Estate Planning For Retirement Assets and Employee Benefits

One of the most challenging aspects of estate planning is posed by retirement assets and client's benefits as an employee. Very significant dollars can accumulate, on a tax-deferred basis, in 401(k) plans, profit sharing plans and individual retirement accounts. Because these dollars are not "in hand," many clients may not even realize how large their vested benefits have grown in these plans.

It is a mistake for advisors or clients to treat employee benefits as they would treat life insurance. Although a beneficiary is designated for both assets, plan benefits are substantially more complicated than are life insurance proceeds.

How Plan Benefits are Different

Benefits under these plans are unlike any other asset owned by your client. These assets have not yet been subject to income tax. Like any other asset in your client's gross estate, of course, these benefits will also be subject to federal estate taxation. Therefore, these assets may be subject to both income and estate taxation at your client's death.[1]

Most other assets included in your client's gross estate are acquired with after-tax income. Those assets are subject only to estate taxation at death. Employee benefits, on the other hand, usually have never been included in your client's taxable income. If plan benefits from accounts not previously subject to income tax are paid to a named beneficiary at your client's death, the beneficiary must report those dollars as taxable income while, at the same time, the executor of your client's estate must include those same benefits in the client's gross estate. This striking difference necessarily leads to special estate planning strategies.

Qualified Plans and IRA's

While you do not need to become an ERISA lawyer to coordinate your clients' employee benefits with their estate plans, some rules vary with the type of plan. Therefore, a brief understanding of some basic concepts is necessary.

A "qualified plan" is one which has received a determination letter from the I.R.S. that the plan is qualified under Code Section 401(a) and that employer contributions are tax-deductible under Code Section 404(a). There are two principal types of plans:

(1) A "defined contribution plan" is one in which the employer makes contributions for the individual account of each employee, based normally upon a percentage of salary. The plan trustee invests those amounts and each employee, upon death or retirement, has a vested interest in whatever is allocated to his or her individual

[1] Code Section 402 imposes income taxation on all distributions from qualified plans, except any portion which is attributable to your client's non-deductible employee contributions and life insurance proceeds distributed from a retirement plan. Code Section 2039 now includes 100 percent of all qualified plan benefits in your client's gross estate for federal estate tax purposes.

account at that time. A "profit sharing plan" is the most common form of defined contribution plan. These plans may also permit voluntary contributions by the employee.

(2) A "defined benefit plan," on the other hand, is one in which the employees are entitled to receive a defined retirement or death benefit. The employer makes contributions to the plan in an amount, actuarially determined, to provide sufficient funds to pay those benefits. Because these benefits are defined in the plan, most defined benefit plans do not permit voluntary employee contributions. If the trustee of a defined contribution plan has excellent investment results, that increases the benefit ultimately paid to your client. If the trustee of a defined benefit plan has excellent investment results, that may only decrease the employer's future contributions (as the benefit ultimately paid to your client is defined in the plan, regardless of the investment performance).

A "Keogh Plan," an "H.R. 10 Plan" and a "self-employed retirement plan" are all one and the same. These plans covered your self-employed clients under prior law. While there previously were significant differences between these and other qualified plans, those differences were generally eliminated in 1982 for plan years beginning after December 31, 1983. Self-employed individuals now establish a qualified plan (either defined contribution or defined benefit) like any other employer.

An "individual retirement account" or IRA is like a defined contribution plan, but it is established by an individual and not by an employer. Although your client may make voluntary contributions to his IRA in excess of the limits set by law, the tax deductible contributions are defined and your client is entitled to the balance in the IRA upon his death or retirement. As in the case of a qualified defined contribution plan, excellent investment results in your client's IRA will increase the benefits ultimately available to him or her. A "Traditional IRA" is one in which tax deductible contributions are made. Clients may also have "Roth IRA's" which uses after-tax dollars for funding.

General Planning Considerations

The goals of your clients for the benefits which they have in qualified plans and IRA's are like their goals for their other assets. That is, they will (in all likelihood) wish to pass those benefits to the beneficiaries of their selection and minimize, or at least defer, the taxes generated by those benefits.

Because these plan benefits will be subject to income taxation upon distribution, there are several ways to minimize or defer the potential income tax:

(1) If you can keep the benefits in the qualified plan for as long as possible, even after your client's retirement or death, those benefits can continue to accumulate while the income tax is deferred.

(2) The special rules for the taxation of lump sum distributions can be used to minimize the income tax on benefits which are fully withdrawn from the qualified plan.

(3) Finally, benefits distributed from a qualified plan in a lump sum can be "rolled" into an IRA created by your client or spouse. Use of an IRA "rollover" permits beneficiaries to defer income taxes on the plan benefits until they are ultimately distributed from the IRA

Where "Should" the Plan Benefits Go?

Because many individual plans are customized to the needs of the employer, <u>the options available to your client may be more restrictive than those allowed by law</u>. It is frequently advisable to read at least the employer's summary of the plan to learn what planning options have been narrowed by this particular plan.[2]

<u>Give plan benefits to the surviving spouse</u>. It is generally preferable to have qualified plan benefits pass to your client's surviving spouse. This not only provides for the spouse's financial security, but the spouse's ability to "rollover" the account to a personal IRA will continue the income tax deferral and the accompanying income tax liability will reduce the surviving spouse's taxable estate at his or her subsequent death.

<u>Avoid the credit trust</u>. It is generally disadvantageous, on the other hand, to pass qualified plan benefits directly to a credit trust. If the credit trust received qualified plan benefits, the amount sheltered in that credit trust would be reduced by the income taxes paid as a result of the trustee of the credit trust receiving the benefits.

If your client's goal is to maximize the tax savings potential of a credit trust, while also providing for the surviving spouse's future financial security, do not have the plan benefits paid to a credit trust. Do have the plan benefits pass to the surviving spouse directly. If there will not be sufficient other assets with which to fund the credit trust, you must weigh the income tax consequences against the potential estate tax savings to determine if the credit trust should be funded with plan benefits.

Defined Benefit Plans

The Retirement Equity Act of 1984 ("REA") restricted the method of distributing benefits from some qualified plans in the case of married employees. This law gives, in effect, certain vested rights to spouses with respect to the distribution of plan benefits.

REA applies to all defined benefit plans.[3] It generally applies only to those defined contribution plans which are not profit sharing or stock bonus plans. Therefore, it is important to understand the type of qualified plan in which your client participates. REA does not apply to IRA's. <u>The easiest way to find out if REA applies to your client's plan is to ask his employer</u>.

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[2] A plan must be communicated to all participating employees. Regs. Section 1.401l(a)(2). ERISA requires that a summary description of all material elements of the qualified plan be given to participants. ERISA Sections 101-111, 29 U.S.C. Sections 1021-1031.

[3] Code Section 401(a)(11)(B)(i).14. 42 U.S.C. Section 9601 (21).5.Code Sections 401(a)(11)(B)(ii) and 401 (a)(11)(B)(iii).

What are the rules if REA applies? If REA applies to your client's qualified plan, the vested interest may be paid in only one of two ways if your client is married, (1) a "qualified joint and survivor annuity" or (2) a "qualified preretirement survivor annuity." Which form of annuity must be taken depends upon whether your client dies before or after retirement.

If your client lives past the "required beginning date" (generally, April 1 following the year in which he or she attains age 70 or retires, whichever is later),[4] payments to your client and spouse must be in the form of a qualified joint and survivor annuity.[5] These annuity payments continue until both spouses have died; payments then stop altogether. There is no "unpaid benefit" to pass on to surviving family members, even if both your client and spouse die long before their life expectancies.

If, on the other hand, your client dies before this required beginning date, the surviving spouse will receive a qualified preretirement survivor annuity.[6] Payments must begin no later than the date on which your client would have attained age 70 had he or she lived (even if that is more than five years after death).[7] Payments are generally based upon the spouse's life expectancy, although he or she may elect to redetermine that expectancy on an annual basis.[8] As in the case of a qualified joint and survivor annuity, there is no "unpaid benefit" upon the death of your client's spouse to pass to other members of their family.

All these annuity payments will be taxable, as they are received, as ordinary income to your client and spouse, or survivor, except to the extent that a portion of each payment is treated as a return of your client's voluntary, non-deductible contribution to the qualified plan.[9]

What If Your Clients Do Not Want The Annuity?

Your client and spouse may conclude that either form of annuity payment does not provide them with sufficient flexibility. They might want all the vested benefits paid to the surviving spouse in a lump sum, so that he or she can spend the after-tax money or so that the survivor can roll the benefits into an IRA They might want an option that left some "unpaid benefit" to pass to their family if both were to die at an early age.

Qualified plans covered by REA frequently allow a client to elect to waive the requirement of an annuity.[10] The client's waiver is valid only if the spouse consents in writing to the waiver.[11] The spouse's consent, in turn, must "acknowledge the effect of" your client's waiver of the annuity.[12] Additionally, the Tax Reform Act of 1986 permits the spouse to execute a consent, which permits your client to make future changes in the estate plan without further consents if (a) the spouse's consent expressly permits future changes by your client without a further consent and (b) the spouse's consent acknowledges the effect of the client's waiver and

[4] Code Sections 401(a)(9)(C) and 408(a)(6), as amended by the Tax Reform Act of 1986 (the "1986 Act") 1121(b).
[5] Code Section 401(a)(11)(A)(i), as amended by the 1986 Act Section 1898(b)(3).
[6] Code Section 401(a)(11)(A)(ii).
[7] Code Section 417(c)(1)(B).
[8] Code Section 401(a)(9)(D).
[9] Code Section 402.
[10] Code Section 417(a)(1).
[11] Code Section 417(a)(2).
[12] Code Section 417(a)(2)(A).

his or her signature is notarized.[13] The spouse's consent is not a taxable gift.[14] If the spouse's consent does not expressly permit later amendments or changes to your client's estate plan (such as even the identity of the trustee, for example), a new spousal consent must be obtained every time a change is made to that portion of your client's estate plan which deals with who receives the benefits.

All this may appear to be harder than it is. Simply tell the personnel manager of your client's employer that your client wants to do something other than the normal annuity. Ask for the needed employer-supplied forms to get that job done, rather than develop your own.

What Else Can Your Client Do?

When REA requires annuity payments for your client's defined benefits, your client does not want the annuity, and normal estate planning considerations lead to the conclusion that qualified plan benefits "should" pass to your client's spouse or to a marital trust for the spouse's benefit, there are other estate planning options available:

1. Lump sum distribution to the spouse. A lump sum distribution to your client's spouse may be the option selected by most people, if permitted by the plan. Your client's spouse may elect to roll those benefits into an IRA of the spouse's own creation so as to defer recognition of income on those benefits until the surviving spouse receives distributions from the IRA If the spouse chooses not to use an IRA rollover, the qualified plan benefits will be taxed as ordinary income; nevertheless, the marital deduction will eliminate any federal estate tax on the lump sum distribution and five year forward averaging can be elected to minimize the income tax liability. Any unspent portion of the lump sum distribution will remain available at the subsequent death of your client's spouse for distribution to beneficiaries of his or her selection.

Most plans which are subject to REA and which permit a lump sum distribution, will require that distribution to be made to your client's spouse immediately upon the death of your client. There should be no marital deduction qualification issues, of course, if that lump sum distribution is made immediately upon your client's death (whether or not those dollars are "rolled" into the spouse's IRA).

Current law (and many qualified plans) permit the client's spouse to leave the qualified benefits in the plan for up to five years after the death of your client. If your client's spouse elects to leave those qualified benefits in the plan for the full five years, marital deduction problems will theoretically arise because of the possibility that the spouse may die during that five year period before the benefits are distributed. That is, the Internal Revenue Service may argue that the spouse had only a terminable interest where those undistributed benefits are then paid at his or her subsequent death to other members of your client's family.

This problem is more theoretical than real, however. That is, your client's spouse will (in all likelihood) simply take the benefits from your client's qualified plan and roll them into an IRA of the spouse's own creation. Those benefits can continue to accumulate in the IRA on a tax-deferred basis and will clearly qualify for the marital deduction in your client's estate.

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[13] United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 577-578 (D. Md. 1986).
[14] I.C. Section 29-1-7-23.

The spouse can, of course, then leave those benefits in the IRA for more than five years after your client's death.

Care must be exercised if your client has entered into a premarital agreement in which you client's spouse (to be) "waived" all rights in the property of the client. This is not the same as the spousal waiver of REA discussed above. Treasury Regulations Section 1.401(a)-20 (Question 28) specifically states that an agreement entered into before marriage does not satisfy the applicable consent requirements. This position has been reconfirmed in Hurwitz v Sher, 982 F.2d 778 (2nd Cir., 1992) and In re Estate of Hopkins, 547 N.E.2d 230 (1991). Even in the case where your client's spouse (to be) has agreed to waive all benefits, the actual forms themselves must be executed after the marriage. The mere agreement to do so in the premarital agreement is not sufficient.

2. Benefits payable to a marital trust. You may represent a client who does not want those qualified plan benefits distributed outright to the surviving spouse for any number of non-tax reasons. Further, your client does not want the normal annuity payments because no unpaid benefit would remain payable to the family. He or she prefers, instead, to have the qualified plan benefits distributed in a lump sum to the trustee of a marital trust to be created at death.

If REA applies to the qualified plan, your client must do the same three things described above: (1) he or she must waive the right to the REA-mandated annuity payments; (2) his spouse must consent to this waiver and acknowledge the effect of that waiver; and (3) he or she must designate the trustee of the marital trust as the plan beneficiary. Again, your client should request the necessary forms from their employer.

(a) Trustee receives the benefits in a lump sum. The trustee of the marital trust will receive the lump sum as a distribution fully subject to ordinary income taxation (five year forward averaging is available). So long as the terms of the marital trust meet the necessary requirements of an estate, power of appointment or QTIP trust, the lump sum distribution should qualify for the estate tax marital deduction in your client's estate. Because only individuals can create IRA's, the trustee of the marital trust (even if that trustee were an individual) cannot roll these qualified plan benefits into an individual retirement account, however.

(b) Trustee leaves benefits in the plan. Since an IRA rollover cannot be used, the trustee of your client's marital trust may wish to leave the benefits in the qualified plan itself for as long as possible before taking the lump sum distribution (if no payments had been made to your client before death). While many plans require an immediate distribution of plan benefits if a lump sum is selected, the law authorizes the trustee of the marital trust to direct continued accumulation of the benefits within the qualified plan for up to five years after your client's death. Problems are presented, however, by the possibility that the surviving spouse may die during this five year period.

If the marital trust is a power of appointment or QTIP trust, the trustee's rights to the plan benefits will be a terminable interest (not qualified for the estate tax marital deduction in your client's estate) unless the "income" tests of those marital trusts are met. That is, the surviving spouse must receive at least annually the net income earned by those trust assets to qualify the trust under Code Section 2056(b)(5) as a power of appointment trust or under Code Section 2056(b)(7) as a QTIP trust.

While the benefits continue to accrue income within the plan, there is no distributable income for the spouse to receive. If the spouse were to die within this five year period (with the plan benefits and income accrued within the plan after your client's death then distributable to other people), the surviving spouse may not receive the necessary "income" interest under Code Section 2056(b)(5) or 2056(b) (7).

To permit the plan income to continue to accumulate within the qualified plan, while still giving the surviving spouse the requisite interest in the "asset's" income, the client's spouse must have either (1) the power to withdraw all benefits from the plan (from the qualified plan to the trustee of marital trust and then outright to him or her) or (2) the power to withdraw at least annually the income earned within the qualified plan on those vested benefits (again, with that income then distributed outright to him or her).

Interestingly, there is no "constructive receipt" rule involved here, so the spouse's right to withdraw income does not cause that income to be taxed to him or her even if the spouse does not exercise the power. These rights should be given to the surviving spouse in your client's beneficiary designation (where he names the trustee of the marital trust as the plan beneficiary) and within the terms of the marital trust itself.

3. Joint and Survivor Annuities. Section 6152 of the Technical and Miscellaneous Revenue Act of 1988 provides that joint and survivor annuities payable at death to the surviving spouse will qualify for the estate tax marital deduction (as qualified terminable interest property) where only the donor spouse and the donee spouse have the right to receive payments. The I.R.S. has informally interpreted this to mean only joint and survivor annuities that are payable outright to the surviving spouse. Annuities payable to a marital trust, on the other hand, are received by the trustee (in the opinion of the I.R.S.) as principal, no portion of which is then distributable as income to the surviving spouse. Therefore, the annuity payable to a marital trust (rather than outright to the surviving spouse) will not qualify for the estate tax marital deduction. See also proposed Regulations Section 20.2056(b)7(c)(2), particularly example 14.

Individual Retirement Accounts

Your client's general objectives for profit sharing plans and IRA's are simply stated: (1) leave the money to accumulate in the plan or IRA on a tax deferred basis for as long as possible; (2) use the special rules for lump sum distributions to minimize the income tax liability; and (3) consider use of an IRA rollover for lump sum distributions to your client or spouse, so as to defer the realization of income until the benefits are distributed.

Basic Distribution Rules for IRAs

In 2002, the IRS issued final regulations under Code §401(a)(9) clarifying and simplifying many of the rules applicable to retirement accounts.

During a client's lifetime, by April 1 of the year after the client reaches age 70½, the client must begin taking distributions from the IRA. This date is referred to as the required beginning date (RBD).[15]

After a client's death, if a Spouse is the beneficiary, that surviving spouse can defer withdrawals from the account until that spouse turns 70½.[16] Any other beneficiary must begin taking withdrawals the year after the taxpayer's death. If the client's surviving spouse is not named as the beneficiary, distribution requirements depend on the beneficiary.

Although individuals and certain qualified trusts can be "Designated Beneficiaries," estates, charities, and business entities are not. If there is a Designated Beneficiary and the taxpayer died *before* the taxpayer's RBD, the beneficiary's required minimum benefit (RMB) is based on an IRS table that takes into account the beneficiary's life expectancy. If there is a Designated Beneficiary and the taxpayer died *after* the taxpayer's RBD, then the beneficiary's RMD is based on an IRS table that takes into account the longer of the (1) beneficiary's life expectancy or (2) taxpayer's life expectancy. If there is *no* Designated Beneficiary and the taxpayer died *before* the taxpayer's RBD, the beneficiary must withdraw all of the retirement account within five years of the taxpayer's death. If there is *no* Designated Beneficiary and the taxpayer died *after* the taxpayer's RBD, then the beneficiary's RMD is based on an IRS table that takes into account the deceased taxpayer's life expectancy. If there are multiple beneficiaries of a retirement account then the RMD is based on the life expectancy of the oldest beneficiary[17] If separate accounts are established for multiple beneficiaries, then the RMD rules will apply separately to each separate account. You should be very aware that most 401(k) plans do not allow a life expectancy payout option, as they typically require a lump sum distribution on death.[18]

Between the taxpayer's death and September 30 of the following year, troublesome beneficiaries, such as beneficiaries that do not qualify as Designated Beneficiaries, may be removed by disclaiming the interest, creating separate accounts, or eliminating them as beneficiaries by distributing their benefits to them.[19]

For a variety of reasons, clients may choose to have a trust be the Designated Beneficiary. These may include, but not limited to, desires to limit the beneficiary's control; creditor protection; divorce protection; or a need to exclude the trusts assets from the estate tax at the beneficiary's death. In order to be a "Designated Beneficiary," a trust must satisfy four tests to qualify. The trust must be valid under state law; irrevocable or become irrevocable at the taxpayer's death; beneficiaries must be identifiable; and documentation must be provided to the plan administrator.[20] If these four tests are met, then the trust generally will be treated as a Designated Beneficiary and the RMD will be based on the oldest trust beneficiary's life

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[15] Treas. Reg. §1/4-1(a)(9)-5.
[16] Rolling over the retirement account into his or her own IRA. Code §§402(c)(9) (qualified plans), 408(d)(3)(C)(ii) (IRAs).
[17] Treas. Reg. §1.401(a)(9)-4, A-5(c); Treas. Reg. §1.401(a)(9)-8, A-2(a)(2).
[18] Treas. Reg. §1.401(a)(9)-5, A-7(a)(1).
[19] Treas. Reg. §1.401(a)(9)-4, A-4(a).
[20] Treas. Reg. §1.401(a)(9)-4, A-5.

expectancy.[21] All of the beneficiaries of the trust must be individuals the age of whom can be identified.

A conduit trust requires the trustee to distribute all of the retirement account withdrawals by the trust to the beneficiary.[22] As the trust may not accumulate any assets withdrawn from the retirement account, the IRS allows the beneficiary to be treated as the oldest beneficiary.[23] Although conduit trusts have the advantage of certainty because they are specifically described in the Treasury Regulations, they also have major disadvantages.

A trust that allows accumulations of retirement account withdrawals (an "accumulation trust") should qualify as a Designated Beneficiary if certain provisions are added to the trust. In addition to requirements for trusts in general, debts, taxes, or expenses payable from the trust cannot be paid after September 30 of the year after the calendar year of the taxpayer's death. The trust agreement must also prohibit trust distributions to anyone who is older than the person whose life expectancy is used to calculate the RMD, to an estate, or to a charity.

Under the IRS's interpretation, if all of the separate trusts created under a revocable trust are qualified trusts, then the RMDs of all such separate trusts will be based on the oldest beneficiary of any of the separate trusts, not the beneficiary of each trust at issue. Therefore, whenever possible, it is best to directly name the separate trusts to be created on the beneficiary designation form, as opposed to naming the funding trust.

<u>Benefits payable to a marital trust</u>. A client may, for any number of reasons, prefer to have his benefits under an IRA or a profit sharing plan distributed to a marital trust, rather than outright to the surviving spouse. If the benefits are distributed in a lump sum to the trustee of the marital trust, the trustee can elect five year forward averaging to minimize its income tax liability. The lump sum distribution to the trustee of a marital trust cannot be rolled into an IRA because only an individual (and not a trustee) can create an IRA[24]

Because an IRA is not available, the trustee may wish to leave the benefits in your client's own IRA or in the profit sharing plan for as long as possible after the client's death (so as to accumulate income thereafter on a tax-deferred basis). Unfortunately, many profit sharing plans and prototype IRA's do not permit this and require an immediate distribution of benefits if a lump sum is selected.

Nevertheless, the law would authorize the trustee of the marital trust to direct the continued retention of the profit sharing plan benefits within the qualified plan for up to five years after your client's death.[25] Therefore, the terms of your client's particular profit sharing plan should be examined to determine whether this option will be available to the trustee of the marital trust.

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[21] Treas. Reg. §1.401(a)(9)-5, A-7(a)(1).
[22] PLR 200537044.
[23] Treas. Reg. §1.401(a)(9)-5, A-7(c)(3), ex. 2.
[24] Code Section 402(a)(5)(A)(ii).
[25] Code Section 401 (a)(9)(B)(ii).

Marital deduction problems may be presented by the possibility that the surviving spouse may die during this five year period after your client's death. If those plan benefits were then to pass to other family members, it is apparent that the surviving spouse had only a terminable interest (not qualified for the marital deduction) unless you can qualify that interest as a power of appointment trust under Code Section 2056(b)(5) or as a QTIP trust under Code Section 2056(b)(7).

As was discussed previously with respect to plan benefits subject to REA,[26] the key issue is whether the surviving spouse has the necessary rights to the accumulated income earned within the profit sharing plan after your client's death. The marital trust must meet the "income" tests of Code Sections 2056(b)(5) or 2056(b)(7). You can assure those rights if your client's beneficiary designation specifies that he or she has either (1) the power to withdraw all benefits from the plan (from the profit sharing plan to the trustee of the marital trust and then outright to him or her)[27] or (2) the power to withdraw at least annually the income earned within the qualified plan on those vested benefits (again, with that income then distributed outright to him or her).[28] The spouse's right to withdraw that income does not cause that income to be taxed to the spouse (even if he or she does not exercise the power) under an exception to the "constructive receipt" rule.

<u>Qualifying IRAs for the QTIP marital deduction</u>. Revenue Ruling 2000-02, dealt with a decedent who had, prior to his death, placed assets into an IRA of his own creation.[29] He designated as beneficiary the testamentary trustee of a QTIP trust. Most importantly, he also provided that income earned on the undistributed portion of the IRA and income earned by the QTIP trustee on the distributed portion of the IRA were to be distributed to the surviving spouse.

The central question in Rev. Rul. 2000-2 was whether a QTIP election could be made if the trustee of the martial trust is the named beneficiary of decedent's IRA and the surviving spouse can compel the trustee to withdraw fro the IRA an amount equal to all the income earned on the IRA assets at least annually and to distribute that amount to the spouse.

A's children, who are all younger than B, B has the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to the income earned on the assets held by the IRA during the year and to distribute that amount through the trust to B. The IRA document contains no prohibition on withdrawal from the IRA of amounts in excess of the annual minimum required distributions.

Trustee of the testamentary trust elects, in order to satisfy section 408(a)(6), to receive annual minimum required distributions using the exception to the five year rule in section 401(a)(9)(B)(iii) for distributions over a distribution period equal to a designated beneficiary's life expectancy. Because B is not he sole beneficiary.

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[26] See the discussion which follows Note 19 supra.
[27] Regs. Section 20.2056(b)5(f)(6).
[28] Regs. Section 20.2056(b)5(f)(8).
[29] Rev. Rul. 2000-2, 2000-1 CB 305, and Rev. Rul. 2006-26, 2006-22 IRB 939.

The IRA is payable to a trust the terms of which entitle B to receive all trust income, payable annually. No one has a power to appoint any part of the property in the trust or the IRA to any person other than B.

B is given the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to all the income earned on the assets held in the IRA and pay that amount to B. If B exercises this power, the trustee must withdraw from the IRA the greater of the amount of income earned on the IRA assets during the year or the annual minimum required distribution. Nothing in the IRA instrument prohibits the trustee from withdrawing such amount from the IRA. If B does not exercise this power, the trustee must withdraw from the IRA only the annual minimum required distribution.

In summary, if your client wishes to name a QTIP trust as the beneficiary under an IRA or profit sharing plan, the trust must meet several requirements for the spouse as a beneficiary of the QTIP trust to be a "designated beneficiary:"

1. The trust must be a valid trust under Indiana law;

2. The will or the trust agreement must identify the spouse as the beneficiary of the trust and the beneficiary designation on the qualified plan or IRA should specifically name the trustee of the QTIP trust as beneficiary;

3. The plan administrator of the qualified plan or IRA must receive a copy of the trust agreement or will;

4. The testamentary trust or trust agreement must become irrevocable as of the date of the participant's death.

So as to satisfy the requirement that the surviving spouse receive all the net income for life, following the pattern established by Revenue Ruling 2000-02, discussed above.

Even if your client were to live past the date on which plan benefits need to be distributed, it may be possible for your client to change the beneficiary designation to someone other than the trustee of the QTIP trust if circumstances were to change. At least one commentator has indicated that this sort of a change in the beneficiary designation would be permissible in those instances where the spouse has executed the necessary REA consent to a new beneficiary designation under which the employee has the right to change future beneficiaries without the further consent of the spouse.[30]

[30] "Qualified Retirement Plans and IRA's: distributions 424 after the participant's death, Wilf, outline for 1990 advanced law of pensions and deferred compensation (ALI-ABA Course of Study), pages 914-917. See also "Should A Trust Be Beneficiary Of Your IRA?", Clark Blackman II, AAII Journal, October 1991 (26-29).

Benefits Payable to the Credit Trust

For income tax reasons, it is preferable that qualified plan benefits pass to the surviving spouse, either outright or in a marital trust.[31] Nevertheless, you may represent a client who does not have sufficient other assets with which to fund the credit trust.

Two problems exist for the client who needs to put some or all of the plan benefits into a credit trust: (1) if benefits from the qualified plan are paid directly to the trustee of the credit trust, those dollars sheltered in the credit trust will be reduced by the income taxes generated by the plan benefits; and (2) if the amount of qualified plan benefits which pass to the credit trust must be determined by a formula (such as a pecuniary formula determined with respect to your client's unused unified credit at death), the trustee of the qualified plan will not know for some time after your client's death what portion of the plan benefits pass to the credit trust and what portion of the plan benefits pass to the surviving spouse (outright or in a marital trust).

Your client may need to have some portion of the plan benefits pass to the credit trust at death. Because your client has insufficient other assets, he or she should use some of the plan benefits in the credit trust in order to take full advantage of the unified credit.

If qualified plan benefits are paid to the trustee of the credit trust in an amount sufficient to bring the total funding up to the amount of the unified credit, income taxes will still have to be paid on the qualified benefits. Even though five year forward averaging can be used to minimize that income tax liability, you can see that something less than the unified credit will be sheltered in the credit trust after the taxes are paid. Unfortunately, there is no way to maximize the shelter provided by the credit trust where plan benefits will be used.

There cannot be a formula allocation to the credit trust in an amount after income taxes that will fully utilize the unified credit as the amount in excess of the unified credit (the income taxes to be paid on the qualified plan benefits) will be subject to federal estate tax at your client's death because they will not qualify for the estate tax marital deduction.

Further, your client's estate cannot be the beneficiary of the qualified plan benefits with the expectation that the executor of your client's estate will receive the plan benefits (presumably in a lump sum) and then allocate after-income tax dollars to the credit trust. The income tax liability generated by the qualified plan benefits would, in that case, reduce the amount passing to the surviving spouse or to the marital trust. Because the spouse never received those income tax dollars, the amount of the federal estate tax marital deduction must be accordingly reduced. The executor would have to pay estate tax on the amount of the income tax liability unless the amount passing to the credit trust was reduced by the amount of those income taxes.

Again, there is no way to fully utilize your client's unused unified credit at death if qualified plan benefits must be used to fund the credit trust. Even though the plan benefits paid to the credit trust (and later sheltered from estate tax at the subsequent death of the surviving spouse) will be reduced by that income tax liability, it is better to shelter these after-income tax plan benefits in the credit trust than forego use of your client's unified credit altogether.

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[31] See the discussion entitled "Where 'Should' Plan Benefits Go?" supra.

Tax considerations may lead you to recommend that your client's plan benefits pass to the surviving spouse if he or she survives. You anticipate placing plan benefits in the credit trust only to the extent that it is necessary to make full utilization of the unified credit. Because you cannot know today how much will have to pass to the credit trust, you may decide to include a formula allocation for your client's other assets either in the will or in a revocable inter vivos trust agreement.

Suppose, for example, that you name as plan beneficiary either the executor (if the formula allocation to the credit trust is in the will) or the trustee of the revocable trust (if the formula allocation is in the inter vivos trust agreement). Two problems are presented by either of those beneficiary designations.

(a) Premature recognition of income. Allocation of life expectancy payments to the credit trust in satisfaction of a pecuniary bequest ("I give to the trustee of the credit trust an amount equal to...") will cause a premature recognition of income under Code Section 691(a)(2). The trustee of the credit trust will report as taxable income at once the amount of all the future life expectancy payments that the trustee has not yet received! The problem is not solved by having a formula gift to the marital trust with a residuary credit trust because the allocation of those payments to the marital trust (where you want the most benefits to go in any event) in satisfaction of that pecuniary bequest will cause the same premature recognition of income.[32]

Selection of a lump sum distribution will eliminate the premature recognition of income by the trustee. The trustee must report the distribution as taxable income, however, because the trustee actually received the income the recognition is not premature.

(b) Beneficiary designation default. A second problem arises from the fact that you will not know until some time after your client's death how much of the plan benefits will be required to "fill up" the credit trust. The administrator of your client's qualified plan will want to know quickly how to pay the benefits. Suppose the distributions passing to the surviving spouse will be made in the form of life expectancy payments, while a lump sum distribution will be made to the credit trust. The plan administrator wants to know how much to pay to the trustee of the credit trust; however, it will be quite a while before you know the final figures.

The plan administrator can risk disqualification of the entire qualified plan unless the required payments are made to the required beneficiaries at the right times and in the right amounts. If the plan administrator cannot be certain (due to the unknown final figures) that the payments are being made correctly, it is likely that the administrator will declare a "default" in the beneficiary designation, perhaps forcing the surviving spouse to take the REA mandated annuity or a lump sum distribution (thereby eliminating the spouse's desire for life expectancy payments).

This same problem exists in any formula allocation. Do not name as beneficiary the trustee of your client's revocable inter vivos trust if that trust agreement contains a formula allocation to a credit trust. Do not name as beneficiary the executor of your client's estate if the will contains a formula allocation to a credit trust.

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[32] Rev. Rule 60-87, 1960-1 Cum.Bul. 286; see also "Handling Death Benefits Payable Under Qualified Plans and Other I.R.D. Problems," Mulligan, 1986 Notre Dame Estate Planning Institute 3-7.

The solution to this problem may be relatively simple. Try to determine the approximate amount of qualified plan benefits which will be required to complete the funding of the credit trust. Translate that amount into a percentage of the plan benefits. If $200,000 of your client's $500,000 qualified plan benefit will be required to "fill up" the credit trust, for example, you can specify in the plan's beneficiary designation that 40% is to go to the credit trust ($200,000 of the $500,000 benefit) and 60% is to go to your client's spouse or to the marital trust. Use of these fractions will give the trustee of qualified plans the assurance that the benefits are being paid correctly. The formula allocation in your client's will or revocable trust agreement will then add more assets to the plan benefits to complete the funding of the credit trust.

The beneficiary designation in that example would provide that 40% passes to "the trustee of the credit trust established under Article _____ of the participant's last will and testament" or to "the trustee of the credit trust established under Article _____ of the revocable trust agreement executed by the participant on _________________________." Do not name as beneficiary the executor (if a testamentary credit trust) or the trustee of the revocable trust (if a continuing credit trust is part of the trust agreement).

You must monitor your client's financial condition with some regularity if a fixed percentage of the plan benefits will go into the credit trust. As the size of those plan benefit increases, the percentage that must pass to the credit trust will presumably decrease.

The second alternative is merely to specify that "the first $_______" in the plan passes to the trustee of the credit trust, while any excess passes to or for the benefit of the surviving spouse. The will or trust agreement would then add additional assets to complete the full funding the credit tax.

A third alternative is to devise an estate plan for your client where there will be only one trust created as of the client's death. The terms of this one trust would provide that all of the net income is to be paid to the surviving spouse. The will or trust agreement could go on to give the trustee the discretionary authority to distribute trust principal to the surviving spouse for his or her health, support, maintenance or education. This trust would, of course, qualify for the QTIP election. If your client were to name the trustee of this type of a trust as the beneficiary of his or her qualified plan, all of the planned benefits could be paid to the trustee who could, after your client's death, determine the amount or percentage which would be qualified for the estate tax marital deduction as a QTIP trust. That portion which was not qualified for the marital deduction would constitute the credit trust.

A final alternative is to name the surviving spouse as the primary beneficiary, with the credit trust as the contingent beneficiary. The spouse can then disclaim as much of the retirement benefit as is necessary to "fill up" the credit trust after the participant's death.

Trusts for Children

Clients with younger children typically want to name a trust as beneficiary of qualified plan benefits if there is no surviving spouse. If the trustee of a "family trust" were named as beneficiary of your client's qualified plan benefits, that trustee could elect to take those benefits in a lump sum (either immediately after your client's death or at any time within five years). The trust need not specify a "designated beneficiary" where the benefits will be received in a lump sum by the trustee.

Where, on the other hand, your client wishes to leave the benefits in the plan for as long as possible after death and to distribute the benefits to the trustee of the family trust in the form of periodic payments, the trust must satisfy four requirements under the 2002 Regs.:

1. The trust must be valid under state laws;

2. The trust must be irrevocable at the death of the participant;

3. The trust beneficiaries must be identifiable; and

4. A copy of the trust instrument must be provided to the plan trustee.

Because the trust would generally become irrevocable at your client's death, there should not be a problem satisfying these tests. Payments are then made to the trust over the life expectancy for the "designated beneficiary" having the shortest life expectancy.

Regardless, however, the plan administrator may or may not allow payment of a qualified plan to a trust, therefore, the administrator should be contacted or the plan summary reviewed.

The trust accounting treatment of these periodic payments will now depend upon language contained in the trust instrument. Even though the payments to the trustee represent taxable income, the trust instrument could categorize the payments entirely as principal (presumably to be accumulated within the trust), entirely as income (presumably to be distributed to the income beneficiaries) or as some combination of principal and income. Because it is impossible to predict now those circumstances which will exist after your client's death, language of this sort might be included:

> "The Trustee is authorized to categorize as principal, as income or as some combination of each any periodic payments it receives in the form of qualified plan benefits payable to a trust for my children, after taking into consideration those facts which, in its sole discretion, it deems appropriate under the circumstances which exists from time to time. The exercise or non-exercise of this power shall be questioned by no one and no person whose interest in any trust created hereunder is diminished by the exercise or non-exercise of this power shall receive any reimbursement for that diminution."

Because the surviving spouse must receive all net income earned by marital trust assets, this clause should <u>not</u> be used in a power of appointment or QTIP trust.

<u>Retirement Plan Assets To Charity</u>

As more clients become aware of the complexity of incorporating retirement plan benefits in their estate plans, some may wish for an "easy" solution.

Many clients are startled when they realize the amount of erosion which may occur in their accumulated benefits: (a) federal income tax (plus state income tax) on distributions made during your client's lifetime; (b) federal estate tax at death; (c) generation skipping transfer tax if the distribution is made to a skip person; and (d) state death taxes. These taxes may be minimized by leaving the benefits ultimately to charity, perhaps with an intervening income interest for the benefit of the client's family

Outright bequest of plan assets to charity. If the plan proceeds are distributed directly to charity, the proceeds are not subject to income taxation. The amount passing to charity qualifies for the estate tax charitable deduction. It is possible that your client may wish to have the plan proceeds pass to a private foundation of your client's creation. Use of a private foundation, of course, would enable your client's family to control the ultimate use and distribution of these funds.

Use of a charitable remainder trust. Substantial benefits may also be obtained by naming a charitable remainder trust as beneficiary of qualified plan benefits. Your client can obtain greater income flow to a surviving spouse and to children, as beneficiaries of the charitable remainder trust, because of the reduction of income and estate taxes on the retirement plan assets. Here are the tax consequences:

1. The amount distributable from the retirement plan or IRA will still constitute income in respect of a decedent ("IRD"); nevertheless, the charitable remainder trust is not subject to taxation on this IRD. See Private Letter Ruling 9237020.

2. If the surviving spouse is the sole income beneficiary of the charitable remainder trust, the value of the gift to the surviving spouse qualifies for the marital deduction. If, on the other hand, children become beneficiaries of the trust after the death of the surviving spouse, no marital deduction is available. It makes more sense under those circumstances to have the qualified plan benefits pass directly to the surviving spouse, who can roll them into his or her own spousal IRA. Upon the death of the surviving spouse thereafter, he or she can distribute those assets to the charitable remainder trust for the benefit of the children and charity.

3 The value of the interest passing to charity at the death of your client (dependant upon the type of charitable trust selected, the duration of the trust, the payout rate and the applicable federal rate at the death of your client) will qualify for the estate tax charitable deduction under Code Section 2055(a).

Planning Ideas to Practice

Do not use retirement benefits to fund a pecuniary bequest. Always remember that the assets within a retirement plan have not yet been subject to income taxation. Unlike other assets owned by your client, the retirement plan does not receive a step up in basis at death (Code Section 1014).

Retirement benefits are "income in respect of a decedent" (hereafter referred to as "IRD"). Those benefits will be taxable income when distributed. An exception to this rule exists for an employee's voluntary after tax contribution to a plan (such as a Roth IRA) and the pure death benefit of any life insurance policy owned within the plan.

Retirement benefits are subject to **both** income and estate taxation. With this background, you should exercise care if the estate plan contemplates the assignment of retirement benefits to a credit trust or to a marital bequest (either outright or in trust). Many estate planners routinely use a pecuniary fraction when describing the "amount" which is to go to the credit trust or marital gift. Whether your forms have an "up front" credit trust, with the residue passing to the marital gift, or an "up front" marital gift with the cut back portion (equal to the unused unified credit) passing to the credit trust, you should examine your language used for the specific bequest as the funding language must be carefully structured.

Code Section 691(a)(2) taxes the "sale, exchange or other disposition" of IRD if made by the estate or by the "person who received such right by reason of the death of the decedent." An exception to this rule is provided for the transfer of retirement benefits to "a person pursuant to the right of such person to receive such amount by ... bequest, devise or inheritance."

Suppose your client named his or her revocable trust as the beneficiary of $2.5 million retirement benefits. The revocable trust has no other assets. You anticipate that $500,000 will end up in the marital gift and $2,000,000 will end up in the credit trust.

The distribution of a portion of the retirement benefit to the credit trust or to the marital gift (whichever gift in your forms precedes the residuary bequest) is in satisfaction of a "bequest, devise or inheritance." That is, you are not "selling" the retirement benefit; rather, the trustee is funding the specific bequest with a portion of the retirement benefit because there are no other assets available.

In this case, the implication of Regulations Section 1.691(a)-4(b)(2) is that the distribution of IRD in satisfaction of a pecuniary bequest will be treated as a "sale," just as if the pecuniary bequest were satisfied with property which appreciated after death. The Service ruled that Code Section 663 applied to the funding of a pecuniary bequest with IRD in Private Letter Ruling 9123036, stating that the distribution of an installment obligation to fund a pecuniary formula credit trust would trigger the realization of taxable gain.

Planning suggestions. If you must use a portion (or all) of the retirement benefits to fund a gift of a specific amount, do not use a pecuniary formula. Here is the preferred way:

(1) Name an individual as the beneficiary of the retirement benefits if possible.

(2) If the retirement benefits must be payable to a trust, do not have them payable simply to your client's revocable living trust, which must be divided between a marital and credit gift after death under a pecuniary formula. In a similar fashion, do not have the retirement benefits simply payable to your client's estate, with the expectation that those benefits will flow into a trust under a pecuniary formula contained in the client's will.

(3) If you do know exactly how much of the retirement benefits will go to satisfy a specific bequest (in either the revocable trust agreement or in the will), do name as beneficiary the specific trust which is to receive the benefits. The benefits will then go directly to that trust and will not pass through any funding formula in the trust agreement or the will.

(4) If you do not know exactly how much of the retirement benefits will be needed to satisfy the specific bequest, do alter your normal funding formula to provide for a fractional division of the retirement benefits. Distribution of IRD is satisfaction of a fractional formula does not trigger the immediate recognition of IRD. See, for example, Private Letter Ruling 9537005.

If at all possible, do not use retirement benefits to fund the credit trust. If retirement benefits are used to fund the credit trust, the income tax is typically paid by the trustee out of those benefits. Therefore, only the after-income tax benefits are sheltered in the credit trust. Suppose, for example, that your client named his or her credit trust as beneficiary on a $2,000,000 IRA. You client wants to shelter those benefits from estate taxation at the subsequent death of the surviving spouse. If the surviving spouse was the income beneficiary of the credit trust, the trustee would distribute to him or her the income earned by those benefits after your client's death.

As the trustee receives the actual $2,000,000 retirement benefit itself, either in a lump sum or in installments after your client's death, those monies will presumably be accumulated within the credit trust as accounting principal. Those amounts will then be subject to income taxation at the trustee's punitive tax bracket. Remember that an <u>individual</u> does not hit that top bracket until his or her income reaches much higher levels.

A trustee cannot elect to "roll" the retirement benefits into a different plan or an IRA under Code Section 402. Death benefits cannot be put into a rollover by any beneficiary other than the surviving spouse.

Even though the suggestion is that you should not use retirement benefits to fund a credit trust "if at all possible." You may conclude that the after-income tax benefit of the credit trust outweighs the disadvantage of having those benefits subject to estate taxation at the death of the surviving spouse. If there are no other assets available to fund the credit trust, the alternatives are to forego the credit trust entirely (so the surviving spouse can put the retirement benefits into a rollover IRA) or to subject to income taxation those benefits paid to the credit trust. The answer to that question may depend upon the age and health of your clients, the availability of other assets to fund the credit trust and other factors.

Naming a QTIP trust as the beneficiary of retirement benefits frequently means the loss of income tax deferral, when compared to naming the spouse as beneficiary. Only the surviving spouse can elect to put the decedent's retirement benefits into a rollover IRA. The trustee of a QTIP trust does not have that option. Just as in the case of the trustee of the credit trust just discussed, the trustee of the QTIP trust must also pay ordinary income tax on those retirement benefits which are accumulated within the QTIP trust as accounting principal.

The trustee of the QTIP trust can mitigate this problem by distributing retirement benefits to the surviving spouse as discretionary distributions of trust principal (assuming that power is granted the trustee and the surviving spouse can meet any document imposed "need" standard); however, the distribution of assets to the spouse would seemingly be at odds with the client's decision to use a QTIP trust in the first place.

If the retirement benefits had been payable outright to the surviving spouse, on the other hand, he or she can maximize the deferral opportunities by placing those benefits into a rollover IRA. That spouse then becomes the "participant" for the minimum distribution rules. He or she can made their own "designated beneficiary" for the IRA and can start to receive distributions at his or her own "required beginning date."

The spouse's rollover decision is made, of course, after the death of your client. Before you advise the spouse to put those benefits into a rollover, however, consider the age and financial well being of the surviving spouse. If he or she is not yet 59-1/2 and if there will likely be the financial need for those benefits before that age, the rollover may not be the best decision. The prepayment 10% penalty on distributions made before age 59-1/2 from a retirement plan does not apply to death benefits; therefore, if the surviving spouse simply keeps those benefits outside of any rollover, he or she will report only income taxation on those distributions and will escape any 10% penalty. If, on the other hand, the spouse put those benefits into his or her own rollover IRA and later needed to withdraw funds before reaching age 59-1/2, those benefits are no longer "death benefits" and the exception to the 10% penalty for withdrawals of death benefits before age 59-1/2 no longer applies.

If a QTIP trust is named as beneficiary, be certain to follow the IRS instructions**.** There are many reasons why your client may want a marital gift to go to the trustee of a QTIP trust rather than outright to the surviving spouse. These non tax reasons may include the current or anticipated incapacitation of the surviving spouse, the spouse's susceptibility to other people or institutions, the fear of remarriage, the client's need for assurance that the remaining assets will go at the death of the surviving spouse as the first spouse intended (for example, to children from that client's first marriage), the fact that the spouse is a spendthrift, alcoholic or drug abuser and so forth.

Remember that any qualified marital bequest means there will be no tax at the death of the first spouse; the "quid pro quo" for that tax free treatment is, of course, the fact that the marital assets are then included in the gross estate of the surviving spouse when he or she later dies. There is no tax difference between an outright gift to the surviving spouse and gifts to the trustee of a power of appointment trust, an estate trust or a qualified QTIP trust. The client who selects a QTIP trust for the marital gift does so for control, not tax, reasons.

If your client wishes to name a QTIP trust as the beneficiary of retirement benefits, care must be taken in three areas: (1) the benefits must be qualified for the estate tax marital deduction; (2) you must be certain that the surviving spouse is the "designated beneficiary" for purposes of the minimum distribution rules; and (3) you must avoid triggering income tax when the QTIP trust is funded.

(1) How to qualify the retirement benefits for the estate tax marital deduction.

Even if the trustee of the QTIP trust can withdraw all the retirement benefits after the death of your client and the QTIP trust meets all the requirements of Code Section 2056(b)(7), there may still be a problem in qualifying those retirement benefits for the estate tax marital deduction. The Service announced in Technical Advice Memorandum 922007 that an IRA itself is "terminable interest property." The IRA agreement considered by the IRS was quite standard.

In that there was no provision stating that the account holder (trustee of the QTIP trust after the death of your client) could withdraw all the assets at any time (rather, it referred to the minimum distribution rules) and there was no provision that the account holder (trustee of the QTIP trust) could withdraw all income annually from the IRA. The IRS announced that the mere naming of the QTIP trust as the beneficiary of the IRA was not enough to qualify the IRA for the marital deduction. And, remember, more guidance was found in Rev. Rul. 2000-02 as discussed above.

(2) <u>How to be certain that the surviving spouse will be the "designated beneficiary" for purposes of the minimum distribution rules</u>.

Recall the advantages of the deferral of income taxes by leaving benefits in the plan as long as possible. Those benefits can accumulate on a tax deferred basis for years into the future. Those dollars which would otherwise be used to pay taxes are available for investment.

If there is no designated beneficiary of the retirement plan, benefits must be taken out of the plan within five years of the participant's death. If, on the other hand, there is a designated beneficiary, those benefits can be taken out of the plan over the life expectancy of the beneficiary. The longer the benefits can be left in the retirement plan, the greater the benefit will ultimately become.

There are five requirements which must be met before you can "look through" the trust, so that the trust beneficiaries will be treated as the designated beneficiary for the minimum distribution rules: (a) the trust must be valid under state law; (b) the trust must be irrevocable at the participant's death; (c) all beneficiaries of the trust must be individuals (no charities or other organizations or institutions); (d) the beneficiaries must be "identifiable from the trust instrument;" and (e) a copy of the trust instrument must be provided to "the plan administrator."

In order for all beneficiaries to be "identifiable from the trust instrument," you do not need to state the names of each beneficiary. Rather, it is sufficient if there is adequate information in the trust instrument for the oldest beneficiary to be identified. It is the oldest beneficiary (the one with the shortest life expectancy) who becomes the "designated beneficiary" and whose age serves as the measuring life for purposes of the minimum distribution rules. Beneficiaries are often referred to by their "class" designation, such as children or issue of the decedent. Members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible at the applicable time to identify the class member with the shortest life expectancy. Suppose, for example, that the class does not close as of the date of your client's death (the beneficiaries are issue living from time to time); even though the class does not close as of the date of death (issue can be born later), the beneficiaries are "identifiable" because no beneficiary with a shorter life expectancy can later enter the class. That is, the oldest beneficiary can be identified with certainty on the date of death.

A copy of the trust instrument must be provided to "the plan administrator." You should send a copy of the trust instrument to the person or institution which will become responsible for being certain that payments are made to the correct beneficiaries and that the minimum distribution rules are complied with. This would be the plan administrator or IRA trustee or custodian. I suggest that you send this copy of the trust agreement, along with the beneficiary designation, as part of the planning process, sooner rather than later. Recall the reason we are doing all this. By complying with the IRS rulings and instructions in this area, you can qualify the QTIP trust for the estate tax marital deduction AND the payments from the IRA or qualified plan can be spread out over the life expectancy of the surviving spouse. Failure to comply with these rules may result in the loss of the marital deduction or (even if you get the marital deduction) the required distribution of the retirement benefits within five years of your client's death or both.

(3) You must avoid triggering income tax when the QTIP trust is funded.

Again, when naming the QTIP trustee as beneficiary of retirement plan benefits, there are two suggestions. If you do know exactly how much of the retirement benefits will go to the QTIP trust, name as beneficiary the trustee of the QTIP trust itself. The benefits will then go directly to the QTIP trust and will not pass through any funding formula. If you do not know exactly how much of the retirement benefits will go to the QTIP trust, alter your normal funding formula to provide for a fractional division of the retirement benefit. Remember that distribution of retirement benefits in satisfaction of a fractional formula does not trigger the immediate recognition of IRD as would pecuniary funding language.

Consider the use of disclaimers to redirect retirement benefits to the "right" beneficiary**.** Disclaimers can frequently be used to "correct" the results of either inadequate planning or changed circumstances. If a disclaimer is qualified, Code Section 2518 provides that there is no gift tax consequence because the person making the disclaimer is treated as never accepted the property in the first place.

Disclaimers can be used, for example, to redirect retirement benefits away from a beneficiary who has no need for more assets; to redirect benefits to a surviving spouse, so he or she can roll them into an IRA; and to redirect benefits to a credit trust which might otherwise have inadequate funding.

Suppose that your client had named as beneficiary a child who already has a substantial estate of her own. She does not need more assets added on to those she presently is trying to dispose of. This child can execute a qualified disclaimer and redirect the retirement benefits to the contingent beneficiaries, perhaps her own children.

For there to be no gift tax consequence, this disclaimer must be "qualified" within the meaning of Code Section 2518:

(a) the disclaimer must be made within 9 months after the retirement benefits were "transferred" to the beneficiary;

(b) the beneficiary must not have accepted any benefit from the disclaimed retirement benefits;

(c) the retirement benefits must pass, as a result of the disclaimer, to someone other than the disclaiming beneficiary (there is an exception for disclaimers by surviving spouses, who can still retain the income from disclaimed property if, for example, the contingent beneficiary is a trust of which the spouse is the income beneficiary);

(d) the disclaiming beneficiary must have no power to control where the retirement benefits go as a result of the disclaimer; and

(e) the disclaimer must be effective under local law.

Whenever disclaimers are contemplated in an effort to pass retirement benefits to the surviving spouse, be certain that qualified disclaimers are executed by all the “right” preceding beneficiaries.

Some estate planners draft documents in contemplation of the post-death disclaimer of assets. Suppose, for example, that your client is not certain whether to name the spouse as primary beneficiary, so as to leave open the option of a rollover, or to name the credit trust as beneficiary, so as to take advantage of the unified credit. You may not know during this planning phase what the “right” answer should be. It is possible, under those circumstances, to name the spouse as the primary beneficiary and the credit trust as the contingent beneficiary. When your client later dies, it is the surviving spouse who can then decide whether to execute qualified disclaimers to divert retirement benefits from the surviving spouse to the credit trust. This plan was specifically approved by the IRS is Private Letter Ruling 9320015; see also Private Letter Ruling 9442032.

Care must be exercised, however, before the estate planner relies extensively upon post-mortem disclaimers. The surviving spouse must not have accepted any benefit from the disclaimed retirement benefit. Suppose that your client had passed his or her required beginning date and had begun to receive benefits before death. It is likely that the plan administrator will continue those recurring distributions even after the death of your client and it is certainly possible that the surviving spouse will simply deposit those benefit checks before you have even thought through the consequences of a disclaimer. This inadvertent action may easily constitute an “acceptance” of the retirement benefits, which will prevent a subsequent disclaimer. Additionally, it is frequently difficult to explain to an emotional surviving spouse why he or she should disclaim retirement benefits. “But I will need that money!” may be a common response. No matter how cooperative and understanding everyone was before death, the rules seem to change after one spouse dies. Remember that fast action (no more than 9 months) is required, with even greater haste required if an IRS ruling is desired. Finally, some plan administrators are unfamiliar with the idea of disclaimers and you may need to do some “education” work before the administrator will accept the disclaimer.

<u>Consider using retirement benefits to fund charitable gifts upon death</u>**.** There are two easy reasons why using retirement benefits to fund charitable gifts at death makes sense: (i) the retirement benefits are subject to income tax when distributed; and (ii) the charity or the charitable remainder trust is exempt from income tax. For those of your clients who have charitable intent, use of retirement benefits for this purpose may be the most cost effective method to fund the gift.

One advantage of naming a charitable remainder trust as beneficiary is the fact that the trust “principal” will never be subject to income taxation because the trust is exempt. This advantage may be useful for those clients who may wish to have a child benefit for life from a charitable remainder trust.

If your client wants to name the charity as the beneficiary of all his or her retirement benefits, there should be no problem. Just name the charity as the beneficiary. If, on the other hand, your client wants the charity to receive only a portion of the retirement benefit, care must be taken to comply with the IRS rules if there will be benefits distributed over the life expectancy of a person. This problem will arise in either: (a) the client who wants a percentage of the retirement benefit to go to charity, with the balance passing to the client's spouse; and (b) the client who wants to put the retirement benefit into a charitable remainder trust.

Recall that in order for benefits to be distributed over life expectancy payments, all retirement beneficiaries must be individuals. You cannot have a charity as a beneficiary if you want life expectancy payments to an individual. The consequence of this rule's violation is the forced distribution of all the retirement plan benefits within five years of the death of a client (because there was no qualified designated beneficiary).

A client who wants to name a charity as beneficiary of only part of his or her retirement benefit, with the balance of the benefits going to family members typically would also prefer that the family members take those benefits out of the retirement over the life expectancy of the oldest beneficiary, so as to leave those tax deferred dollars in the retirement plan as long as possible. In this situation, I suggest that your client divide his or her retirement funds into two separate accounts before death. The charity (or a charitable remainder trust) can be named the beneficiary of one account and the family members (or a trust for their benefit) can be named beneficiaries of the other account. If this course of action is taken, there is no charitable beneficiary of the retirement plan which passes to the family. Benefits of that plan can then be distributed over the life expectancy of the designated beneficiary.

If your client is approaching age 70-1/2. When your client reaches the Required Beginning Date, he or she must begin to take distributions from the retirement plan over the joint life expectancy of your client and the Designated Beneficiary. If this beneficiary is a charity, your client will be limited to his or her own life expectancy because the charity is not an individual. That same result would occur if the beneficiary were a charitable remainder trust.

How can a client spread out benefits over more than one life expectancy, while later passing the remaining benefits to charity? If a typical charitable remainder trust is used, payments can be made only over your client's life expectancy.

This client may also consider splitting the qualified plan into two accounts, with one account designated for charity (from which distributions will be made only over your client's sole life expectancy) and the other account designated for the family (from which distributions will be made over the joint life expectancies of your client and the designated beneficiary).

If your client is married, he or she can, as an alternative, name that spouse as the Designated Beneficiary of all the retirement plan. Payments during your client's lifetime will be spread over the joint life expectancies of your client and his or her spouse. When your client later dies, the surviving spouse can roll the retirement benefits into his or her own IRA and can name the charity as beneficiary (distributions from the surviving spouse's IRA will then be based solely upon her own remaining life expectancy). The spouse could also disclaim retirement benefits upon the death of your client, in which case the disclaimed benefits will pass to the charity as the contingent beneficiary (assuming the charity had been so named).

Examples for Planning With Qualified Plans and IRAs

Example 1: The client who has no other assets to fund the credit trust.

Suppose that you represent a couple whose assets look like this:

Asset	Husband	Wife	Jointly Held
Residence			$250,000
Investments			$850,000
Life Insurance	$100,000		
IRA	$1,100,000		
	$1,200,000	$-0-	$1,100,000

The goal is to find a way for this client to provide for the spouse's financial well-being, to take advantage of both unified credits and to maximize the income tax deferral, perhaps by spreading out the IRA distributions over the lifetime of the oldest child. While it may be possible to accomplish some of these objectives, it is not possible to accomplish all three.

Minimize income and estate taxes. It is possible for the client to minimize both income and estate taxes, but only at the cost of the spouse's financial security. If the husband were to name his oldest child as the designated beneficiary of his IRA, the income tax consequence is minimized because distributions from the IRA can be spread out over the life expectancy of the oldest child after his death; even if he were to reach age 70-1/2 before death, he can elect to take the IRA benefits from the plan over the joint life expectancy of the husband and the youngest child. Estate taxes are also minimized because the IRA is less than the amount of the husband's unified credit; therefore, there is no estate tax on that value.

Those IRA benefits will also escape taxation at the subsequent death of the wife, because she never owned those benefits. And yet that is the problem. The husband has achieved his tax goals, but has jeopardized his wife's financial security. The benefits go their child and are not available to the surviving spouse. Because the economic well- being of the surviving spouse is frequently the primary estate planning goal of our clients, it seems that this alternative will not be acceptable.

Provide for the surviving spouse, while maximizing the income tax deferral. If your client wants primarily to provide for his or her spouse, the client could simply name the spouse as the beneficiary on the IRA. The spouse could then roll those benefits into her own IRA at the husband's death. If the wife named their oldest child as the designated beneficiary of her rollover IRA, distributions can be spread out over the joint life expectancy of the wife and child. If the wife dies before the husband, the oldest child will presumably become the designated beneficiary (named as contingent beneficiary on the IRA), so the results will be the same as discussed in the first part of this section.

This plan carries with it an estate tax disadvantage, however. At the subsequent death of the surviving spouse, her gross estate will include the residence and investments (presently owned in joint name) plus the remaining value of the rollover IRA. To the extent that those assets exceed the amount of the survivor's unified credit, federal estate tax will be payable. The husband's unified credit is not utilized.

<u>Trying to maximize estate tax savings, while still providing for the surviving spouse</u>. The husband could name his credit trust as the beneficiary on the IRA, thereby keeping the retirement benefits out of the wife's estate when she later dies. He can specify that his wife receives all the net income earned by the credit trust and the trustee can be given the discretion to distribute principal to the surviving spouse under an ascertainable standard.

While this approach does provide estate tax savings (any balance of the IRA at the subsequent death of the surviving spouse will not be included in her gross estate as it is in the credit trust, contrary to the alternative just discussed), there may be income tax disadvantages. To the extent that distributions from the IRA are retained as accounting principal within the credit trust, the trustee must report those amounts on Form 1041 at a tax rate far in excess of the spouse's bracket (had she been named directly as beneficiary). Secondly, benefits from the IRA must be distributed to the credit trust solely over the life expectancy of the surviving spouse, which is at a much faster rate than would be the case had those benefits been payable to that spouse directly had she rolled them into her own IRA (where she could have named the oldest child as her designated beneficiary, leading to distributions being spread over the joint life expectancy of the surviving spouse and the oldest child).

Clearly, it is preferable to fund the credit trust with other assets, so as to leave the IRA to the surviving spouse. But this client has no other assets, with the exception of his $100,000 life insurance policy (which can certainly be made payable to the credit trust). If they could predict with certainty which spouse will die first, they could put into that dying spouse's name alone the residence and investments. If their expectations are met, the spouse who then died owning those assets could put them into a credit trust. However, remember that one of Murphy's Laws is "the wrong spouse will die first."

Whether the estate tax savings from naming the credit trust as beneficiary of the IRA benefits outweigh the income tax disadvantages may depend upon the age of the surviving spouse and the manner in which those proceeds are invested. If, for example, the IRA is paid to the credit trust and income tax is deducted, you must consider how long the remaining assets will be invested within the credit trust for the benefit of the surviving spouse. To the extent the surviving spouse is young and will presumably live a long time after the death of your client, it may be reasonable to conclude that a great deal can be sheltered within the credit trust, particularly if the after-income tax assets are invested in growth stocks.

Suppose that this client decides to go for the maximum estate tax savings, while providing for his wife's financial well being. Recognizing the income tax disadvantage of naming the credit trust as beneficiary, he nevertheless believes that far more than the credit equivalent will eventually be sheltered in the credit trust at his wife's subsequent death (because she will likely survive him for many years and because her frugal lifestyle will lead the trustee to invest in long term growth stocks).

While the IRA has a present balance of $1,200,000, your client reasonably expects this value to increase over the next few years. Indeed, he expects it to continue to grow faster than the required minimum distributions when your client reaches age 70-1/2. To the extent that the IRA balance exceeds the unified credit at your client's death, he wants the excess benefits payable outright to his wife, so that

she can roll them into her own IRA. This client needs a carefully drafted IRA beneficiary designation and a carefully drafted formula allocation of assets to the credit trust. The beneficiary designation should send to the credit trust a fractional share of the IRA sufficient to use up the unified credit, with the balance sent outright to the surviving spouse.

Example 2: The retirement plan millionaire with few other assets.

Suppose that you represent a client whose retirement benefits are far in excess of the 15% excise tax threshold. Unfortunately, all your client's remaining assets are mortgaged or leased. This client may look like this:

Asset	Husband	Wife	Jointly Held
Residence			$25,000 (equity)
IRA	$5,000,000		
	$5,000,000	$-0-	$25,000

Suppose, further, that these clients are already taking out distributions from the IRA; however, the balance continues to grow because of excellent investment performance. These clients want to minimize estate tax by taking advantage of both unified credits, to defer the payment of unavoidable estate tax until the death of the surviving spouse and to minimize income taxes if possible.

Whether your client should name his credit trust as beneficiary of part of the IRA involves consideration of the estate tax savings of the credit trust (measured at the subsequent death of the surviving spouse)and the adverse income tax consequences of having retirement benefits paid and accumulated within the credit trust.

Deferral of income tax, but with estate tax consequences. If your client named his wife as the sole beneficiary of the IRA, the estate tax can be deferred until her subsequent death. By placing the retirement benefits into her own IRA rollover, no income tax will be due upon your client's death, except on those amounts she withdraws from her own IRA for living expenses (assuming she is more than 59-1/2).

The entire amount will qualify for the estate tax marital deduction at your client's death, of course. The surviving spouse can then name the eldest child as the designated beneficiary, so that payments from her own IRA can then be spread out over the life expectancy of the child. Nevertheless, the unpaid and unspent balance of the IRA will then be subject to estate taxation when the surviving spouse later dies. The participant's unified credit is wasted. By naming her as beneficiary and allowing her to roll those benefits into her own IRA, you are only deferring the liability for the estate tax.

Use of a credit trust. It may be advisable to distribute some assets to the credit trust and pay the income tax at the participant's death, so as to get it over with. Then the IRA can continue to grow during the subsequent lifetime of the surviving spouse and be free of the estate tax burden.

The client could also withdraw assets now from the IRA, so as to have after-tax assets to fund the credit trust. The only other asset owned by these clients which would be available to fund the credit trust is their residence and that is in joint name. Because you cannot predict with certainty which spouse will die first, you might recommend that they change ownership to tenants in common. Each spouse's one-half interest in the residence would then become a probate asset, which could pass into the credit trust.

Even if that recommendation were acted upon, the spouse who did, in fact, die first could have put additional assets into the credit trust tax free. You might recommend further that the husband begin an annual program of IRA withdrawals (assuming he is more than 59-1/2), so that the after-income tax benefits could be available to fund the credit trust.

While this recommendation will accelerate the recognition of income on those withdrawals, the income will be taxed at your client's "married filing jointly" bracket, rather than at the trust's confiscatory bracket (had he simply made benefits payable to the credit trust at his death).

Withdrawals over a sufficient period of years might produce enough after-income tax assets to enable your client to make lifetime gifts to his wife, so as to enable her to fund a credit trust herself were she to die first. Indeed, these are people who should consider a lifetime gift program to their children. That may produce even another reason for them to consider withdrawals from the retirement plan now, so as to accumulate after- income tax assets to give away.

Example 3. The retirement millionaire with many other assets.

Suppose you represented a wealthy couple whose assets look like this:

Asset	Husband	Wife	Jointly Held
Residence			$2,000,000
Investments	$2,000,000	$500,000	$1,000,000
IRA	$2,500,000		
	$4,500,000	$5,000	$2,000,000

This couple also receives a qualified pension from the husband's prior employer. It is not listed as an asset on their balance sheet because the pension payments will stop at the death of the surviving spouse; therefore, it will not be subject to estate tax (nor will there be any "unpaid" benefit available to pass on to their children).

The children of this couple are already successful in their own right. The husband is more than 70-1/ 2 and is taking distributions from his IRA. He has named his wife as beneficiary on the IRA.

Estate planning considerations. It appears that he has sufficient assets to fund a credit trust without touching the IRA. They might want to transfer the jointly held investments to the wife, so that she will also have sufficient non-IRA assets to fund a credit trust. You can, in this fashion, assure the full funding of a credit trust no matter which spouse were to die first.

If the husband were to die first, his wife can roll his IRA into her own IRA and can elect to defer the recognition of the income tax (she did receive all the retirement benefit in this example). She can then name the children or grandchildren as beneficiaries of her IRA.

Suppose she wants to leave the benefits in this new IRA as long as possible, so as to maximize the income tax deferral. She wants to have the benefits distributed over the life expectancy of the oldest grandchild, so that the current required distributions each year are minimized (leaving more to accumulate within the IRA). There are two complications for the surviving spouse: (a) care must be taken to stay under the generation skipping tax exemption; and (b) she must divide her IRA into two separate IRA's. Let me deal quickly with each of these issues.

The wife can make $2,000,000 of the IRA payable at her death to a trust for the grandchildren without subjecting the transfer to generation skipping tax. It will still be subject to estate tax, of course, upon the wife's death. Any IRA balance in excess of the GST exemption can be made payable to a trust for the benefit of the children.

You should not have the children and then the grandchildren be the beneficiaries of this GST trust. Whenever there are multiple beneficiaries of a trust, the retirement plan benefits must be distributed over the life expectancy of the oldest member of the entire group of beneficiaries. If the single trust included both children and grandchildren as beneficiaries, the designated beneficiary would be the oldest child.

Therefore, you might consider dividing the surviving spouse's IRA into two separate accounts. One account would not exceed $2 million (so as to stay under the GST exemption) and would name as beneficiary the trust which is for the exclusive benefit of the grandchildren. Payments after the death of both grandparents can be made to this trust over the life expectancy of the oldest grandchild. The second account would be for the IRA assets in excess of $2 million and would name as beneficiary the trust which is for the benefit of the children. Payments after the death of both grandparents can be made to this trust over the life expectancy of the oldest child.

Recall that both clients are living today. The balance in the IRA is fluctuating with investment results and as a result of the required minimum distributions. To accomplish these goals, the husband may want to divide his IRA now into two separate IRA's. The first IRA would contain less than $2 million of retirement plan assets and would name his wife as primary beneficiary and the trust for the grandchildren as contingent beneficiary; the second IRA would contain all the other retirement plan assets and would name his wife as primary beneficiary and the trust for the children as the contingent beneficiary. Care should be exercised to avoid having the first IRA exceed $2 million.

The IRA benefits will be subject to income tax as they are distributed over the lifetime of the oldest grandchild; therefore, you might argue that the full $2 million exemption is not being utilized ($2 million minus income tax equals less than $2 million certainly). Nevertheless, you may still want to recommend the plan outlined above simply because of the tremendous investment leverage that can be obtained by leaving the IRA balance invested on a tax deferred basis for so many years. That is, the life expectancy of the oldest grandchild could result in the benefits staying within the plan for decades after the death of both of your clients. What a tremendous way to maximize the ultimate benefit to the grandchildren.

FORMS

I. Introductory Language to be Used With All the Following Forms

These forms should be used with all the forms which follow. The first form is to be used with IRAs and the second is to be used with qualified plans. Obviously, these forms and the ones which follow must be modified by you, the estate planner, to fit the particular facts and circumstances presented by your client.

(A) Introductory Provisions for IRAs:

DESIGNATION OF BENEFICIARY

TO: Name of Custodian of IRA

FROM: Name of Participant

RE: Account No.

I. Introductory Provisions

A. Definitions

The following words, when used in this form and capitalized, shall have the meaning indicated in this Section.

"Account" means the "Individual Retirement Account" or "Individual Retirement Trust" referred to above, which is established and maintained under Code Section 408.

"Administrator" means the IRA custodian or trustee named above, and its successors in that office.

"Beneficiary" means any person entitled to ownership of all or part of the Account as a result of my death (or as the result of the death of another Beneficiary).

"Code" means the Internal Revenue Code of 1986, as amended.

"Contingent Beneficiary" means the person(s) I have designated in this form to receive the Death Benefit if my Primary Beneficiary does not survive me (or disclaims the benefits).

"Death Benefit" means all amounts payable under the Account on account of my death.

The "Minimum Distribution Amount" is, in each year, the minimum amount required to be distributed from the Account in such year under Code Section 408(a)(6) and the regulations thereunder.

"Primary Beneficiary" means the person or persons I have designated in this form to receive the Death Benefit in the event of my death.

"Successor Beneficiary" means a person entitled to receive the balance of another Beneficiary's benefits if such other Beneficiary dies before distribution of all of his or her share of the Death Benefit.

B. Form of Benefit Payments after my Death.

After my death, there must be distributed, in each calendar year, at least the Minimum Distribution Amount for such year; provided, that this sentence shall not be deemed to limit any Beneficiary's right to use the alternative method of compliance described in IRS Notice 88-38. Except as may be otherwise specifically provided herein, or in the agreement establishing the Account, or by applicable law, each Beneficiary shall be entitled to elect the form and timing of distribution of benefits payable to him or her.

C. Death of Individual Beneficiary.

No person shall have the discretion, after my death, to change my Beneficiaries. The Death Benefit shall be payable to the Primary (or Contingent) Beneficiary specified herein, whichever is applicable. However, if an individual Primary or Contingent Beneficiary, having survived me, becomes entitled to ownership of all or part of the Account, but later dies prior to the complete distribution of such Beneficiary's share of the Account to him or her, the remaining balance of such Beneficiary's share of the Account shall belong to a Successor Beneficiary, who shall be:

(i) such person or persons as such Beneficiary shall have indicated by written notice to the Administrator; or, if such Beneficiary shall have failed to give such written notice, or to the extent such written notice does not make effective disposition of all of such Beneficiary's share of the Account,

(ii) such Beneficiary's issue surviving such Beneficiary, by right of representation, or in default of such issue,

(iii)my issue surviving such Beneficiary, by right of representation, or in default of such issue,

(iv) such Beneficiary's estate.

D. Payment to Minors. If any Beneficiary becomes entitled to ownership of any part of the Account at a time when he or she is under the age of twenty-one (21) years, such ownership shall instead be vested in the name of such Beneficiary's surviving parent, if any, otherwise in the name of my oldest then living child if any, otherwise in the name of some other person selected by my personal representative, as custodian for such Beneficiary under the Uniform Transfers to Minors Act of Indiana, and such custodian shall have the power to act for such Beneficiary in all respects with regard to the Account.

E. Governing Law.

The interpretation of this beneficiary designation form shall be governed by the law of the State of Indiana.

F. Multiple Beneficiaries.

If there are multiple Beneficiaries entitled to ownership of the Account simultaneously, they shall be entitled, to the maximum extent permitted by law, by joint written instructions to the Administrator, to have the Account divided into separate accounts corresponding to each Beneficiary's separate interest in the Account, as of at any time after my death, and following such division the separate accounts shall be maintained as if each were an Account in my name payable solely to the applicable Beneficiary. Following such division, no Beneficiary shall have any further interest in or claim to any part of the account other than the separate Account representing his or her interest.

G. Transferring Account.

The Beneficiary shall have the right to have the Account (or, if the Account has been divided, such Beneficiary's share of the Account) transferred to a different Individual Retirement Account or Individual Retirement Trust, still in my name, with the same or a different custodian or trustee, if such transfer is permitted by law.

H. Determination of Spouse's Life Expectancy.

If my death occurs prior to April 1 of the year following the year in which I reach age 70-1/2, then, unless the Beneficiary makes a different election prior to the date of payment of the first "minimum required distribution" (under the Code) after my death, the life expectancy of my spouse shall not be redetermined annually.

(B) Introductory Provisions for Qualified Plans.

DESIGNATION OF BENEFICIARY

TO: Name of Trustee or Plan Administrator

FROM: Name of Participant

RE: Account No.

I. Introductory Provisions.

A. Definitions.

The following words, when used in this form and capitalized, shall have the meaning indicated in this Section.

"Administrator" means the Trustee or Plan Administrator named above, or its successors in such office.

"Beneficiary" means any person entitled to receive benefits under the Plan as a result of my death (or as a result of the death of another Beneficiary).

"Code" means the Internal Revenue Code of 1986, as amended.

"Contingent Beneficiary" means the person(s) I have designated in this form to receive the Death Benefit if my Primary Beneficiary does not survive me (or disclaims the benefits).

"Death Benefit" means all benefits payable under the Plan on account of my death.

The "Minimum Distribution Amount" is, in each year, the minimum amount of my benefits under the Plan that is required to be distributed from the Plan under Code Section 401(a)(9) and the regulations thereunder.

"Plan" means the qualified retirement plan or other retirement arrangement described at the beginning of this form.

"Primary Beneficiary" means the person designated in this form to receive benefits under the Plan on account of my death.

"Successor Beneficiary" means a person entitled to receive the balance of another Beneficiary's benefits if such other Beneficiary dies before distribution of all of his or her share of the Death Benefit.

B. Form of Benefit Payments After My Death.

Except as may be otherwise specifically provided herein, in the Plan, or by applicable law, each Beneficiary shall be entitled to elect the form and timing of distribution of any benefits payable to such Beneficiary, provided there must be distributed, in each calendar year, at least the Minimum Distribution Amount for such year.

C. Death of Beneficiary.

No person shall have the discretion, after my death, to change my Beneficiaries. The Death Benefit shall be payable to the Primary (or Contingent) Beneficiary specified herein, whichever is applicable. However, if an individual Primary or Contingent Beneficiary, having survived me, becomes entitled to benefits under the Plan, but later dies prior to the complete distribution of such benefits to him or her, such deceased Beneficiary's remaining benefits shall be payable to a Successor Beneficiary, who shall be:

(i) such person or persons as such Beneficiary shall have indicated by written notice to the Administrator; or, if such Beneficiary failed to give such written notice, or to the extent such written notice does not make effective disposition of all of such Beneficiary's benefits under the Plan, then

(ii) such Beneficiary's issue surviving such Beneficiary, by right of representation; or, in default of such issue,

(iii) my issue surviving such Beneficiary, by right of representation; or, in default of such issue,

(iv) such Beneficiary's estate.

D. Payments to Minors. If any Beneficiary becomes entitled to benefits under the Plan at a time when he or she is under the age of twenty-one (21) years, such benefits shall be instead payable to such Beneficiary's surviving parent, if any, otherwise to my oldest then living child, if any, otherwise to some other person selected by my personal representative, as custodian for such Beneficiary under the Uniform Transfers to Minors Act of Indiana, and such custodian shall have the power to act for such Beneficiary in all respects with regard to the benefits to which such Beneficiary is entitled.

E. Governing Law.

The interpretation of this beneficiary designation form shall be governed by the law of the State of Indiana.

F. Multiple Beneficiaries. If there are multiple Beneficiaries who are simultaneously entitled to the Death Benefit, they shall be entitled, to the maximum extent permitted by law, by joint written instructions to the Administrator, to have the Death Benefit divided into separate accounts corresponding to each Beneficiary's separate interest in the Death benefit, as of or at any time after my death, and following such division the separate accounts shall be maintained as if each were a Death Benefit payable solely to the applicable Beneficiary. Following such division, no Beneficiary shall have any further interest in or claim to any part of the Death Benefit other than the separate account representing his or her interest.

G. Determination of Spouse's Life Expectancy.

If my death occurs prior to April 1 of the year following the year in which I reach age 70-1/2, then, unless the Beneficiary makes a different election prior to the date of payment of the first "minimum required distribution" after my death, the life expectancy of my spouse shall not be redetermined annually.

II. Fractional Split of Retirement Benefits Between Spouse and Credit Trust

[Remember that you must have both the proper beneficiary language and comparable language in the trust or will]

This form could be used by the client who wants to use retirement benefits to "fill up" the credit trust, leaving the remaining retirement benefits outright to the surviving spouse who can roll them into an IRA. This beneficiary designation includes a formula division of the death benefit; if the plan administrator refuses to accept this designation (in spite of the "hold harmless" language), you can use Form III as an alternative.

Beneficiary Designation Form

(A) Introductory Provisions from Above

(B) Beneficiary Designation

A. Primary Beneficiary.

If my spouse survives me, then I name both by spouse, individually, and the Trustee of the Credit Trust created under Article of the Trust Agreement created by me on ______________, (hereinafter referred to as the "Trustee"), a copy of which trust agreement is attached hereto, as my Primary Beneficiaries. The Death Benefit shall be divided into two shares at my death, with one for each of the respective Primary Beneficiaries, according to the following formula:

1. The share that shall be allocated to the Credit Trust shall be determined by multiplying the Death Benefit by a fraction. The numerator shall be the "Credit Shelter Amount" (as defined below). The denominator shall be the value of the Death Benefit.

2. The fractional share allocated to my spouse individually shall be one minus the fraction determined under paragraph 1 times the value of the Death Benefit.

3. The relative fractional shares of the Primary Beneficiaries shall be determined as of the date of my death. The fraction as so determined shall then be applied to the values of the Death Benefit on the date or dates of distribution to the Primary Beneficiaries.

4. The "Credit Shelter Amount" means the maximum amount which, if it passed at my death to beneficiaries other than my spouse or charity, would not be subject to federal estate tax by virtue of any credits and exemptions available to my estate, reduced by all amounts includible in my estate which pass to the Credit Trust (or to any other beneficiary other than my spouse or charity) otherwise than under this instrument. In applying the foregoing formula: the credit for state death taxes shall be taken into account only to the extent its use does not increase the state death taxes otherwise payable on my estate; and the property passing to a trust which qualifies for federal estate tax marital deduction, or which would so qualify if my personal representative so elected, shall be deemed to have passed to my spouse.

5. The Primary Beneficiaries, and not the Administrator, shall have sole responsibility for determining and applying the foregoing formula. The Administrator may rely absolutely, without further liability, on a certificate of the Trustee as to the amount payable to each Primary Beneficiary under the foregoing formula, and shall have no liability to any person for any misapplication of said formula.

B. Contingent Beneficiary.

If my spouse does not survive me, the entire Death Benefit shall be paid to [include contingent beneficiary here] as Contingent Beneficiary.

Related Trust Agreement Provision

If the Settlor's Spouse Survives. If the Settlor's spouse survives the Settlor, the Trustee shall make these allocations:

The Credit Trust. Effective as of the Settlor's death, the Trustee shall allocate to the Credit Trust that amount, if any, needed to increase the Settlor's taxable estate to the largest amount that, after taking into account the unified credit available to the Settlor's estate, will result in no federal estate tax payable by the Settlor's estate. Any asset distributed in kind in partial or complete satisfaction of the foregoing allocation may be distributed on a non-pro rata basis without regard to its income tax basis, shall be distributed at its estate tax value in partial or complete satisfaction of his bequest and shall be fairly representative of appreciation and depreciation in the value of all property available for distribution in satisfaction of the foregoing allocation; provided, further, if any asset held by the Trustee does not qualify for the estate tax marital deduction at the Settlor's death, that asset shall be distributed in satisfaction of the foregoing allocation. The assets of this trust shall be held, administered and disposed of by the Trustee pursuant to the terms of the Credit Trust hereinafter set forth.

Marital Gift. Effective as of the Settlor's death, the Trustee shall distribute to the Settlor's spouse, outright and free of trust, all the rest, residue and remainder of the Trust Property.

Disclaimers. Any assets of the Marital Gift effectively disclaimed after the Settlor's death shall be held, administered and disposed of as a part of the principal of the Credit Trust.

If the Settlor's Spouse Does Not Survive. If the Settlor's spouse does not survive the Settlor, the Trustee shall: [include contingent provisions here].

III. Benefits Payable to One Trust With the "Division" Language Between the Spouse (Outright) and the Credit Trust are in the Trust Agreement

As in the case of the prior form, this form can be used by that client who decides to use some of the retirement benefit to "fill up" the credit trust, with the balance of the retirement benefit passing outright to the surviving spouse (with the expectation that the surviving spouse will roll that benefit into his or her own IRA). This form can be used in those cases where the plan administrator will not accept the formula beneficiary designation of the prior form

Beneficiary Designation Form

(A) Introductory Provisions from Above

(B) Designation of Beneficiary

A. Primary Beneficiary.

I hereby designate as my Primary Beneficiary, to receive all of the Death Benefit in case of my death, the trustee of the trust (hereinafter referred to as the "Trustee") created by me under the Trust Agreement executed on ____________________, a copy of which trust agreement is attached hereto.

B. Distribution of Benefits to Spouse.

The Trustee is directed under that Trust Agreement to allocate the Death Benefit, pursuant to a formula, between my spouse and a credit trust established under that Trust Agreement. The Trustee is further directed, if so requested by my spouse, to cause the part of the Death Benefit so allocated to my spouse to be distributed outright to my spouse or transferred directly to an individual retirement account in my spouse's name. Therefore, if the Administrator is so directed by the Trustee, the Administrator shall, with respect to the amount indicated by the Trustee, distribute that amount outright to my spouse or shall transfer that amount directly to an individual retirement account in the name of my spouse, as directed by the Trustee.

Related Trust Agreement Provision

If Settlor's Spouse Survives. If the Settlor's spouse survives the Settlor, the Trustee shall make these allocations:

Credit Trust. Effective as of the Settlor's death, the Trustee shall allocate to the Credit Trust a portion of the Trust Property determined by multiplying the Trust Property by a fraction. The numerator of the fraction shall be the that amount, if any, needed to increase the Settlor's taxable estate to the largest amount that, after taking into account the unified credit available to the Settlor's estate, will result in no federal estate tax payable by the Settlor's estate. The denominator of the fraction shall be the value of the Trust Property. Any asset distributed in kind in partial or complete satisfaction of the foregoing allocation may be distributed on a non-pro rata basis without regard to its income tax basis, shall be distributed at its estate tax value in complete or partial satisfaction of this allocation and shall be fairly representative of appreciation or depreciation in the value of all property available for distribution in satisfaction of the foregoing allocation; provided, further, if any asset held by the Trustee does not qualify for the estate tax marital deduction at the Settlor's death, that asset shall be distributed in satisfaction of the foregoing allocation. The assets of this trust shall be held, administered and disposed of pursuant to the terms of the Credit Trust hereinafter set forth.

Marital Share. Effective as of the Settlor's death, the Trustee shall distribute to the Settlor's spouse, outright and free of trust, all the remaining Trust Property. To the extent that the Marital Share shall consist of tax-favored retirement plan benefits, the Trustee may (and shall, if so requested by the Settlor's spouse) cause such part or all of those retirement plan benefits (a) to be distributed directly from that retirement plan to the Settlor's spouse as beneficiary or (b) to be transferred directly from that retirement plan into an individual retirement account in the name of the Settlor's spouse, both without the necessity of an intervening step of transferring those retirement plan benefits to this trust.

Disclaimers. Any assets of the Marital Share effectively disclaimed after the Settlor's death shall be held, administered and disposed of pursuant to the terms and conditions of the Credit Trust.

If Settlor's Spouse does not Survive. If the Settlor's spouse does not survive the Settlor, the Trustee shall, effective as of the Settlor's death, [insert alternative provisions here].

IV. Benefits Payable to One Trust With the "Division" Language Between a QTIP Trust and the Credit Trust in the Trust Agreement.

This form is similar to the prior one, except that the marital gift is put into a QTIP trust instead of being left outright to the surviving spouse. That is, this form can be used by that client who decides to use some of the retirement benefit to "fill up" the credit trust, with the balance of the retirement benefit being placed in a QTIP trust. Remember that the trustee of the QTIP trust cannot roll that portion of the benefit into an IRA.

The goal is to create language which will enable the trustee of the QTIP trust to qualify that portion of the retirement benefit for the estate tax marital deduction, while spreading the payments out over the lifetime of the surviving spouse. The surviving spouse will receive the net income earned by the retirement benefit after the date of your client's death (or at least the minimum required distribution). The balance of the distributions from the retirement plan will be accumulated within the QTIP trust as accounting principal.

That portion of the retirement benefit which remains in the trust (after the payment of income taxes) will be available for distribution to the remainder beneficiaries of the QTIP trust upon the subsequent death of the surviving spouse.

<u>Beneficiary Designation Form</u>

(A) Introductory Provisions from Above

(B) Designation of Beneficiary.

A. Primary Beneficiary

I hereby designate as my Primary Beneficiary, to receive all of the Death Benefit in case of my death, the trustee of the trust (hereinafter referred to as the "Trustee") created by me under the Trust Agreement executed on __________________, a copy of which trust agreement is attached hereto.

B. Division of Benefit.

Under the terms of that Trust Agreement, the Trustee is directed, if my spouse survives me, to divide the assets of the trust into two separate trusts, to be designated the "Marital Trust" and the "Credit Trust." If so directed by the Trustee, the Administrator shall divide the Death Benefit into two separate accounts, both still in my name, one payable solely to the Marital Trust as Beneficiary and the other payable solely to the Credit Trust as Beneficiary; or, in accordance with instructions received from the Trustee, shall designate the entire Death Benefit as payable to only one of those trusts, as Beneficiary. The Administrator shall have no responsibility to determine the correctness of the Trustee's instructions regarding those allocations, and shall have no liability whatsoever to any person for complying with the Trustee's instructions. The beneficiaries of the Marital Trust and the Credit Trust shall look solely to the Trustee for enforcement of their rights under the Trust Agreement.

C. Benefits Payable to Marital Trust.

With regard to any portion of the Death Benefit so allocated to the Marital Trust, there must be distributed to the Marital Trust in each year, beginning with the year of my death, from the Marital Trust's portion of the Death Benefit, at least the net income of the Marital Trust's portion of the Death Benefit for such year accrued after my death. The Trustee, and not the Administrator, shall have sole responsibility for determination of the amount of that income or larger amount, and directing the distribution of that amount to the Marital Trust.

Related Trust Agreement Provision

If Settlor's Spouse Survives. If the Settlor's spouse survives the Settlor, the Trustee shall make these allocations:

Credit Trust. [same language as prior trust agreement form]

Marital Trust. Effective as of the Settlor's death, the Trustee shall allocate to the Marital Trust all the remaining Trust Property, to be held, administered and disposed of pursuant to the terms of the Marital Trust hereinafter set forth. Disclaimers. Any assets of the Marital Trust effectively disclaimed after the Settlor's death shall be held, administered and disposed of pursuant to the terms and conditions of the Credit Trust.

If Settlor's Spouse does not Survive. If the Settlor's spouse does not survive the Settlor, the Trustee shall, effective as of the Settlor's death, [include contingent beneficiary provisions here].

The Marital Trust

During the Lifetime of the Settlor's Spouse. From and after the death of the Settlor and during the lifetime of the Settlor's spouse, the Trustee shall pay to the Settlor's spouse all the net income of the Marital Trust, in quarterly or other installments not less often than annually. If the Trustee of the Marital Trust, as beneficiary of any qualified plan benefits, elects to accumulate those benefits within the plan after the Settlor's death, the Settlor's spouse shall be the "designated beneficiary" with respect to the Marital Trust's interest in those qualified plan benefits; the Settlor's spouse shall have the power to require the Trustee to withdraw from the qualified plan the amount of income earned within the qualified plan on those accumulated benefits or the Code Section 401(a)(9) minimum distribution, whichever is more, and to record those amounts as "income" on its books and records. If the Trustee of the Marital Trust is entitled to payments from any individual retirement account, the Trustee shall allocate to "income" on its books and records (from payments received in any calendar year) an amount equal to the income earned by the individual retirement account in that year; any excess distributions received from the individual retirement account shall be allocated to "principal" on the books and records of the Trustee. If the payments in any year from the individual retirement account shall be less than the amount equal to the income earned by the retirement account in that year, the Settlor's spouse shall have the continuing right to require the Trustee to withdraw from the individual retirement account and to pay to the Settlor's spouse as income an additional amount, so that the Settlor's spouse can receive an amount equal to the income earned by the individual retirement account in that year.

Conclusion

Many clients are now finding that more and more of their net worth is tied up in their qualified plans or in IRAs. These are the "hidden" assets which they cannot reach today. While these plan benefits share that characteristic with life insurance proceeds, it would be a mistake to equate the two. Estate planning for employee benefits is substantially more complex because those benefits have not yet been subject to income taxation. Life insurance proceeds, on the other hand, will not normally be subject to income taxation.

Planning considerations might be summarized this way: plan benefits should generally be paid to your client's surviving spouse; plan benefits should be paid to a credit trust only if there are insufficient other assets to utilize the unified credit; plan benefits should not be apportioned between a credit trust and a marital gift by use of a pecuniary formula; and you must exercise caution in drafting language to insure qualification for the estate tax marital deduction of any plan benefits payable to a power of appointment or QTIP trust; and plan benefits are the best assets to use to satisfy charitable giving.

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