IRA Beneficiary – Outright or to Trust?

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Background Information

- Mary Kay Foss is a CPA with over thirty years practical experience.
- Ms. Foss is a frequent lecturer for community, professional and business groups. She has authored and presented courses for tax professionals throughout California. She focusses on advising clients about retirement, income and estate planning issues.
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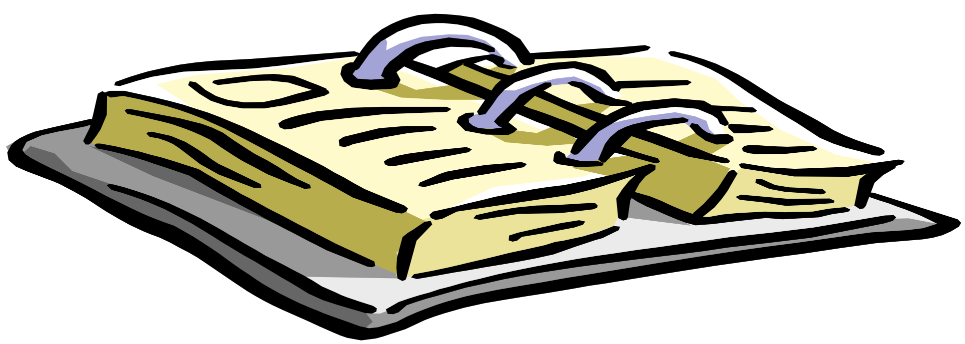
- Ms. Foss is a past chair of both the Estate Planning Committee and the Committee on Taxation of the California Society of Certified Public Accountants. She volunteers for AICPA (immediate past chair of AICPA Trust, Estate and Gift Tax Technical Resource Panel) and is the past president of the Estate Planning Council of Diablo Valley, the East Bay Chapter of the California CPA Society and the Estate Planning Council of the East Bay. She teaches **Retirement Distributions: Planning Options** and **Top 10 Things Financial Planners Need to Know About Estate Planning** for the California CPA Education Foundation and has been quoted in *California CPA Magazine* as well as national publications.

What is the significance of the Retirement Plan Beneficiary?

- During lifetime
  - The uniform distribution table is used for Required Minimum Distributions ("RMDs") during life.
  - When the sole beneficiary is ten years younger and the spouse of the owner, the joint and last survivor table is used.
- At death
  - The married participant's spouse is the beneficiary for most qualified plans unless another is named with the spouse's consent.
  - A designated beneficiary has a life expectancy. The life of the beneficiary with the shortest life expectancy is used.

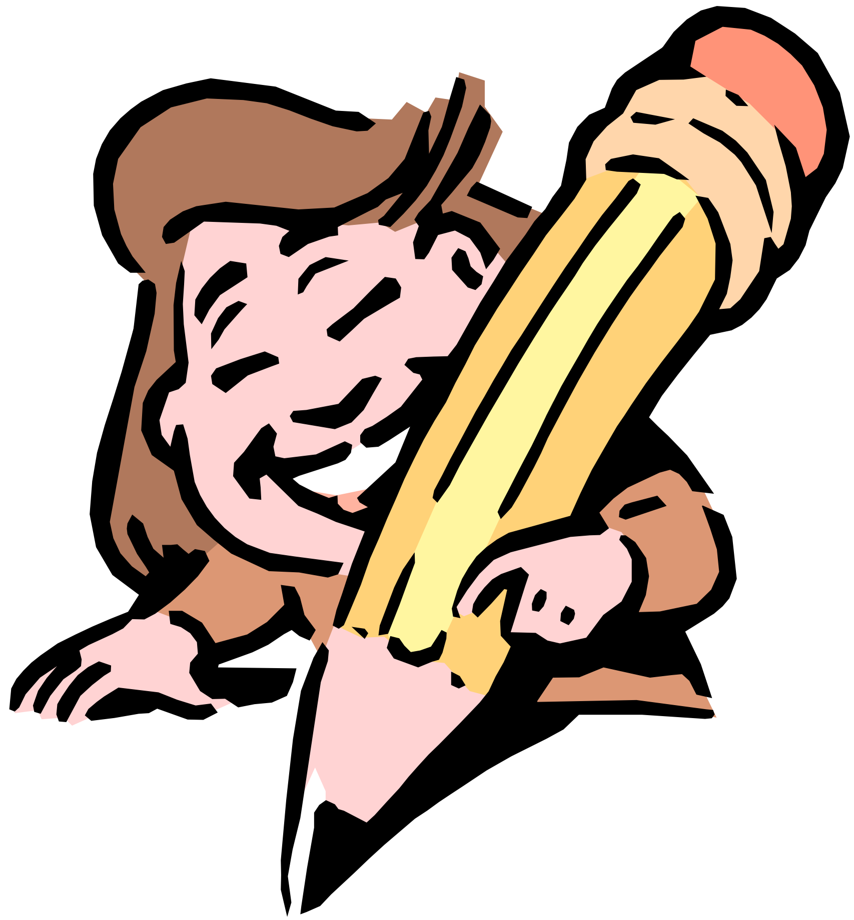
Required Minimum Distributions

- Begin on Required Beginning Date
- April 1 after individual attains age 70½
- If employed at age 70½ April 1 after retirement is Required Beginning Date for that employer's plan
- December 31 of year after death for beneficiaries

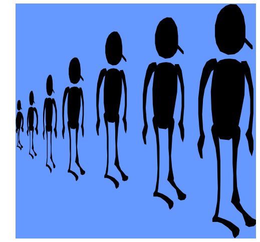


WHEN TO DESIGNATE A BENEFICIARY

- 1. When account is opened.
- 2. Life changing event.
- 3. When updating estate plan.

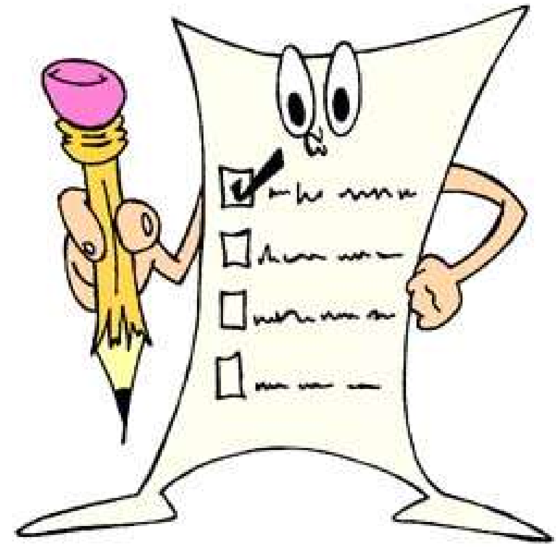


Primary vs. Contingent



- The contingent beneficiary is entitled to benefits contingent on an event other than the participant's death
- Naming a contingent beneficiary allows flexibility in planning for disclaimers or the incompetency of a plan participant
- If the primary beneficiary is alive when the original account owner dies and doesn't disclaim, the contingent beneficiary is no longer important.

Designated Beneficiary



- Not just the beneficiary named
- Must have a life expectancy
- Life expectancy is the default method for all retirement benefits with a designated beneficiary

Is a trust a "designated beneficiary?"

- Can you see through the trust to determine life expectancy?
  - Is the trust legal?
  - Are beneficiaries identifiable?
  - Is the trust irrevocable or will it be irrevocable?
  - Is documentation furnished on a timely basis?
- Is qualification as a designated beneficiary necessary?

What if no designated beneficiary?

- Limited payout options

- No nonspouse rollover
- Probate proceeding likely to be required
- How can executor be discharged?

Payouts with no designated beneficiary

- If the participant dies before the required beginning date:
  - Distributions follow the 5-Year Rule
  - Spousal rollover may be possible but far from automatic

- If the participant dies after the required beginning date:
  - Minimum distributions continue “at least as rapidly”
  - Distribution period based on participant’s age

At Least As Rapidly

- Phrase in the Internal Revenue Code
- It means follow the IRS Regulations
- A life expectancy is required to determine RMDs

How many trusts should be named?

- Final regulations indicate that RMDs are based upon the oldest beneficiary of a trust in existence at the death of the IRA owner or plan participant.
- To qualify as a “separate share” a trust must be in existence at death and the beneficiary form must include the formula for division of the separate shares.

Why name a trust?

- Control is the primary consideration
- IRA owners or plan participants want control over:
  - Timing of payments
  - Determining ultimate beneficiary
  - Payment of estate taxes
  - Non-pro rata distributions to beneficiaries

Spouse as Beneficiary

- Can use life expectancy
- Can roll over and name new beneficiaries
- Can defer start of payments until deceased spouse would be 70½

Qualifying Trust Requirements

1. Valid under State Law
2. Must be Irrevocable or become Irrevocable upon Death of Owner
3. Beneficiaries must be Identifiable
4. Trust Documentation Must be Provided

Conduit Trust

- LTR 200228025 provided that contingent beneficiary’s life expectancy be used because trust could accumulate income
- Ruling stated that a conduit trust would allow use of the actual beneficiaries lives
- RMD is distributed each year; additional withdrawals are also distributed. No trust accumulations.

Beneficiary bankruptcy?

- Inherited IRA benefits are not exempt in bankruptcy
- An interest in a trust is exempt in bankruptcy
- Risk is only to current required distributions

QTIP Trust

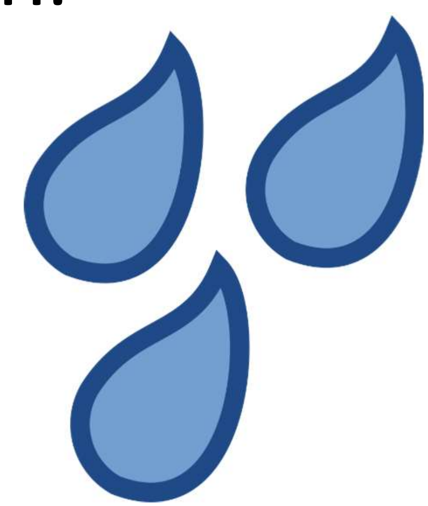
- QTIP trust allows decedent to control the identity of the ultimate beneficiary
- The IRA income or RMD whichever is greater is to be distributed to the survivor each year
- Rev. Rul. 2006-26 clarifies these requirements for income distributions in states with varying definitions of "trust income"
- The IRA as well as the trust make the QTIP election

Estate tax control

- An irrevocable trust can be used to pay estate taxes
  - Useful when IRA beneficiaries differ from beneficiaries of balance of estate
  - Timing is critical, estate tax must be paid by September 30 of year after the death
- Exemption or Bypass Trust funded by Retirement Benefits?
  - Not the best asset for a Bypass Trust because of high income taxes

Sprinkle power

- Allowing a trustee to allocate IRA distributions may allow grantor’s wishes to be followed.
- Useful when assets not sufficient to meet needs with a pro-rata distribution.



Income Tax Aspects

- IRA remains intact – funds transferred to a "beneficiary" account
- RMD transferred annually from the IRA to the trustee
- Trustee distributes what is required and accumulates the rest as directed by the trust agreement

How is the RMD taxed?

- If it constitutes trust accounting income, and income is distributed the RMD is part of the income distribution.
- What if the trust agreement is silent?
- What if state law changes the definition of income?
- What if taxable income is distributed instead of trust accounting income?

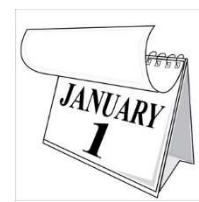
Trust termination

- The trust agreement controls the benefits even after the death of the primary beneficiary
- The IRA payout period does not change due to the death of the oldest trust beneficiary
- The trustee can assign trust beneficiaries a share of the IRA at death
- Trust beneficiaries continue to use the life expectancy of the oldest trust beneficiary

Any differences for qualified plan?

- Most qualified plans have no special provisions for beneficiaries other than a surviving spouse.

- Often the qualified plan will provide for a lump sum payment within 2 years of the death.



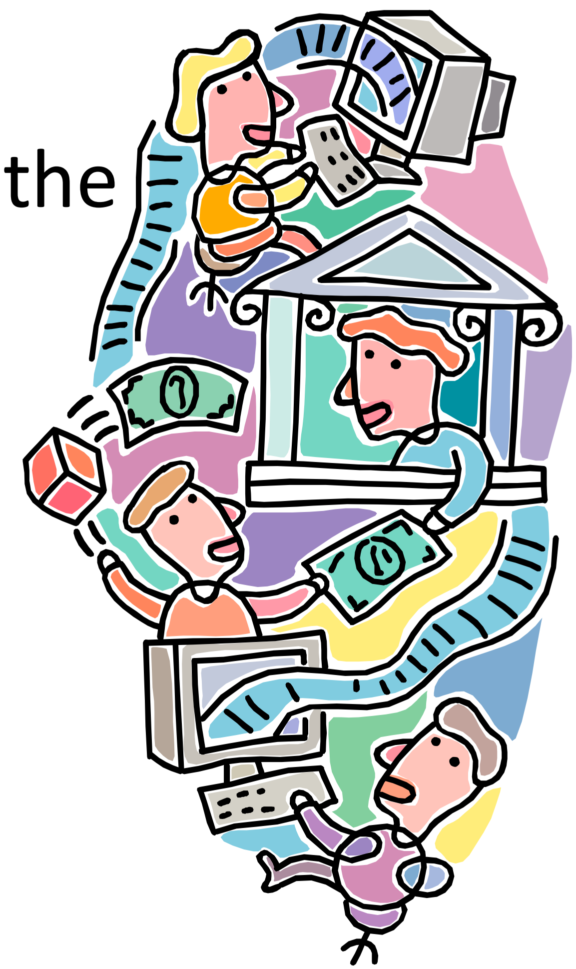
- Pension Protection Act (2006) allows a rollover to a nonspouse designated beneficiary

What about a spousal rollover?

- It may be possible for a spouse to roll over a benefit payable to a trust:
  - Spouse must be trustee and beneficiary
  - Custodian must agree
  - PLR may be required
- If a rollover is intended, the spouse should be named beneficiary, the trust can be contingent

How does the beneficiary proceed?

- Notify custodian – will need death certificate
- How do you know the identity of the beneficiary?
- Do custodians make mistakes?



What to do now

- Fill out NEW beneficiary forms
- Notify executor/trustee or beneficiary
- Be aware that beneficiaries can be changed at any time

Questions?