA) between income and principal in a manner that fulfills the trustee's duty of impartiality between the income and remainder beneficiaries. The trustee of Trust makes a similar allocation with respect to the IRA. The allocation of the total return of the IRA and the total return of Trust in this manner constitutes a reasonable apportionment of the total return of the IRA and Trust between the income and remainder beneficiaries under § 20.2056(b)-5(f)(1) and §1.643(b)-1. Under the terms of Trust, the income of the IRA so determined is subject to B's withdrawal power, and the income of Trust, so determined, is payable to B annually. Accordingly, the IRA and Trust meet the requirements of § 20.2056(b)(7)(B)(ii) and therefore B has a qualifying income interest for life in both the IRA and Trust because B has the power to unilaterally access all of the IRA income, and the income of Trust is payable to B annually.

Depending upon the terms of Trust, the impact of State X's version of sections 409(c) and (d) of the UPIA may have to be considered. State X's version of section 409(c) of the UPIA provides in effect that a required minimum distribution from the IRA under Code section 408(a)(6) is to be allocated 10 percent to income and 90 percent to principal. This 10 percent allocation to income, standing alone, does not satisfy the requirements of §§ 20.2056(b)-5(f)(1) and 1.643(b)-1, because the amount of the required minimum distribution is not based on the total return of the IRA (and therefore the amount allocated to income does not reflect a reasonable apportionment of the total return between the income and remainder beneficiaries). The 10 percent allocation to income also does not represent the income of the IRA under applicable state law without regard to a power to adjust between principal and income. State X's version of section 409(d) of the UPIA, requiring an additional allocation to income if necessary to qualify for the marital deduction, may not qualify the arrangement under § 2056. Cf. Rev. Rul. 75-440, 1975-2 C.B. 372, using a savings clause to determine testator's intent in a situation where the will is ambiguous, but citing Rev. Rul. 65-144, 1965-1 C.B. 422, for the position that savings clauses are ineffective to reform an instrument for federal transfer tax purposes.

Based on the facts in Situation 1, if B exercises the withdrawal power, the trustee is obligated under Trust's terms to withdraw the greater of all of the income of the IRA or the annual required minimum distribution amount under § 408(a)(6), and to distribute at least the income of the IRA to B. Thus, in this case, State X's version of section 409(c) or (d) of UPIA would only operate to determine the portion of the required minimum distribution amount that is allocated to Trust income, and (because Trust income is determined without regard to the IRA or distributions from the IRA) would not affect the determination of the amount distributable to B. Accordingly, in Situation 1, the requirements of § 2056(b)(7)(B)(ii) are satisfied. However, if the terms of a trust do not require the distribution to B of at least the income of the IRA in the event that B exercises the right to direct the withdrawal from the IRA, then the requirements of §

2056(b)(7)(B)(ii) may not be satisfied unless the Trust's terms provide that State X's version of section 409(c) of the UPIA is not to apply.

In Situation 2, the trustee determines the income of Trust (excluding the IRA) and the income of the IRA under a statutory unitrust regime pursuant to which "income" is defined as a unitrust amount of 4 percent of the fair market value of the assets determined annually. The determination of what constitutes Trust income and the income of the IRA in this manner satisfies the requirements of § 20.2056(b)-5(f)(1) and § 1.643(b)-1. The Trustee distributes the income of Trust, determined in this manner, to B annually, and B has the power to compel the trustee annually to withdraw and distribute to B the income of the IRA, determined in this manner. Accordingly, in Situation 2, because B has the power to unilaterally access all income of the IRA, and the income of Trust is payable to B annually, the IRA and Trust meet the requirements of § 20.2056(b)(7)(B)(ii). The result would be the same if State Y had enacted both the statutory unitrust regime and a version of section 104(a) of the UPIA and the income of Trust is determined under section 104(a) of the UPIA as enacted by State Y, and the income of the IRA is determined under the statutory unitrust regime (or vice versa). Under these circumstances, Trust income and IRA income are each determined under state statutory provisions applicable to Trust that satisfy the requirements of § 20.2056(b)-5(f)(1) and § 1.643(b)-1, and therefore B has a qualifying income interest for life in both the IRA and Trust.

In Situation 3, B has the power to compel the trustee to withdraw the income of the IRA as determined under the law (whether common or statutory) of a jurisdiction that has not enacted section 104(a) of UPIA. Under the terms of Trust, if B exercises this power, the trustee must withdraw the greater of the required minimum distribution amount or the income of the IRA, and at least the income of the IRA must be distributed to B. Accordingly, in Situation 3, the IRA and Trust meet the requirements of § 2056(b)(7)(B)(ii), and therefore B has a qualifying income interest for life in both the IRA and Trust, because B receives the income of Trust (excluding the IRA) at least annually and B has the power to unilaterally access all of the IRA income determined in accordance with § 20.2056(b)-5(f)(1). The result would be the same if State Z had enacted section 104(a) of the UPIA, but the trustee decided to make no adjustments pursuant to that provision.

In Situations 1, 2, and 3, the income of the IRA and the income of Trust (excluding the IRA) are determined separately and without taking into account that the IRA distribution is made to Trust. In order to avoid any duplication in determining the total income to be paid to B, the portion of the IRA distribution to Trust that is allocated to trust income is disregarded in determining the amount of trust income that must be distributed to B under § 2056(b)(7).

The result in Situations 1, 2, and 3 would be the same if the terms of Trust directed the trustee annually to withdraw all of the income from the IRA and to distribute to B at least the income of the IRA (instead of granting B the power, exercisable annually, to compel the trustee to do so). Furthermore, if, instead of Trust being the named beneficiary of a decedent's interest in the IRA, Trust is the named beneficiary of a decedent's interest in some other qualified retirement plan described in section 4974(c) that is a defined contribution plan, the same principles would apply regarding whether B is considered to have a qualifying income interest for life in the qualified retirement plan.

HOLDING

If a marital trust is the named beneficiary of a decedent's IRA (or other qualified retirement plan described in section 4974(c) that is a defined contribution plan), the surviving spouse, under the circumstances described in Situations 1, 2, and 3 in this revenue ruling, will be considered to have a qualifying income interest for life in the IRA (or qualified retirement plan) and in the trust for purposes of an election to treat both the IRA (or qualified retirement plan) and the trust as QTIP under § 2056(b)(7). If the marital deduction is sought, the QTIP election must be made for both the IRA and the trust.

Taxpayers should be aware, however, that in situations such as those described in this revenue ruling in which a portion of any distribution from the IRA to Trust may be held in Trust for future distribution rather than being distributed to B currently, B is not the sole designated beneficiary of A's IRA. As a result, both B and the remainder beneficiaries must be taken into account as designated beneficiaries in order to determine the shortest life expectancy and whether only individuals are designated beneficiaries. See A-7(c) of § 1.401(a)(9)-5.

PROSPECTIVE APPLICATION

Under the authority provided by § 7805, the principles illustrated in Situations 1 and 2 of this revenue ruling will not be applied adversely to taxpayers for taxable years beginning prior to May 30, 2006, in which the trust was administered pursuant to a state statute described in §§ 1.643(b)-1, 20.2056(b)-5(f)(1), and 20.2056(b)-7(d)(1) granting the trustee a power to adjust between income and principal or authorizing a unitrust payment in satisfaction of the income interest of the surviving spouse.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 2000-2, 2000-1 C.B. 305, is modified, and as modified, is superseded.

c. Sample Trust Language

Notwithstanding any provision herein to the contrary, if any interest in or rights with respect to any pension or profit sharing plan qualified under Internal Revenue Code §401(a), any individual retirement accounts, or any annuity contract or custodial account qualified under Internal Revenue Code §403(b) (collectively referred to as qualified plan benefits) are or become payable to any Marital Share of this trust which is eligible for a state or federal marital deduction in accordance with Internal Revenue Code §2056(b)(7), then in accordance with Revenue Ruling 2006-26, the Trustee shall elect to receive from the pension or profit sharing plan, individual retirement account, annuity contract or custodial account each year during the life of the Donor's surviving spouse the greater of (i) the annual income of the qualified plan plus an amount equal to any current expenses attributable to such qualified plan, or (ii) the minimum distribution amount as determined under §401(a)(9) of the Internal Revenue Code and the regulations thereunder. The Donor's spouse shall have the power to enforce this direction to the Trustee. All amounts distributed from such plan to the Trustee while the Donor's spouse is living must be paid directly to the surviving spouse upon receipt by the Trustee.

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: 200644020

Release Date: 11/3/2006

CC:PSI:B02:BRPoston
POSTU-159830-05

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 691.01-02, 642.03-02

date: December 15, 2005

to: Territory Director, Midwest Area
(Examination, PSP)

from: Branch Chief, Branch 2
(Passthroughs & Special Industries)

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subject:

This Chief Counsel Advice may not be used or cited as precedent.

LEGEND

Trust =

Decedent =

IRA =

Charity 1 =

Charity 2 =

Charity 3 =

Year 1 =

D1 =

x =

y =

z =

ISSUES

1. Did Trust have gross income under § 691(a)(2) on the assignment of a portion of Decedent's IRA to the Charities in satisfaction of a pecuniary legacy?
2. If Trust had gross income under § 691(a)(2), was it entitled to a deduction under § 642(c)(1) for the portion of Decedent's IRA assigned to the Charities?

CONCLUSIONS

1. Trust had gross income under § 691(a)(2) on the assignment of a portion of Decedent's IRA to the Charities.
2. Trust was not entitled to a deduction under § 642(c)(1) for the portion of Decedent's IRA assigned to the Charities.

FACTS

Decedent died on D1. At the time of Decedent's death, Decedent owned an individual retirement account (IRA), of which the designated beneficiary was Decedent's revocable trust (Trust).

Article I(B), section (1), of Trust provides that upon the death of Decedent, the sum of $100,000 shall be distributed "in cash or in kind" as follows: $x to Charity 1, $y to Charity 2, and $z to Charity 3 (collectively, the Charities).

Article I(B), sections (2), (3), and (4), provide that the residue of the Trust property shall be distributed to Decedent's children outright or in trust as provided therein.

Article II(A)(12) provides that the trustee shall possess the discretion and power to make distributions or divisions of principal in cash or in kind, or both, at fair market values current at a date of distribution fixed by the trustee, without any requirement that each item be distributed or divided ratably.

Trust completed the distribution of IRA in Year 1, by instructing the IRA custodian to divide IRA into shares, each titled in the name of a beneficiary under Trust. Thus, each of the Charities became the owner and beneficiary of an IRA equal in value, at the time of division, to the dollar amount it was entitled to under Trust.

LAW AND ANALYSIS

Section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent (IRD) which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a)(2) provides that if a right, described in § 691(a)(1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

Rev. Rul. 92-47, 1992-1 C.B. 198, holds that a distribution to the beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the decedent's death, less any nondeductible contributions, is IRD under § 691(a)(1) that is includable in the gross income of the beneficiary for the taxable year the distribution is received.

Section 642(c)(1) provides that in the case of an estate or trust (other than a trust meeting the specifications of subpart B of part I of subchapter J of chapter 1), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)).

The amount of the balance in IRA at Decedent's death, less any nondeductible contributions, is IRD under § 691(a)(1). If an estate or trust satisfies a pecuniary legacy with property, the payment is treated as a sale or exchange. See Kenan v.

Commissioner, 114 F.2d 217 (2d Cir.1940). Because Trust used IRA to satisfy its pecuniary legacies, Trust must treat the payments as sales or exchanges. Therefore, under § 691(a)(2), the payments are transfers of the rights to receive the IRD and Trust must include in its gross income the value of the portion of IRA which is IRD to the extent IRA was used to satisfy the pecuniary legacies.

The terms of Trust do not direct or require that the trustee pay the pecuniary legacies from Trust's gross income. Accordingly, the transfer of a portion of IRA in satisfaction of the pecuniary legacies does not entitle Trust to a deduction under § 642(c)(1).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This memorandum responds to a private letter ruling request from Trust, requesting various rulings regarding the rollover of IRA to the beneficiaries of Trust and the amendment of Trust to provide for a disabled child of Decedent. These rulings, involving issues under the jurisdiction of T:EP:RA, were granted in a letter dated November 30, 2005, which has not yet been publicly released. After we informed the taxpayer that this office was adverse to the taxpayer on the § 691 issue described above, the taxpayer withdrew that portion of their original ruling request. Because the adverse determination on this issue was not included in the letter issued by T:EP:RA, this memorandum is necessary to inform your office of our position on the transaction.

The taxpayer does not agree that the partial assignment of IRA to the Charities results in a sale or exchange of the IRD element of IRA (and thus gross income under § 691(a)(2), with no allowable § 642(c) deduction for the reasons described above). The taxpayer argues that this conclusion is preempted by the application of § 408(d)(1), which provides that "any amount paid or distributed out of an IRA shall be included in gross income by the payee or distributee." The taxpayer maintains that this rule, requiring actual payment or distribution, prevents the application of the Kenan priniciple and § 691(a)(2) to currently tax Trust since it has not received payments or distributions from IRA.

We disagree with this interpretation. We believe that under Kenan, Trust has received an immediate economic benefit by satisfying its pecuniary obligation to the Charities with property on which neither Trust nor Decedent have previously paid income tax which is a disposition for § 691(a)(2) purposes. We further believe that the language of § 408(d)(1) simply prevents the immediate taxation of IRA recipients on amounts in an IRA which are not currently payable under a theory of "constructive receipt." T:EP:RA, which has jurisdiction over § 408, does not object to our conclusion on this issue.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call of this office at if you have any further questions.

Joint Trusts Revolutionize Estate Planning for Retirement Assets & Estates Under $3,000,000 for Couples

Part I: The Challenge of Estate Planning for Estates Under $3,000,000 with Large Qualified Plans in an Era of Rising Estate

By Leo J. Cushing, Esq., CPA, LLM
Melissa S. Conover, Esq.

The federal government has implemented new estate tax exemptions currently set at $1,500,000 in 2004 and rising to $3,500,000 in 2009. For one year, in 2010, there will be no federal estate tax but, in 2011, the exemption will be brought back to $1,000,000.

There is now federal legislation pending that either will eliminate the federal estate tax entirely (not a likely scenario) or at least increase the exemption to $3,500,000 per person permanently (a more likely scenario).

Massachusetts has also been busy on the estate tax front by reinstating the death tax. For deaths occurring on or after January 1, 2003, Massachusetts has implemented a new estate tax system with its own set of exemptions, currently set at $850,000 and rising only to $1,000,000 in 2006.

Retirement-plan assets present a perplexing problem for estate-planners. While retirement plans can be made payable to a credit shelter trust, it is preferable that they be payable to the surviving spouse to minimize income taxes. Stock options, incentive stock options and restricted stock may or may not be permitted to be held by or payable to a trust, so must be made payable to the spouse. How, then, should the decedent's exemption be fully utilized? These are questions the estate planner must face every day in every case, regardless of the size of the couple's estate.

Another dilemma is how to make complex planning simple and cost effective in such an uncertain legislative world. Until now, this goal was almost impossible to obtain. Two new rulings from the Internal Revenue Service, however, will revolutionize estate planning for smaller estates and solve the problem of estate planning for retirement assets. Let's take a look at a couple of examples.

First, consider the case of the married couple with total assets of $2,000,000 consisting of their home worth $1,000,000 and cash and marketable securities worth $1,000,000. All of their assets are owned jointly. The usual estate plan would involve the establishment of two separate revocable trusts, one for each spouse. The assets would then be split equally so that $1,000,000 worth of assets would be owned by the husband's trust and $1,000,000 would be owned by the wife's trust. If, however, the husband dies first in 2004, his credit shelter trust would be funded with the assets in his trust equal to $1,000,000, resulting in an underutilization of his federal estate tax exemption amount, currently set at $1,500,000.

It clearly would be preferable to have the decedent's by-pass trust funded with the maximum amount of $1,500,000, regardless of which spouse dies first, thereby assuring that these assets will escape taxation in the future upon the death of the surviving spouse. This is particularly important in light of the fact that, should there be a death between now and 2010, the goal would be to have all of the assets allocated to the by-pass share to escape estate taxation upon the death of the survivor, remembering that the current increasing exemptions will sunset on December 31, 2010 and will return to $1,000,000.

Another challenging estate planning situation is presented when the couple has a large retirement account. The most favorable income tax solution would be to have the surviving spouse roll the decedent's IRA account balance into a spousal rollover, but this is inconsistent with good estate planning since the decedent's credit shelter amount will be unused. One widely used solution is to have the IRA account owner designate the surviving spouse as the primary beneficiary with the taxpayer's by-pass trust listed as the contingent beneficiary in the event the surviving spouse disclaims any portion or all of the retirement benefit. This technique allows the surviving spouse to take a second look to re-evaluate his or her situation following the death of the account owner, in order to obtain the best of all possible worlds. It is important that the nine-month limitation within which to file a disclaimer not be forgotten and all conflict of issue questions resolved when utilizing this approach.

The joint trust technique will assure full utilization of the applicable exclusion amount upon the death of the first spouse to die, regardless of which spouse dies first, and permit the most favorable income tax treatment attributable to retirement plan assets and other assets that do not lend themselves to funding a by-pass trust, such as restricted stock, stock options and incentive stock options.

Consider the case of a married couple with combined assets of $3,000,000, with $1,500,000 in the husband's IRA and $1,500,000 consisting of other jointly owned assets. As the federal exemption amounts increase, this amount will also increase so that it will equal two times the federal exemption amount.

In the typical estate plan, both the husband and wife would implement pourover wills and revocable trusts, and the joint assets would likely be transferred to the wife. The IRA, which cannot be transferred without income tax consequences, will be made payable to the surviving spouse with the husband's by-pass trust named as a contingent beneficiary in the event the surviving spouse disclaims the asset.

In a joint trust plan, the IRA would remain payable to the surviving spouse with the joint trust as the contingent beneficiary. The $1,500,000 in jointly owned assets would be transferred directly to the joint trust. In the event the husband dies first, his estate would be worth $3,000,000 with the $1,500,000 IRA flowing over to the surviving spouse eligible for the marital deduction and $1,500,000 allocated to the husband's by-pass trust. The surviving spouse would then be able to delay distributions until he or she attains age 70 and then take advantage of the new uniform life table stretching out the IRA benefits, to the extent permitted under the new IRA distribution Final Regulations.

Part II will be published in the Summer I issue of *SumNews*.

Joint Trusts Revolutionize Estate Planning for Retirement Assets & Estates Under $3 Million for Couples

Part II: Understanding the Operation of Joint Trusts in Planning Estates Under $3 Million and Estates with Large Qualified Plans in an Era of Rising Estate Tax Exemptions

By Leo J. Cushing, Esq., CPA, LLM
Melissa S. Conover, Esq.

Read the first part of this article online www.mscpaonline.org/resources/onlinereview.php?id=284

In Part I, the challenges involved in planning estates under $3 million (or that amount equal to two times the federal estate tax exemption amount) and those with large qualified plans were outlined and the benefit of utilizing joint trusts discussed. This Part II provides a detailed discussion of how the joint trust works to achieve a desirable result and overcome the challenges outlined in Part I.

Here is how the technique works. Both the husband and wife become donors as well as co-trustees of a single joint trust. In both cases, the couple's non-retirement assets will be contributed to the joint trust directly with the IRA remaining payable to the surviving spouse. Upon the first death of a spouse, the assets contributed by the deceased spouse are includible in the decedent's estate under IRC § 2038 by virtue of a power of revocation contained in the instrument. As to those assets which were contributed and/or become payable to the trust by the surviving donor's spouse, such assets would also be includible in the estate of the first spouse to die under IRC § 2041 by virtue of a testamentary general power of appointment given to the deceased spouse by the surviving spouse.

While joint trusts have been used for many years, particularly in jurisdictions governed by community property rules, there were, prior to the IRS Private Letter Rulings 200101021 and 200210051, several unanswered questions. Specifically, in a joint trust, when was the gift from the surviving donor's spouse to the deceased spouse complete and would it be complete for the marital deduction? Second, if, and to the extent assets contributed to the joint trust by the surviving donor, were allocated to the by-pass trust, would the assets in the by-pass trust be includible in the estate of the surviving spouse under IRC § 2036?

The IRS answered all of these questions favorably to the taxpayer. A closer look at the facts in the Private Letter Rulings 200101021 and 200210051 show the details of the technique. In PLR 200101021, the trust provided that Grantor A and Grantor B were husband and wife and proposed to create a joint trust. Grantor A was the initial trustee of the trust and the grantors proposed to fund the trust with assets that they owned as tenants by the entirety. During the joint lives of the grantors, the trustee was permitted to apply income and principal of the trust as the trustee deemed advisable for the

comfort, support, maintenance, health and general welfare of the grantors. The trustee also could pay additional sums to either or both of the grantors, or to a third party for the benefit of either or both grantors as Grantor A directed or, if not capable of making such a decision, then as Grantor B directed.

While both grantors were living, either grantor could terminate the trust by written notice to the other grantor and, if terminated, the trustee was directed to deliver the trust property to the grantors in both their names as tenants in common. Either grantor could amend the trust while both grantors were living by delivering the amendment in writing to the other grantor at least 90 days before the effective date of the amendment.

Upon the death of the first grantor to die, he or she possessed a testamentary general power of appointment exercisable alone and, in all events, to appoint part or all of the trust assets, including the assets contributed by the surviving spouse, free of trust to such deceased grantor's estate, or to or for the benefit of one or more entities in such proportions, outright, in trust, or otherwise, as the deceased grantor may direct in his or her will. In the event the first grantor to die fails to exercise his or her testamentary general power of appointment, and providing the surviving grantor survives the first grantor to die by at least six months, an amount of trust property sufficient to equal the largest amount that can pass free of federal estate taxes by way of the unified credit, was to be transferred to the credit shelter trust with the excess of such amount needed to fund the credit shelter trust that has not been appointed, passing directly to the surviving grantor.

In PLR 200210051, the husband and wife established a joint trust and funded it with assets that they owned jointly. The trust was funded with the assets that the donors owned as joint tenants with rights of survivorship or other assets which they owned in their individual capacity. The trust could be altered or amended by either donor with the consent of the trustees while both husband and wife were living. The trust also provided that, during the joint lives of the husband and wife, the trust could be revoked by either of the donors in whole or in part and, upon revocation, the trustee must, if so directed, transfer and convey in accordance with the direction of the donors, any or all of the trust property then held. Upon the death of either the husband or the wife, the trust became irrevocable.

Upon the death of the first donor to die, the trust provided that an amount of the trust property equal to the maximum marital deduction allowable to the deceased spouse's gross estate, reduced by the amount necessary to create the largest taxable estate, which, after utilizing the unified credit, will result in no tax due, is to be transferred to a marital trust. During the life of the surviving spouse, the trustee is directed to pay the net income to the surviving spouse at least quarter annual in such amounts of principal as the surviving spouse may direct. Upon the death of the surviving spouse, the trustee shall pay over any remaining principal to such persons that the surviving spouse shall appoint by his or her last will.

As to the remaining trust assets, these were to be held in a family trust. The family trust provided that during the life of the surviving spouse, the trustee is to pay all the net income to the surviving spouse. The trustee may also pay so much of the principal allocated to the family trust to or for the benefit of the surviving spouse and the issue of both donors as the trustee shall deem advisable for their health, support, maintenance or education. Upon the death of the surviving spouse, the remaining income and principal in the family trust shall be distributed to the donor's living issue, per stirpes.

As to the trusteeship, the trust provided that the husband and wife would act as co-trustees during their joint lives fol-

lowed with the surviving spouse serving alone, and, upon the death of the surviving spouse, the living children of the donor jointly, or the survivor of such children, would serve as trustees. In drafting joint trusts, it is important to either include a disinterested trustee or to allow the spouse to name a disinterested trustee to make non-support distributions to the spouse of principal to take advantage of a step up in basis upon the death of the surviving spouse. Finally, if no trustees were then serving, a trustee would be elected by majority of the beneficiaries and additional or successor trustees may be appointed by the trustees then serving.

The questions presented in each of the rulings were essentially the same.

(1) At what point in time was there a "completed gift" of the assets in the joint trust from one spouse to the other?

(2) Will the value of the entire trust assets be includible in the gross estate of the first grantor to die?

(3) On the death of the first deceasing grantor, will the surviving grantor be treated as making a gift that qualifies for the marital deduction to the deceased grantor, with respect to the portion of the trust property that is attributable to the surviving grantor's contributions to the trust?

(4) To the extent that assets contributed by the original grantor are used to fund the credit shelter trust, will those assets be considered contributed by such grantor? and finally,

(5) Will payments from the credit shelter trust to beneficiaries, other than the surviving grantor, constitute a gift from the surviving grantor to those beneficiaries and will any of the assets in the credit shelter trust be includible in the estate of the surviving grantor?
In each ruling, the IRS ruled that the initial contribution of assets to the joint trust will not constitute a completed gift by either grantor under Regulation 25.2511-2(c), since each will retain the right, exercisable unilaterally, to revoke their respective transfer and re-vest title in themselves.

In both PLR 200210051 and 200101021, the IRS ruled that the surviving grantor will have made a completed gift to the deceased grantor on the death of the deceased grantor under IRC § 2501 and the gift will be eligible for the marital deduction under IRC § 2523. The IRS ruled that, upon the death of the first grantor to die, the trust property attributable to the deceased grantor transferred to the trust will be includible in the deceased grantor's gross estate under IRC § 2038 and the balance of the trust property to the property contributed by the surviving grantor will be includible in the deceased grantor's estate under IRC § 2041 by virtue of the power of appointment.
cont. on page 31

Joint Trusts Revolutionize Estate Planning

cont. from page 14

Finally, to the extent the credit shelter trust is funded, the property funding the credit shelter trust will be treated as passing to the trust from the deceased grantor and not from the surviving grantor so that the surviving grantor will not be deemed to have transferred property to a trust in which the surviving grantor is a beneficiary. As a result, the property allocated to the credit shelter trust will not be included in the estate of the surviving spouse under IRC § 2036.

It should be noted that the ruling sought advice as to whether all of the joint assets contributed by the couple would receive a step-up in basis under IRC § 1014(e). The IRS ruled unfavorably for the taxpayer in ruling that only those assets which were contributed by the decedent's spouse would be eligible for a step-up in basis relying upon IRC § 1014, which provides an exception to the general step-up rules of IRC § 1014(a).

Under IRC § 1014(e), if appreciated property was acquired by gift during the one year period ending on the date of the decedent's death, and the property is acquired from the decedent by, or passes from the decedent to, the donor of such property, the basis of such property in the hands of the donor is the adjusted basis of the property in the hands of the decedent immediately before the death of the decedent.

The ruling of the IRS in this regard is questionable. Since, in reality, the exception of IRC § 1014(e) should not apply to any property that was includible by virtue of the testamentary general power of appointment in which is paid over to the by-pass trust since this property did not "pass from the decedent to the donor" of such property.

This battle, however, can wait for another day since the question about the step-up in basis need not be resolved until the death of one of the spouses.

Leo J. Cushing is an attorney and a CPA practicing tax law with the Boston law firm of Cushing & Dolan, PC. Cushing concentrates on estate planning, closely-held corporations and tax litigation.

Understanding Interpretation 101-3 Independence and Nonattest Services

cont. from page 23

attest clients, such as valuations, appraisals, actuarial work and information systems design and implementation.

The revised Interpretation also incorporates an explicit requirement under Rule 101– *Independence,* that members must comply with more restrictive independence rules of other bodies - such as the state accountancy boards, the SEC, and the GAO - where applicable.

Previously, failures to comply with the independence requirements of these bodies had not been enforced under Rule 101, but rather were enforced under Rule 501 – *Acts Discreditable* of the Code.

Further Guidance and Clarification

The AICPA has dedicated an entire section of its Web site to providing background information and additional guidance on Interpretation 101-3. You can access this special section at:
www.aicpa.org/members/div/ethics/intr_101-3.htm

Uniform Lifetime Table For Determining Applicable Divisor *			
Age	**Applicable Divisor**	**Age**	**Applicable Divisor**
70	27.4	92	10.2
71	26.5	93	9.6
72	25.6	94	9.1
73	24.7	95	8.6
74	23.8	96	8.1
75	22.9	97	7.6
76	22.0	98	7.1
77	21.2	99	6.7
78	20.3	100	6.3
79	19.5	101	5.9
80	18.7	102	5.5
81	17.9	103	5.2
82	17.1	104	4.9
83	16.3	105	4.5
84	15.5	106	4.2
85	14.8	107	3.9
86	14.1	108	3.7
87	13.4	109	3.4
88	12.7	110	3.1
89	12.0	111	2.9
90	11.4	112	2.6
91	10.8	113	2.4
92	10.2	114	2.1
93	9.6	115 and older	1.9

*From Regs. § 1.401(a)(9)-9

SINGLE LIFE TABLE

One Life – Expected Return Multiples

Age	Life expectancy	Age	Life expectancy	Age	Life expectancy
5	*77.7*	42	*41.7*	79	*10.8*
6	*76.7*	43	*40.7*	80	*10.2*
7	*75.8*	44	*39.8*	81	*9.7*
8	*74.8*	45	*38.8*	82	*9.1*
9	*73.8*	46	*37.9*	83	*8.6*
10	*72.8*	47	*37.0*	84	*8.1*
11	*71.8*	48	*36.0*	85	*7.6*
12	*70.8*	49	*35.1*	86	*7.1*
13	*69.9*	50	*34.2*	87	*6.7*
14	*68.9*	51	*32.3*	88	*6.3*
15	*67.9*	52	*52.3*	89	*5.9*
16	*66.9*	53	*31.4*	90	*5.5*
17	*66.0*	54	*30.5*	91	*5.2*
18	*65.0*	55	*29.6*	92	*4.9*
19	*64.0*	56	*28.7*	93	*4.6*
20	*63.0*	57	*27.9*	94	*4.3*
21	*62.1*	58	*27.0*	95	*4.1*
22	*61.1*	59	*26.1*	96	*3.8*
23	*60.1*	60	*25.2*	97	*3.6*
24	*59.1*	61	*24.4*	98	*3.4*
25	*58.2*	62	*23.5*	99	*3.1*
26	*57.2*	63	*22.7*	100	*2.9*
27	*56.2*	64	*21.8*	101	*2.7*
28	*55.3*	65	*21.0*	102	*2.5*
29	*54.3*	66	*20.2*	103	*2.3*
30	*53.3*	67	*19.4*	104	*2.1*
31	*52.4*	68	*18.6*	105	*1.9*
32	*51.4*	69	*17.8*	106	*1.7*
33	*50.4*	70	*17.0*	107	*1.5*
34	*49.4*	71	*16.3*	108	*1.4*
35	*48.5*	72	*15.5*	109	*1.2*
36	*47.5*	73	*14.8*	110	*1.1*
37	*46.5*	74	*14.1*	111	*1.0 and older*
38	*45.6*	75	*13.4*		
39	*44.6*	76	*12.7*		
40	*43.6*	77	*12.1*		
41	*42.7*	78	*11.4*		

Massachusetts Association of Accountants

Trust Planning for Retirement Benefits... To Do or Not To Do!?!

Tuesday, May 17, 2016
9:00 AM - 12:30 PM

Prepared and Presented by

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EXAMPLE 1:

Decedent dies with a $1,000,000 IRA and $1,000,000 in other assets in his own name. The beneficiary of the IRA is the decedent's estate. The decedent had a Will leaving 100% of his assets to his surviving spouse, if living, otherwise to his children. The decedent is survived by spouse. Decedent was age 73. Spouse is age 72.

EXAMPLE 2:

Same facts as Example 1 except the beneficiary of the IRA is the decedent's revocable trust. The trust provides that all income is payable to spouse for life, at least annually. The independent trustee has the ability to pay principal to spouse in trustee's discretion. Upon spouse's death, the children are beneficiaries and the assets are to be paid outright. The decedent has used up his entire lifetime gift giving exemption.

EXAMPLE 3:

Same facts as Example 1 except that the decedent had a pourover Will to his trust and did not use up any of the decedent's estate tax exemption during life. The trust provides that it will be broken down into a marital share (a pecuniary marital) and a family share. The marital share will be funded with the amount necessary to eliminate federal estate taxes and the family share will be funded with the balance. The IRA is made payable to the decedent's trust. What are the consequences.

EXAMPLE 4:

Same facts as Example 3 except that the marital share is to be funded with a fraction, the numerator of which is the amount necessary to eliminate Massachusetts estate taxes and the denominator of which will be the decedent's adjusted gross estate. The balance will be allocated to the family share (this is a fractional).

EXAMPLE 5:

Decedent is single and has a $1,000,000 IRA. The IRA is payable to the decedent's two children, ages 35 and 30.

EXAMPLE 6:

Same facts as in Example 5 except this time the decedent has made the IRA payable to his revocable trust. The trust provides that upon death the trust will break down into two separate shares for the benefit of each child and the trust will pay over (assuming both children are at least age 30).

EXAMPLE 7:

Same facts as Example 5. Decedent is single and the IRA is payable to the decedent's trust. There are two children. The trust provides that income and principal from the trust will be paid to the class consisting of the decedent's issue of all generations. The trust will last for 90 years after the death of the decedent. In default of issue, the trust will be paid over to the decedent's University. There are two children and no grandchildren.

EXAMPLE 8:

Same facts as Example 5 except that the trust divides into shares, one share for the benefit of each child, and thereafter income and principal is payable to the child and such child's issue as the trustee deems advisable in the trustee's sole and absolute discretion. In default of issue from one share, the share will be paid over to the other share for the benefit of that child. In complete default of issue, the share will be paid over to the University.

EXAMPLE 9:

Decedent is single and leaves 50% of his IRA to his University and 50% in equal shares to his two living children.