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Beneficiary Designations for Individual Retirement Accounts and Qualified Plans

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I. INTRODUCTION

If a client has a large-balance traditional individual retirement account (IRA) or qualified employee benefit plan (QP), the beneficiary designation for the IRA or QP will be an important part of the client's estate plan. The beneficiary designation not only governs who receives the IRA or QP upon the death of the client, but it also affects how rapidly the IRA or QP must be distributed after the death of the client.

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Virtually all clients with large accrued benefits in qualified employee benefit plans will roll over those benefits into a traditional IRA account. The estate planning professional thus faces the problem of planning for a large balance IRA account.

II. CLIENT'S GOALS AND TAX FACTORS

A. Client's Goals in Planning for IRA Accounts

While the client is alive, his or her main goal is to keep the assets inside the IRA as long as possible in order to defer income taxation of the assets and continue to use the IRA as a tax shelter. As a result, many clients withdraw nothing from their IRAs until they are forced to begin receiving distributions at age 70½.

The client's main after-death goals for the rollover IRA are

1. to direct to whom it should be given and whether it should be given outright or in trust;

2. to have distributions from the IRA paid out over as long a period of time as possible, in order to defer income taxation of the IRA;

3. to qualify the IRA for the estate tax marital deduction, in order to defer and minimize estate tax on the IRA; and

4. if the IRA is used to fund a trust, to avoid recognizing income in respect of a decedent.

The above goals may conflict with each other. The estate planner's task is to help the client determine which goals are most important and how to achieve those goals. The selection of a beneficiary for the rollover IRA will affect all of the above points.

B. Tax Factors Affecting IRAs

1. Minimum Distribution Rules

The minimum distribution rules under Code §§408(a)(6) and 401(a)(9) and Treas.Reg. §§1.401(a)(9)-1 through 1.401(a)(9)-9 require that assets eventually must be distributed out of an IRA to the client or a beneficiary. Most clients want to keep assets in the IRA as long as possible to defer income taxation of the assets.

a. Living Client

For a living client, the client must begin receiving distributions from his or her IRA by April 1 of the year following the calendar year in which the client attains age 70½. This is the client's "required beginning date."

While an IRA owner is alive, the required minimum distributions from the IRA are determined by looking at one simple table, the uniform lifetime table. The table considers only the age of the IRA owner. See Treas.Reg. §1.401(a)(9)-5, Q & A 4(a). While the IRA owner is alive, the identity of the IRA beneficiary usually is not considered in calculating the required minimum distributions from the IRA.

There is one situation in which the uniform lifetime table is not used during the IRA owner's lifetime. If the spouse is the sole designated beneficiary of the IRA, during the IRA owner's lifetime the applicable distribution period for the IRA is the longer of (a) the distribution period in the uniform lifetime table or (b) the joint life expectancy of the IRA owner and spouse, with their joint life expectancy being recalculated each year. See Treas.Reg. §1.401(a)(9)-5, Q & A 4(b). The joint life expectancy period provides a longer distribution period only when the spouse is more than ten years younger than the IRA owner.

b. Year of Death of Client

For the year in which the IRA owner dies, the required minimum distribution from the IRA is made as provided in the uniform lifetime table (or, if the spouse is the sole designated beneficiary and is more than ten years younger than the IRA owner, as provided above). See Treas.Reg. §1.401(a)(9)-5, Q & A 4(a).

If the IRA owner dies in the middle of the year before the required minimum distribution has been made, the required minimum distribution for the year is made to the beneficiary of the IRA (and not to the estate of the IRA owner, unless the estate is the beneficiary of the IRA).

c. After Death of Client

For the years following the death of the IRA owner, required minimum distributions are made according to Treas.Reg. §1.401(a)(9)-5, Q & A 5.

(1) If the IRA has a designated beneficiary, the applicable distribution period for the IRA is as follows:

(A) If the IRA owner dies before his or her required beginning date (age 70½), the applicable distribution period is over the life expectancy of the designated beneficiary. Treas.Reg. §1.401(a)(9)-5, Q & A 5(b).

(B) If the IRA owner dies after the required beginning date, the applicable distribution period is the longer of (i) the life expectancy of the designated beneficiary or (ii) the life expectancy of the IRA owner. Treas.Reg. §1.401(a)(9)-5, Q & A 5(a)(1).

Distributions from the IRA must commence by December 31 of the year following the year in which the IRA owner dies. If the IRA owner's spouse is the sole designated beneficiary of the IRA, however, then required distributions need not commence until the year in which the deceased IRA owner would have attained age 70½. In each subsequent calendar year, the distribution period is reduced by one year. If the spouse is the sole designated beneficiary, however, the spouse's life expectancy is recalculated each subsequent year. Treas.Reg. §1.401(a)(9)-5, Q & A 5(c).

(2) If the IRA does not have a designated beneficiary, the applicable distribution period for the IRA is as follows:

(A) If the IRA owner dies before his or her required beginning date (age 70½), all of the IRA must be distributed within five years after the death of the IRA owner. Treas.Reg. §1.401(a)(9)-3, Q & A 1.

(B) If the IRA owner dies after the required beginning date, the applicable distribution period is over the remaining life expectancy of the deceased IRA owner. In each subsequent calendar year, the distribution period is reduced by one year. Treas.Reg. §1.401(a)(9)-5, Q & A 5(c)(3).

d. Designated Beneficiary

A client usually wants his or her IRA to have a permissible "designated beneficiary" so that the IRA may be paid out over a longer period of time after his or her death. For an IRA to have a "designated beneficiary" for purposes of Code §401(a)(9), the beneficiary of the IRA must be either

(i) an individual (Treas.Reg. §1.401(a)(9)-4, Q & A 1); or

(ii) a trust if the following requirements are met:

(1) the trust is valid under state law;

(2) the trust is irrevocable or will, by its terms, become irrevocable upon the death of the IRA owner;

(3) the trust has identifiable beneficiaries; and

(4) a copy of the trust instrument (or a list of all trust beneficiaries, including contingent and remaindermen beneficiaries) is provided to the plan administrator by October 31 of the year following the death of the IRA owner (Treas.Reg. §1.401(a)(9)-4, Q & A 5).

e. Trust as Beneficiary of IRA. The Trust "Look-Through" Rule.

If the requirements of (d)(ii)(1-4) are met, all of the beneficiaries of the trust will be considered to be "beneficiaries" of the IRA for purposes of determining the life expectancy payout from the IRA, even though the trust is the beneficiary of the IRA. *Id.* This is sometimes called the "look-through" rule, because one looks through the trust to all of the beneficiaries of the trust.

Under the look-through rule, generally all of the current beneficiaries and presumptive remaindermen of the trust are considered. For example, if a trust pays income to client's spouse for life, with remainder to client's descendants per stirpes, the spouse and the children will be considered in determining the "designated beneficiary" of the client's IRA. See Treas.Reg. §1.401(a)(9)-5, Q & A 7(c)(3)(Example 1). The children are possible beneficiaries because some amounts distributed from the IRA during the spouse's lifetime could be accumulated in the trust and distributed to them upon the death of the spouse.

A trust often has remote contingent beneficiaries, and sometimes this may create problems under the look-through rule. For example, upon the death of the income beneficiary of the trust, the presumptive remaindermen (e.g., client's minor children) sometimes receive their shares not outright, but rather in further trust. In such case, the presumptive remaindermen of the children's trusts (e.g., client's brothers and sisters, a charity) are also considered as beneficiaries of the client's IRA. The fact that the children probably will survive to an attained age and receive the trust property outright in the future is disregarded by the IRS. See Pvt.Ltr.Ruls. 200438044, 200610026.

A beneficiary of a trust may have a testamentary power of appointment over the trust estate. If the trust is beneficiary of the client's IRA, it appears that all of the permissible objects of the power of appointment must be considered to be "beneficiaries" of the IRA for minimum distribution rule purposes. For example, assume that the income beneficiary may appoint the trust estate by will to anyone other than himself, his estate, his creditors, or the creditors of his estate. In such case, under the trust look-through rule it appears that everyone in the world (other that the excluded four appointees) is considered to a beneficiary of the client's IRA for minimum distribution rule purposes. Pvt.Ltr.Ruls. 200235038–200235041 and 200537044 involved testamentary powers of appointment that could not be exercised in favor of anyone who was older than the intended "designated beneficiary" of the IRA. In drafting a trust that will be the beneficiary of an IRA, it is advisable to limit the objects of a power of appointment to individuals who are younger than the oldest beneficiary of the trust.

- Also, powers of appointment may cause a trust not to qualify for the look-through rule, because some of the trust's beneficiaries might not be identifiable. Likewise, many commentators fear that a trust that lasts forever (a so-called "dynasty trust") does not have identifiable beneficiaries.

Finally, if the trust is a "conduit trust," only the current beneficiary of the trust is considered in determining the designated beneficiary of the IRA. See Article III, A, 2, d, *infra*.

f. September 30 Date

The designated beneficiaries of an IRA are determined on September 30 of the year following the year of the client's death. The designated beneficiaries of the IRA are determined based on the beneficiaries designated on the date of death who remain as beneficiaries as of September 30 of the year following the IRA owner's death. Treas.Reg. §1.401(a)(9)-4, Q & A 4(a).

A person can be a beneficiary of the IRA at the client's death but not be an IRA beneficiary at that later September 30 date. For example, a person may disclaim his or her interest in the IRA or receive his or her entire benefit before that September 30 date. If a person is "cashed out" before September 30, that person is not considered in determining who are the designated beneficiaries of the IRA.

The September 30 rule has many advantages. Because of it, more post-mortem IRA planning can be done, and more IRAs will be able to use the separate account rule.

A designated beneficiary might survive the IRA owner but die before September 30 of the following year. In such a case, the individual continues to be treated as a designated beneficiary of the IRA for determining the required minimum distributions from the IRA. The secondary beneficiary of the IRA is not considered, because the primary beneficiary did survive the IRA owner. Treas.Reg. §1.401(a)(9)-4, Q & A 4(c).

g. Multiple Beneficiaries. The Separate Account Rule.

If an IRA has multiple beneficiaries, the general rule is that the designated beneficiary with the shortest life expectancy will be used in determining the required minimum distributions from the IRA. See Treas.Reg. §1.401(a)(9)-5, Q & A 7(a)(1). For example, assume that the beneficiary of the IRA is a QTIP marital trust that pays income to the spouse for life with remainder to the children. The spouse and children all are designated beneficiaries of the IRA, so the life expectancy of the oldest beneficiary (the spouse) is used in determining the required minimum distributions from the IRA.

If one or more of the multiple beneficiaries of the IRA is not a permissible designated beneficiary, then the IRA is considered to have no designated beneficiary at all. This can occur if a charity or a probate estate is one of the beneficiaries of the IRA. See Treas.Reg. §1.401(a)(9)-4, Q & A 3.

The separate account rule is an important exception to the general rule. If a single IRA has multiple beneficiaries at the IRA owner's death, then the single IRA can be divided into separate accounts for the different beneficiaries. If the division is done by December 31 of the year following the year of death, the minimum distribution rules are applied separately to each separate account. See Treas.Reg. §1.401(a)(9)-8, Q & A 2.

EXAMPLE: A client names her three children, Abel, Baker, and Charlie, as beneficiaries of an IRA. The client dies. By December 31 of the year following death, the IRA custodian divides the IRA into three equal sub-accounts, one for each child. Under the separate account rule, the minimum distribution rules are applied separately to each sub-account. The required distributions from Abel's sub-account are made over Abel's life expectancy, the required distributions from Baker's sub-account are made over Baker's life expectancy, etc.

2. Income in Respect of a Decedent

A traditional IRA is income in respect of a decedent (IRD). It has a built-in income tax liability.

Thus, an IRA is an ideal asset to qualify for the marital deduction. For example, if an IRA of $100 qualifies for the marital deduction, the client's estate receives a $100 estate tax deduction. During the surviving spouse's lifetime, the $100 is paid out of the IRA and incurs income tax at the rate of 28 percent. At the death of the spouse, only $72 is subject to estate tax.

Also, since an IRA is a shrinking asset due to its built-in income tax liability, the client might give other assets that increase in value to a credit shelter bypass trust.

An IRA should not be used to satisfy a pecuniary amount trust or pecuniary amount obligation, since such use results in the premature recognition of the IRD for income tax purposes. See Code §691(a)(2); Treas.Reg. §1.691(a)-4; Chief Counsel Memo. 200644020.

For example, assume a client's living trust agreement establishes a pecuniary amount bypass trust at the client's death. The trustee uses the client's $300,000 IRA to fund the bypass trust. Upon funding, the living trust recognizes $300,000 of taxable income, even though the $300,000 is still inside the IRA and the bypass trust (not the parent living trust) owns the IRA. The client's family is unhappy with this result. Instead, the client's living trust should have used a fractional share formula, so that no pecuniary amount would have been involved.

III. BENEFICIARY DESIGNATIONS FOR IRAs

A. Beneficiary Designations for Married Client

Exhibit A contains rules of thumb to consider in counseling a married client about the beneficiary designation for his or her IRA. Note two critical pieces of information:

- Is the client willing to relinquish control of the IRA to his or her surviving spouse after death, or does the client want to control the disposition of the IRA from the grave?

- Does the client need to use the IRA to fund a $3,500,000 Bypass Trust in whole or in part, because the client does not have sufficient other assets to fund the Bypass Trust fully?

1. Relinquishing Control of IRA to Surviving Spouse After Death: Spouse Is Outright Beneficiary of IRA

If the client is willing to relinquish control of the IRA after death, naming the client's surviving spouse as the outright beneficiary-owner of the IRA gives the best tax results. See Exhibit B.

With this beneficiary designation, the beneficial ownership of the IRA is vested in the surviving spouse upon the death of the client. The spouse may withdraw any part or all of the IRA at any time, and upon the subsequent death of the spouse, the spouse's 100-percent beneficial interest in the IRA passes by beneficiary designation, or if none, as an asset of the spouse's probate estate. This beneficiary designation does *not* mean that all of the assets in the IRA must be distributed out of the IRA to the spouse upon the death of the client.

The estate tax benefit of this beneficiary designation is that the IRA qualifies for the marital deduction in the client's estate and declines in value because of its built-in income tax liability.

The income tax benefit of this beneficiary designation is the ability to defer income taxation of the IRA. The surviving spouse need not begin receiving mandatory distributions from the client's IRA until the year that client would have attained age 70½. Also, the spouse may roll over the client's IRA to the spouse's own IRA. The spouse need not begin withdrawals from his or her own IRA until the spouse attains age 70½, and, thereafter, mandatory distributions from the spouse's IRA may be made using the uniform lifetime table. After the death of the spouse, mandatory distributions may be made over the life expectancies of the designated beneficiaries of the spouse's IRA (*e.g.,* the children of the spouse).

2. Retaining Control of IRA After Death: QTIP Trust is Beneficiary of IRA.

If a client wants to control the disposition of the IRA from the grave, he or she should consider naming a QTIP trust as the beneficiary of his or her IRA. The QTIP trust is the standard way that clients control property after death and still qualify for the marital deduction. See Exhibit C.

Clients customarily designate the surviving spouse as outright beneficiary of their IRAs out of ignorance and habit and without consulting an attorney. However, two questions should be considered before making any such designation:

- If the client's main estate planning document uses a QTIP trust, is it incongruous to give the IRA (which may be client's largest asset) to the spouse outright?

- On the other hand, in order to control the IRA from the grave, is the client willing to have distributions of principal from the IRA taxed in a QTIP trust at the highest income tax rate, when the spouse probably will be in a lower income tax bracket?

a. "All Income" Requirement

(1) In general

The primary concern about naming a QTIP trust as beneficiary of a client's IRA always has been that the surviving spouse might not receive all of the income from the IRA at least annually. For example, assume that an IRA is worth $100,000, the required minimum distribution for the year is $5,000 (1/20), and the IRA earns $7,000 of interest and dividends for the year. A QTIP trust is beneficiary of the IRA. If the QTIP trust receives only $5,000 from the IRA for the year, the spouse does not receive all of the income generated by the IRA and the IRA will not qualify for the marital deduction. Even if the QTIP trust receives all of the $7,000 of income from the IRA, the spouse will not receive all the income, and the marital deduction will be lost, if the trustee adds any of the $7,000 to the principal of the QTIP trust.

(2) Revenue Ruling 2006-26

In Rev.Rul. 2006-26, a testamentary QTIP trust was the beneficiary of an IRA, and the IRA qualified for the marital deduction. The key point in the Ruling is that the surviving spouse must either receive or have the right to compel the QTIP trustee to withdraw from the IRA and pay to the spouse, at least annually, all of the trust accounting income earned on the IRA assets during the year. The principles of Rev.Rul. 2006-26 are also mentioned in the finalized regulations for the minimum distribution rules. See Treas.Reg. §1.401(a)(9)-5, Q & A 7(c)(3).

(3) Principal and Income Acts of the Several States Do Vary

If the trust instrument is silent on determining the income and principal from the IRA, then applicable state law governs the matter. The principal and income acts of the several states do vary on this.

(A) 1997 Uniform Principal and Income Act

Many states (e.g., Arizona, California, Michigan) have adopted Section 409 of the 1997 Uniform Principal and Income Act ("UPIA"). Section 409(c) of the UPIA provides that

- Required minimum distributions from the IRA are allocated 10% to trust accounting income and 90% to principal.

- All other distributions from the IRA (e.g., the trustee withdraws additional amounts from the IRA) are allocated 100% to principal.

This does not satisfy the requirements of Rev. Rul. 2006-26.

Section 409(d) of the UPIA is a marital deduction savings provision -- if the trustee must allocate more of a payment from an IRA to income in order to obtain the estate tax marital deduction, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction. Unfortunately, in Rev. Rul. 2006-26 the Internal Revenue Service states that "Section 409(d) of the UPIA, requiring an additional allocation to income if necessary to qualify for the marital deduction, may not qualify the arrangement under Section 2056." This is based on the IRS position that savings clauses are ineffective to reform an instrument for federal transfer tax purposes.

Rev. Rul. 2006-26 was issued on May 5, 2006, and it was not clear how practitioners would respond to it in situations where the 10% - 90% rule of UPIA Section 409(c) applies to a marital trust that holds an IRA. The Ruling applies only prospectively for tax years beginning on or after May 30, 2006. It is possible that the courts could uphold the validity of the savings clause in UPIA Section 409(d), despite the IRS position in Rev. Rul. 2006-26.

- For the time being, QTIP trustees probably will continue to administer the IRA as before, using the savings clause in UPIA Section 409(d).

In response to Rev. Rul. 2006-26, the National Conference of Commissioners on Uniform State Laws amended UPIA Section 409 in July, 2008 to satisfy the requirements of the Revenue Ruling. Under the amendment, the Revenue Ruling's provisions apply (and the 10% - 90% rule no longer applies) to marital deduction trusts that hold IRAs.

(B) Other State Statutes

Some states have not adopted Section 409 of the UPIA or have modified Section 409. For example, in Florida and Illinois

- The trust accounting income of the IRA as shown by the statements of the IRA custodian, is trust accounting income of the trust which owns the IRA.

- If the trust accounting income of the IRA or other retirement plan cannot be determined, then a marital deduction savings provision applies. (Example: If a QTIP trust is the beneficiary of decedent's 403(b) annuity, the annuity company often is unable to tell the QTIP trustee how much interest, dividends and other trust accounting income has been earned by decedent's 403(b) account. TIAA-CREF is the best-know provider in the 403(b) market.)

(4) Uncertainty may require drafting.

The above discussion shows the difficulty in relying upon state law to determine the income and principal of an IRA account that is owned by a QTIP trust. Thus, it is advisable that the QTIP trust document have a specific provision on this matter of principal and income.

In QTIPing an IRA, careful drafting is needed. This includes the drafting of both the QTIP trust instrument (to ensure that the QTIP trust satisfies the "all income" requirement) and the IRA's beneficiary designation and payment direction (to ensure that the trustee of the QTIP trust has the right to withdraw from the IRA all of the income earned inside the IRA).

(5) Drafting approaches to satisfying all income requirement.

Given the above considerations, how does the estate planner have a QTIP trust as beneficiary of a client's IRA and ensure that it qualifies for the marital deduction? Two approaches are mentioned in Rev.Rul. 2006-26 and Treas.Reg. §1.401(a)(9)-5, Q & A 7(c)(3):

(A) Simple Approach: Pay All Income Out of IRA to Surviving Spouse.

In this simple approach, both (i) the QTIP trust and (ii) the beneficiary designation and payment direction for the IRA, are drafted to so that the surviving spouse receives all of the income earned on the IRA assets.

(i) The QTIP trust document expressly provides that the trustee of the QTIP trust must withdraw all of the income earned by the IRA at least quarterly and pay it to the surviving spouse. See Exhibit D.

- In the above example, the QTIP trustee withdraws the $7,000 of income from the IRA, and pays that $7,000 to the spouse as income of the QTIP trust.

(ii) The IRA document, or its beneficiary designation and payment direction, must permit the trustee of the QTIP trust to withdraw all of the income earned by the IRA. In Exhibit B, the first sentence of Section 2(a) accomplishes this by giving the beneficiary (i.e., the QTIP trustee) the right to withdraw any part or all of the income and principal of the IRA at any time or times.

This simple approach sometimes might not produce maximum income tax deferral. All of the income is paid out of the IRA, even if that income exceeds the IRA's required minimum distribution amount for the year. Approach (B) below is more complicated. It seeks to both obtain the marital deduction and have only the required minimum distribution paid out of the IRA.

(B) *More Complicated Approach: Spouse May Withdraw the Income from the IRA*.

In this more complicated approach, the terms of the QTIP trust do not direct the trustee to pay to the spouse all of the income earned by the IRA. Rather, the QTIP trust gives the spouse the right to compel the QTIP trustee to withdraw from the IRA all of the income earned by the IRA assets, and to pay that income to the spouse. See Exhibit E.

This approach relies on Treas. Reg. §20.2056(b)-5 (f)(8), which provides that the spouse's right to withdraw all the income of the trust is sufficient to satisfy the "all income" requirement of IRC §2056(b)(5), even though any income not withdrawn is accumulated and added to trust corpus. In this approach:

- The IRA pays the required minimum distribution amount to the QTIP trust. This payment is income to the QTIP trust, to the extent that the IRA earned income during the year. According, the QTIP trust pays that income to the spouse.

- The IRA may have income in excess of the minimum distribution amount. The spouse has the continuing right to compel the QTIP trustee to withdraw that excess income from the IRA and pay it to the spouse.

In the above example, the QTIP trustee receives the $5,000 required minimum distribution from the IRA, and the QTIP trustee pays that $5,000 to the surviving spouse as income of the QTIP trust. The last $2,000 of IRA income remains inside the IRA, subject to the spouse’s continuing right to compel the QTIP trustee to withdraw the $2,000 and pay it to the spouse.

With this approach, the spouse must have a *continuing* right to withdraw the excess IRA income. If her withdrawal right lapses during her lifetime, the spouse will have made a taxable gift to the remaindermen of the QTIP trust. The spouse's continuing withdrawal right will lapse upon the death of the spouse, but at that time all of the IRA will be included in spouse's gross estate for federal estate tax purposes in any event.

(C) Evaluation of two "QTIPing" approaches

Both the simple and more complicated approaches to "QTIPing" the IRA appear to be reasonable. The simple approach recognizes that a majority of surviving spouses always will need to receive all of the income earned by the IRA to help pay for their living expenses. Also, with this approach, if the spouse does not need all of the income earned by the IRA, the IRA can invest in assets that produce less trust accounting income (*e.g.,* zero coupon bonds or stocks with low dividend yields). The more complicated approach may provide more income tax deferral in some years (*i.e.,* years in which the income earned by the IRA is more than the required minimum distribution from the IRA for the year).

b. Naming a QTIP Trust as Beneficiary of an IRA

Naming a QTIP trust as beneficiary of client's IRA is straightforward. See Exhibit C.

The client will want the surviving spouse to be the designated beneficiary of the IRA for minimum distribution rule purposes, even though the QTIP trust is named as the beneficiary of the IRA. Accordingly, the spouse should be the oldest of all of the present and future beneficiaries of the QTIP trust, and a charity should not be a remainderman of the QTIP trust. See Article II, B, 1, e, *supra*.

NOTE: When a client names a QTIP trust as beneficiary of his or her IRA, this funding of the QTIP trust will not cause recognition of IRD because it is similar to a specific bequest of property. See Treas.Reg. §1.691(a)-4(b)(2) and Pvt.Ltr.Rul. 200702007.

c. Income Tax Problem

The QTIP trust, as beneficiary of the client's IRA, often will receive a minimum required distribution from the IRA that is larger than the income earned by the IRA. For example, in a calendar year, a $1,000,000 IRA may have interest, dividends and other trust accounting income of only $40,000 but a required minimum distribution of $100,000. The QTIP trust will receive $100,000 from the IRA, pay the $40,000 of income to the spouse, and retain the last $60,000 as principal of the QTIP trust. The QTIP trust will pay income tax on that $60,000.

The income tax problem is that the QTIP trust is in the maximum federal income tax bracket above $7,500 of taxable income (adjusted for inflation). On the other hand, the surviving spouse is not in the maximum bracket until he or she has $250,000 of taxable income (adjusted for inflation). The surviving spouse might demand that the QTIP trust distribute $92,500 ($100,000 – 7,500) to him or her because he or she is in a lower income tax bracket than the trust. Note that the entire $100,000 is included in the QTIP trust's distributable net income, so paying $92,500 to the spouse would carry out $92,500 of taxable income from the QTIP trust to the spouse.

Such a $92,500 payment to the spouse may save some income tax, but it may defeat the client's intent of controlling the IRA property from the grave. The trustee of the QTIP trust might properly be unwilling to pay the spouse $52,500 of trust principal ($92,500 total distribution minus $40,000 of income required to be distributed) simply to equalize the income tax brackets of the trust and the spouse. Indeed, the terms of the QTIP trust often will not permit such a distribution of principal to the spouse.

How will the client deal with this income tax problem, and how will it affect the choice of beneficiaries for his or her IRA? Possibilities include the following:

(1) Name the spouse as outright beneficiary. The client might name the spouse as the outright beneficiary of the IRA. The client might have some desire to "QTIP" the IRA and control it from the grave, but the problem of dealing with the maximum income tax rate outweighs the benefit of "QTIPing" the IRA.

(2) Pay the tax at the maximum rate. If a client has a second spouse and children by a first marriage, the client probably will "QTIP" the IRA. The QTIP trust retains principal distributions from the IRA and pays the tax on them at the maximum rate. Achieving the client's personal goals is worth paying the higher income tax rate.

(3) Conduit trust. The QTIP trust can be drafted as a conduit trust for minimum distribution rule purposes, so that all distributions from the IRA to the QTIP trust are promptly distributed out to the spouse. See Article III, A, 2, d, *infra.*

(4) IRA trust itself is a QTIP trust. In this approach, the IRA itself operates as a QTIP trust. The IRA pays all of its trust accounting income directly to the spouse. The spouse also receives any additional amounts required to be distributed from the IRA under the minimum distribution rules, and the IRA trustee in its discretion may invade principal for the spouse. See Article III, A, 2, e, *infra.*

(5) Trustee gives spouse a *Crummey* power. If a QTIP trust is the beneficiary of the IRA, perhaps distributions of principal from the IRA to the QTIP trust could nonetheless be taxed to the spouse personally. In this approach, the QTIP trust instrument authorizes the QTIP trustee to grant the spouse a *Crummey* withdrawal right over IRA principal distributions to the trust. Those distributions are taxed to the spouse personally (at the lower individual income tax rate), but they are retained in the QTIP trust as trust principal because the spouse does not exercise the *Crummey* right. The trust reimburses the spouse for the income tax paid on distributions taxed to him or her.

In the above example, the trustee would take $52,500 of the principal distribution from the IRA and hold it as a separate trust identical to the QTIP trust. The trustee grants the spouse a *Crummey* withdrawal right over the $52,500, so it is taxed to the spouse personally under Code §678(a)(1). The withdrawal right lapses, so the $52,500 remains in the separate QTIP trust. The separate QTIP trust is a grantor trust, so each year it distributes principal to reimburse the spouse for the additional income tax that he or she pays because of the grantor trust.

Commentators have suggested this approach in non-IRA situations. In the IRA area, it is a novel, aggressive approach. Its advantage is that it enables the client to control the IRA from the grave and also use the spouse's lower income tax rates. Its disadvantages are that it is untested, it involves the work and expense of a second QTIP trust, and it is difficult to draft and to administer.

d. Conduit Trust

If a trust is the beneficiary of an IRA, the general rule is that for minimum distribution rule purposes, all of the present and future beneficiaries of the trust must be considered in determining the designated beneficiary of the IRA for minimum distribution rule purposes. See Treas.Reg. §§1.401(a)(9)-4, Q & A 5; 1.401(a)(9)-5, Q & A 7(c)(1). Therefore, if a QTIP marital trust is the beneficiary of an IRA, the remaindermen of the QTIP trust (as well as the income beneficiary) are considered in determining the designated beneficiary of the IRA. This can be a problem if the spouse has a testamentary power of appointment over the trust assets, if remaindermen are older than the spouse, or if a charity is a remainderman of the trust. See Article II, B, 1, e, *supra.*

The QTIP trust may be drafted, however, so that only the current beneficiary of the trust is considered in determining the designated beneficiary of the IRA for minimum distribution rule purposes. In this technique, the trust operates as a "conduit trust." The QTIP trust provides that all distributions (including required minimum distributions and all other distributions) that the trust receives from the IRA must be paid by the trust to the spouse. The general concept is that the surviving spouse must receive all of the distributions that are made from the IRA during the spouse's lifetime. See Treas.Reg. §1.401(a)(9)-5, Q & A 7(c)(3), Examples 2 and 3.

This technique is an IRA planning opportunity because it enables the IRA owner to

(1) retain some control over the IRA after death by means of a QTIP trust;

(2) obtain the income tax deferral benefits given to the IRA when the spouse is the sole designated beneficiary; and

(3) avoid paying income tax at the highest marginal rate on distributions of principal from the IRA (if these distributions are retained by the QTIP trust as trust accounting principal, the QTIP trust pays income tax on the retained distributions; the QTIP trust gets into the top income tax bracket quickly).

The technique is similar to the IRA trust itself serving as a QTIP trust, which is discussed in the next section.

An IRA owner in a first marriage might want to have a QTIP marital trust that satisfies the requirements for a conduit trust. See Exhibit F.

An IRA owner in a second marriage probably will not use this technique. If the second spouse lives out a normal life expectancy, most of the principal of the IRA will be distributed to the second spouse during the spouse's lifetime. An IRA owner in a second marriage probably wants the QTIP marital trust to retain all of the distributions of principal from the IRA, even if the QTIP trust must pay the highest income tax rate on those distributions.

NOTE: In addition to a QTIP marital trust, other types of trusts (e.g., child's trust, grandchild's trust, bypass trust) also may be drafted to be conduit trusts for minimum distribution rule purposes.

e. IRA Itself Is a QTIP Trust

In the preceding approaches, a marital trust is the beneficiary of the IRA. The trust is interposed between the IRA and the surviving spouse, and the client uses the trust to control the disposition of the IRA assets from the grave.

Another possible approach is for the IRA itself to qualify as a QTIP trust. The IRA document is an IRA trust agreement (see IRS model Form 5305) rather than an IRA custodial agreement (compare IRS model Form 5305A). No separate trust is placed between the IRA and the surviving spouse. Rather, the IRA trust agreement has detailed payment instructions that

- qualify the IRA for the marital deduction as QTIP property;
- satisfy the minimum distribution rules under Code §401(a)(9); and
- do not permit the spouse to withdraw the IRA.

In this approach, the IRA is a separate QTIP marital trust. It enables the client to control the IRA assets after death. The approach is sometimes called the "inside QTIP" approach because the QTIP trust is created inside the IRA. See Exhibit G.

After the death of the client, the spouse receives each year all of the income from the IRA and the additional amount, if any, required to satisfy the minimum distribution rules under Code §401(a)(9). If desired, the trustee of the IRA can be given authority to distribute other principal amounts to the spouse for the spouse's benefit, but the spouse does not have the right to withdraw all of the property from the IRA.

Advantages of this approach include:

- Avoiding the high income tax rate on a separate QTIP trust
- Using the life expectancy of the spouse for the IRA's distribution period, even though without this the IRA would not have any designated beneficiary at all for minimum distribution rule purposes (e.g., a charity is a remainder beneficiary of the IRA). The charity is not considered one of the "designated beneficiaries" of the IRA for purposes of the minimum distribution rules, because the spouse will receive all of the distributions that are made from the IRA during his or her lifetime.

There are, however, several disadvantages with this approach:

- The IRA operates like a QTIP trust, so the client probably will have a three-trust estate plan: the client's will or revocable trust establishes a QTIP marital trust and a bypass trust, and the IRA operates as a second QTIP marital trust. The approaches discussed above result in a two-trust estate plan -- the client's estate plan creates a QTIP marital trust and a bypass trust, and the IRA is an asset of the QTIP marital trust.

- The spouse receives some principal from the IRA, so the client has less control over the IRA assets after death than if a QTIP or bypass trust had been the beneficiary of the IRA.

- Many IRA custodians are not capable of administering (or refuse to administer) an IRA under this approach. To use this approach, the IRA should be an IRA trust. The trustee should be a financial institution that has a trust department that is experienced in administering QTIP trusts.

f. Alternative to QTIPing the IRA: Give the IRA in Shares to Spouse and Children

The above discussion shows the complexity of QTIPing an IRA. Especially in second marriages, some IRA owners might reject the complexity and simply decide to give the IRA outright in shares to the surviving spouse and children (e.g., ____% to the surviving spouse and ___% to the descendants, by representation).

3. Funding Bypass Trust with IRA

A client may have to use his or her IRA to fund a $3,500,000 Bypass Trust in whole or in part, because the client does not have sufficient other assets to fund the Bypass Trust fully. For example, a client's only significant assets might be a residence (held in joint tenancy with the spouse) and a $4,000,000 rollover IRA account. If the IRA is given to the spouse outright, the client will waste his or her applicable credit amount.

Because of the 2001 Tax Act, even more clients will have to use their IRAs to fund the Bypass Trust. As the applicable exclusion amount has now increased to $3,500,000, more clients will not have sufficient other (non-IRA) assets to fund the Bypass Trust fully. This is because as the applicable exclusion amount increases for the client and spouse:

- The size of client’s Bypass Trust increases, and also

- The client probably will give more assets to the spouse, so that the spouse has enough assets in her own name to fund a Bypass Trust fully. The client will give non-IRA assets to the spouse, so that the client is left with the IRA and few other assets.

From a tax viewpoint, an IRA is an undesirable asset to fund the bypass trust (see Article I, B, 2, *supra*) and it is a desirable asset to give to the surviving spouse outright (see Article III, A, 1, *supra*). Some IRA owners may decide to give the IRA to the spouse outright, even though this results in the bypass trust not being funded with a full $3,500,000.

- The income tax benefits of a spousal IRA rollover may outweigh the benefits of funding the bypass trust fully, especially since the surviving spouse’s applicable exclusion amount has now increased to $3,500,000.

If the client decides to use part or all of the IRA to fund the bypass trust, to accomplish this there are two traditional techniques (the disclaimer approach and the revocable trust approach) and one new possible technique (the joint trust approach):

a. Disclaimer Approach

For clients in a first marriage, the disclaimer approach is the most popular technique for using an IRA to fund the Bypass Trust. The client relies on the spouse to disclaim part or all of the IRA to shelter client's unified credit.

In the disclaimer approach, the client names the spouse as primary beneficiary of the IRA. If the spouse disclaims a part or all of the IRA, the beneficiary of the disclaimed part of the IRA is: The Bypass Trust created under client's revocable trust or will. See Exhibit B. The client hopes that after death, the surviving spouse will disclaim exactly enough of the IRA to fund the Bypass Trust fully.

The advantage of the disclaimer approach is its simplicity (and ease of drafting) at the estate planning stage. Its main disadvantage is that the surviving spouse might not disclaim the IRA after client's death but simply roll over all of the IRA into the spouse's own IRA, thus wasting client's applicable exclusion amount. This approach also requires a sophisticated, formula disclaimer by the surviving spouse, and it assumes that the surviving spouse has the legal capacity to disclaim.

The client may die in the middle of the calendar year, before receiving the required minimum distribution from the IRA for the year. This distribution must be paid to the IRA beneficiary (the spouse) by December 31, which may occur before the spouse has disclaimed a portion of the IRA. When the spouse receives the RMD, is this an acceptance of benefits from the IRA, which precludes the spouse from disclaiming any portion of the IRA? Revenue Ruling 2005-36 provides that the spouse may receive the required minimum distribution and still make a qualified disclaimer of the IRA (other than the required minimum distribution, and the income thereon, which was paid to the spouse).

b. Client's Revocable Trust or Testamentary Trust. Rule of Thumb.

The beneficiary of the IRA can be the client’s revocable trust or the trust created under client’s will. The trust establishes a marital share and a bypass trust. The IRA is an asset of the trust, and the trustee allocates the IRA between the marital share and the bypass trust.

- The revocable trust should use a fractional share marital formula to avoid premature recognition of IRD on funding the marital share and the bypass trust.

- The marital share can be given to the surviving spouse outright or given to a marital trust.

Many clients want to enable the surviving spouse to roll over the IRA to the spouse's own IRA since this gives the best tax results. If this result is desired,

- give the marital share to the surviving spouse outright or

- if a marital trust is used, give the spouse the right to withdraw the IRA from the marital trust,

and in either case direct the trustee to use the IRA first to fund the marital share or trust.

General Rule of Thumb: In IRA beneficiary designation planning, a general rule of thumb is:

> Do not name a revocable trust as beneficiary of an IRA,
> unless there is no other way to accomplish the client's goals.

This beneficiary designation has many pitfalls. Unfortunately, an IRA owner often does not consult the estate planning attorney when naming a beneficiary for an IRA. Out of ignorance, he or she names the revocable trust as beneficiary of the IRA. This mistake is not discovered until after the IRA owner has died, and then the attorney must do post-mortem IRA planning to salvage the situation.

Pitfalls of Revocable Trust as Beneficiary of IRA. A revocable trust usually has multiple beneficiaries, both present and future. If the client intends the spouse to be the designated beneficiary of the IRA for minimum distribution rule purposes, the spouse should be the oldest beneficiary of the revocable trust. Because of the trust "look-through" rules (Article II, B, 1, e, *supra*), it is difficult to name a revocable trust as beneficiary of the IRA. It is easy for the IRA inadvertently to have the wrong designated beneficiary, or no designated beneficiary at all, for minimum distribution rule purposes. Consider the following examples:

- The client's revocable trust might give $5,000 to the client's parent. Because the parent is older than client's spouse, the parent (and not the spouse) will be the designated beneficiary of the IRA for purposes of the minimum distribution rules. See Treas.Reg. §1.401(a)(9)-5, Q & A 7(a)(1).

- The client's revocable trust might give $5,000 to a charity. A charity is not a permissible designated beneficiary, so the IRA is considered to have no designated beneficiary at all for minimum distribution rule purposes.

- The revocable trust might have primary responsibility for paying the client's death taxes, administration expenses, debts, and other obligations of the client's probate estate. If the revocable trust has this primary responsibility, the IRS could argue that the probate estate is one of the multiple beneficiaries of the revocable trust, and a probate estate is not a permissible designated beneficiary under the minimum distribution rules. See Treas.Reg. §1.401(a)(9)-4, Q & A 3 and Pvt.Ltr.Ruls. 200440031 (Oct. 1, 2004), 200432027 (May 12, 2004).

Naming a revocable trust as beneficiary of an IRA requires careful planning. To avoid the above problems, the gifts to the parent and to charity might be made in the client's will and not in the revocable trust. The probate estate might have primary responsibility for paying the expenses and obligations of the estate, even if the client hopes to avoid probate. Alternatively, the revocable trust agreement could include a provision which states that IRA assets shall not be used to make gifts to the parent or to charity, or to pay the obligations of the client's estate. See Pvt.Ltr.Ruls. 200235038–200235041 (Aug. 30, 2002) and 200537044 (Sept. 16, 2005).

Post-Mortem IRA Planning. After the death of the client, the trustee of the revocable trust can use the "cash-out" technique described in Article II, B, 1, f, *supra*. In this technique, beneficiaries of the revocable trust with short (or no) life expectancies are cashed out before September 30 of the year following death. Before the September 30 date, the trustee could pay in full the gifts to the parent and to charity and also pay the obligations of the client's estate.

As the trustee of the revocable trust proceeds to cash out certain beneficiaries of the revocable trust, there may be concern that it might not be possible to make some payments by the September 30 deadline. For example, additional probate estate obligations, such as additional federal estate tax on audit, might arise after September 30. As a back-up to the cash out technique, perhaps the trustee of the revocable trust could release and disclaim the trustee's power and ability, after September 29, to use the assets of client's IRA to make the gifts to the parent or charity or to pay the obligations of the client's estate. See Exhibit H.

c. Joint Trust Approach

The joint trust approach is a new possible technique for funding the bypass trust when the IRA owner does not have enough other, non-IRA assets in his or her name to accomplish this. This approach was discussed in Pvt.Ltr.Ruls. 200101021, 200210051 and 200403094.

Consider the following commonplace example: The IRA owner and his or her spouse own $7,000,000 of assets, titled as follows:

$3,500,000 IRA	IRA owner
$3,500,000 of other assets	Spouse

All of the couple's non-IRA assets have been re-titled into the spouse's name alone, so that if the spouse dies first, the spouse will have enough assets to fund a $3,500,000 bypass trust for the benefit of the surviving IRA owner. This has the disadvantage, however, that if the IRA owner dies first, the bypass trust will be funded solely with the IRA.

The tax goals of the joint trust approach are to

Give the IRA to the surviving spouse outright, so the spouse can roll decedent's IRA over to the spouse's own IRA, and also

Fund the bypass trust fully with non-IRA assets, regardless of whether the IRA owner or the spouse dies first.

To accomplish this, in the joint trust approach:

- The IRA owner names the surviving spouse as the outright beneficiary of the $3,500,000 IRA, and

- The couple transfers the remaining $3,500,000 of non-IRA assets to a joint living trust agreement established by them as co-settlors. The joint trust agreement provides that upon the death of the first settlor to die, the deceased settlor has a general testamentary power of appointment over the applicable exclusion amount, and in default of appointment that amount passes to an irrevocable bypass trust for the benefit of the surviving settlor.

Thus, the bypass trust is fully funded with non-IRA assets, regardless if the IRA owner or the spouse dies first.

The joint trust approach is a creative, novel technique, and commentators have discussed it. See Montgomery, "Joint Trusts: Opportunities and Pitfalls," 48 IICLE Estate Planning Short Course Sec. 5 (April/May 2005). See also Gans and Blattmachr, "Making Spousal Estate Tax Exemptions Transferable," 19 Am. Bar Assoc. Property & Probate No. 6, at 10 (Nov./Dec. 2005).

- Its advantage is that the bypass trust is funded with the couples' non-IRA assets, even if the IRA owner dies first, so that the IRA can be given to the surviving spouse outright.

- Its disadvantages include

  (i) so far the Internal Revenue Service has issued only private letter rulings on this technique, and

  (ii) non-marital property transferred to the joint trust may be converted into marital property for divorce law purposes. [This same problem arises in the original example, however, if the IRA owner retitles non-marital property into the spouse's name alone.]

4. Noncitizen Spouse

If the client's spouse is not a citizen of the United States, the client's IRA will not qualify for the marital deduction unless the IRA passes to a qualified domestic trust. Code §§2056(d), 2056A.

a. If the client wants his or her IRA to pass to a QTIP marital trust, then the QTIP trust should be drafted to satisfy the requirements of a qualified domestic trust.

b. If the IRA is payable to the noncitizen spouse outright, then the spouse can withdraw all of the IRA assets in a lump-sum distribution and roll them over to the spouse's own IRA trust. Code §408(d)(3). There are at least two ways to satisfy the requirements for a qualified domestic trust.

(i) First, the spouse's IRA trust itself can be a qualified domestic trust. Since the spouse may withdraw any part or all of the IRA's income and principal at any time, the IRA trust is a Code §2056(b)(5) marital trust. The spouse and trustee can amend the IRA trust document to include provisions for a U.S. trustee and estate tax withholding. However, before amending a prototype IRA trust agreement, the spouse should make sure that the amendments do not cause the document to lose the protection of its favorable IRS determination letter. As an alternative, the IRS model trust account agreement (Form 5305) could be used for the IRA trust document with U.S. trustee and estate tax withholding provisions added in Article VIII.

The spouse's rollover to the IRA trust should qualify as a transfer to a qualified domestic trust under Code §2056(d)(2)(B). See Treas.Reg. §20.2056A-4(b)(7)(iii), in which it is stated that a noncitizen surviving spouse may assign an IRA to a qualified domestic trust. See also Pvt.Ltr.Rul. 9623063 (June 7, 1996).

(ii) A second possible approach might be for the surviving spouse to create a qualified domestic trust and then assign the surviving spouse's IRA to that qualified domestic trust. See Treas.Reg. §20.2056A-4(b)(7)(iii). See also Pvt.Ltr.Rul. 200620025.

5. IRA as Community Property

If a married client has ever resided in a community property state, client's IRA account may be community property. This applies not only to clients who currently reside in a community property state, but also to clients who used to reside in a community property state but now reside in a common law property state.

Example: Client and spouse reside in Arizona, and the client participates in his employer's qualified plan (e.g., a 401(k) plan). Client and spouse decide to move to Illinois. Accordingly, the client separates from the service of the Arizona employer, receives a lump sum distribution from the Arizona employer's 401(k) plan, and rolls the lump sum distribution over to an IRA titled in client's name. The client and spouse move to Illinois, and the rollover IRA has an Illinois financial institution as its custodian.

The IRA is community property. It is funded with tax-deferred compensation that the client earned while he and his spouse were residents of a community property state (Arizona). The location of the rollover IRA custodian (e.g., Illinois, Arizona, elsewhere) does not affect the community property status of the IRA.

a. IRA participant dies first.

Assume that the IRA is community property and that the IRA participant dies with the spouse surviving. The surviving spouse has a 1/2 community property interest in the IRA. The beneficiary designation for the IRA does *not* control the surviving spouse's 1/2 of it. Rather, the spouse owns 1/2 of the IRA outright.

- Some IRA forms contain a spousal consent, in which the spouse agrees that the participant's beneficiary designation disposes of all of the IRA, including the spouse's 1/2 community property interest in it. An IRA custodian usually includes this consent in its IRA form for administrative convenience. Query whether such a provision might cause a spouse unknowingly to relinquish her community property rights in the IRA, and whether such a provision is binding on a spouse who signs it without being represented by independent counsel.

At the death of the IRA participant, the IRA custodian should divide the community property IRA into two subaccounts, to reflect that

- decedent's 1/2 of the IRA is owned by the beneficiaries named by the decedent, and

- the spouse's 1/2 of the IRA is owned by the spouse.

The spouse probably will withdraw all of her share of the IRA and roll it over to an IRA established by the spouse in her name.

b. Spouse dies first; IRA participant is still alive.

Assume that the IRA is community property and that the spouse dies first, with the IRA participant still being alive.

The predeceased spouse has a 1/2 community property interest in the IRA. The deceased spouse's 1/2 interest in the IRA is an asset of her probate estate, and it will pass according to the terms of her will or by interstate succession.

If the spouse predeceases the IRA participant, usually it is desired that the spouse's 1/2 interest in the IRA should be owned by the surviving IRA participant outright (and not owned by an irrevocable bypass trust or marital trust created by the deceased spouse).

Specific Bequest. The simplest way to accomplish this, is for the spouse to specifically bequeath her interest in the IRA to the participant outright. The spouse's will could provide:

> If my husband John Doe survives me, I give to him outright all of my interests in any individual retirement plans in his name and in any employee benefit plans in which he is a participant.

Disproportionate Allocation of Community Property IRA. If the spouse's will does not specifically bequeath her 1/2 share of the IRA to the surviving participant outright, perhaps the IRA share can nonetheless be allocated to the participant outright by a disproportionate allocation of community property between the surviving IRA participant and the deceased spouse's probate estate. In Pvt.Ltr.Rul. 199925033, the IRS stated that an equal but non-pro rata partition of community property at death did not result in a taxable exchange.

Also, in community property estate planning, the spouse's probate estate often pours over to the joint revocable trust of the client and spouse. The joint revocable trust might authorize the trustee to make disproportionate allocations of property among the various trusts created under the trust agreement. In such case, the trustee of the revocable trust can allocate the IRA solely to the Survivor's Trust, and allocate other assets solely to the Bypass Trust and/or Marital Trust, without suffering a taxable exchange between the trusts.

6. Designating a Secondary Beneficiary

A client should designate a secondary beneficiary for his or her IRA in case the spouse does not survive the client. This type of designation is similar to the beneficiary designations made by an unmarried client.

B. Beneficiary Designations for Unmarried Client

An unmarried client faces the same problems which a married client encounters in naming a beneficiary for his or her IRA, but on a simpler scale. See Part II of Exhibit A.

1. Popular IRA beneficiary designations for an unmarried client.

Popular IRA beneficiary designations for an unmarried client include:

a. *Client's descendants who survive her, by representation*. This beneficiary designation gives client's IRA to the children outright. The client understands and intends that after the death of the client, each child will control his or her share of the IRA.

b. *Client's descendants who survive her, by representation, with shares added to trusts created under client's revocable trust or will*. The client may want one or more of the children to receive their inheritances in trust rather than outright. See Exhibit I.

The client names her descendants, by representation, as beneficiary of the IRA. If client's revocable trust or will creates a separate trust for a descendant, however, the descendant's share of the IRA is not allocated to the descendant outright. Rather, the descendant's share is allocated to the descendant's trust.

With this beneficiary designation, the separate account rule should apply to each child's share of the IRA. The division into shares occurs in the IRA beneficiary designation and not in the revocable trust. See Pvt.Ltr.Rul. 200537044.

The trust for each descendant should be drafted so that the descendant is the "designated beneficiary" of the IRA share. Under the trust look-through rules, the descendant should be the oldest of all of the present and future beneficiaries of the trust. If this is not possible (e.g., because the child has a testamentary power of appointment, or because a charity is a presumptive remainderman of the trust), consider drafting the descendant's trust as a conduit trust. See Article III, A, 2, d, *supra*, and Exhibit F.

The beneficiary designations in (a) and (b) both provide each child with significant income tax deferral.

2. The client's revocable trust. An unmarried client often names his or her revocable trust as beneficiary of an IRA. As discussed in Article III, A, 3, b, *supra*, this beneficiary designation is problematic.

- The IRA might have no designated beneficiary at all (e.g., a charity is one of the beneficiaries of the revocable trust).

- Also, the separate account rule does not apply to the beneficiaries of the revocable trust. See Treas.Reg. §1.401(a)(9)-4, Q & A 5(c).

  EXAMPLE: An unmarried client names her revocable trust as beneficiary of the IRA. The revocable trust provides that upon death, the trust assets are distributed outright to her three children, Abel, Baker, and Charlie.

  The separate account rule does not apply in this situation, and the required minimum distributions from the IRA must be made over the life expectancy of the oldest child. See Pvt.Ltr.Ruls. 200317041, 200317403, 200317044 (Apr. 25, 2003).

- To obtain separate account rule treatment, the division of the IRA into shares must occur in the IRA beneficiary designation (and not in the revocable trust). See the beneficiary designation in #1(b) above.

3. Charity. If a client is charitably inclined, the client also should consider charitable giving with the IRA.

C. Charitable Giving with IRAs

An IRA has a built-in income tax liability, so at death it may be a good asset to give to charity.

Under the old 1987 proposed minimum distribution rule regulations, if a charity was the beneficiary of an IRA, the required minimum distributions from the IRA had to be made over the client's single life expectancy (and not over a longer joint and survivor life expectancy). With the 2002 finalized regulations and the uniform lifetime table, the required distributions to the IRA owner are based only on the owner's age. Naming a charity as the beneficiary of an IRA will not shorten the IRA's distribution period while the client is living.

Under the old regulations, a client often would divide the IRA into two separate IRAs and name a charity as the beneficiary of one of the IRAs. With the 2002 regulations, this cumbersome technique is not needed anymore because of the uniform lifetime table and the change in the date when "designated beneficiaries" are determined. If the client used this technique in the past and currently has two separate IRAs, perhaps the two IRAs can now be merged back into one IRA.

At death, an unmarried client might want to give some money to charity and the balance of his or her assets to children. Assume that the client has both an IRA and other assets. Should the client give the IRA to charity or to the children? Professional advisers have no single answer to this question. An IRA can be a good asset to give to charity because of its built-in income tax liability. On the other hand, an IRA can also be a good asset to give to a child, if the child keeps the money inside the IRA for a long time and uses the IRA as an income tax shelter.

If the client wants to use the IRA for charitable gifting at death, this may be accomplished in several ways:

1. Outright Gift to Charity at Death

a. Entire IRA to Charity.

If the client wants the entire IRA to pass to one or more charities at death, the client simply can name the charities as the beneficiary of the IRA.

- The charities can be donor advised funds or private foundations for client's children, if desired. The client should meet with the donor advised fund, so the client during lifetime can complete any documentation required by the donor advised fund.

With this approach, the amount of the gift to charity is not fixed by the client. The IRA will fluctuate in value during client's lifetime, and the amount of the charitable gift will be the value of the IRA that remains at client's death.

b. Part of IRA to Charity. Percentage or Dollar Amount.

The client may want to give a *percentage* of his or her assets to charity and a percentage to the children. If the IRA is to be allocated in percentages, it is simple to provide for this in the IRA beneficiary designation as well as in the client's estate planning document. The IRA beneficiary designation could provide for "___ % to charity" and "___ % to client's descendants who survive, by representation."

On the other hand, the client may want to give a *dollar amount* to charity and the balance of his or her estate to the children. If these gifts are made in the client's trust, the trust should not use the client's IRA to fund the dollar amount gift to charity. The trust would incur immediate income taxation of the IRA, because the trustee is using income in respect of a decedent to satisfy a pecuniary amount obligation.

In this case, the client might move the charitable gifts out of the trust and into the IRA beneficiary designation. The client's IRA beneficiary designation could provide for "$__________ to charity" and "the balance to client's descendants who survive, by representation."

- The IRA custodian must make the distribution to the charity before September 30 of the year following the client's death. This will cash out the charity, so that the charity will not be considered when the IRA's designated beneficiary is determined on the September 30 date. [If this is not done by September 30, the separate account rule will not apply to the descendants' shares of the IRA. See Treas.Reg. §1.401(a)(9)-8, Q & A 3.]

- At the death of the client, the remaining value of the IRA may be less than the dollar amount of the charitable gift in the IRA beneficiary designation. To prevent abatement of the charitable gift, the client can amend his or her revocable estate planning document to provide for payment of the balance (if any) of the charitable gift from that document.

2. Split-Interest Trusts

The client may want the IRA to benefit an individual for life, with remainder to charity. This can be accomplished with a charitable remainder trust (CRT) under Code §664 or with a regular trust that does not qualify as a CRT.

a. Regular Trust

The client's estate plan can create a regular trust that simply benefits the individual beneficiary for life, with the remainder interest passing to charity. The client can name this trust as beneficiary of the IRA.

If the trust is drafted to pay the individual all of the distributions that the trust receives from the IRA, then the trust is a conduit trust (see Article III, A, 2, d, *supra*). The individual will be considered the sole designated beneficiary of the IRA for minimum distribution rule purposes, and the required distributions from the IRA can be made over the life expectancy of the individual. If the trust is not a conduit trust, however, the IRA will not have a designated beneficiary for minimum distribution rule purposes because one of the beneficiaries of the trust is a charity.

b. Charitable Remainder Trust Under Code §664

Alternately, the client could create a charitable remainder trust that benefits the individual for life, with remainder to the charity. After the death of the IRA owner, the trustee of the CRT can withdraw all of the property from the IRA without adverse income tax consequences, because the CRT is not subject to income tax.

A CRT is not as flexible as a regular trust. With a CRT, the individual beneficiary receives only the unitrust amount or annuity. In comparison, a regular trust can permit discretionary distributions of principal to the individual beneficiary and also give the individual withdrawal rights over the trust principal.

D. Use of Beneficiary Designation Forms

1. Poorly Drafted Commercial Forms.

Beneficiary designation forms often are poorly designed. Many forms just have two or three blanks followed by percentages; the client simply fills in the names of the beneficiaries and the percentage each is to take. Frequent shortcomings of such preprinted forms include the following:

a. Beneficiary designation forms often do not cover the situation in which a beneficiary predeceases the IRA owner. For example, assume that the beneficiaries are three children, each receiving $33^{1}/_{3}$ percent. If one of the children predeceases the IRA owner, who receives the child's $33^{1}/_{3}$ percent share of the IRA? A beneficiary designation should have primary and secondary beneficiaries.

b. Beneficiary designation forms, and plan documents, often are silent on the rights of the beneficiary, such as whether the beneficiary may withdraw any part or all of the property from his or her share of the IRA on demand or whether the beneficiary may direct the investments of the IRA share.

c. Beneficiary designation forms, and IRA plan documents, often are silent on what happens to the beneficiary's share of the IRA after the death of the beneficiary, leaving questions such as the following:

- Who owns the deceased beneficiary's share of the IRA? Possibilities include the secondary beneficiary named by the IRA owner, the probate estate of the deceased beneficiary, etc.

- Once the new owner of the share is determined, what are the rights of that new owner with respect to the share? See shortcoming (b) above. What happens to the share upon the death of this new owner?

2. Solution: Custom Drafted Beneficiary Designation.

As a result of the above shortcomings, the attorney often will have to draft a customized beneficiary designation and payment direction for the client's IRA. For example, an IRA owner might want the following beneficiary designation:

> Primary beneficiary: My spouse at the time of my death, if living.
>
> If my spouse survives me but disclaims a part or all of the IRA, the beneficiary of the disclaimed part of the IRA shall be: The trustee of the bypass trust created under my revocable trust agreement dated xx-xx-20xx.
>
> Secondary beneficiary: If my spouse does not survive me, the secondary beneficiary of the IRA shall be: My children who survive me, in equal shares, except that the then

living descendants of a deceased child of mine shall take by representation the share which the child would have received if living.

Many IRA custodians resist such a beneficiary designation, because it does not use the custodian's printed IRA beneficiary designation form. Also, printed IRA custodial forms often ask for much information about each beneficiary (e.g., name, address, date of birth, social security number, relationship to IRA owner).

Possible solution: Draft a customized beneficiary designation, but also provide the IRA custodian with all of the beneficiary information that it requests in its pre-printed form. See Exhibit J.

E. Tax Apportionment Problems

An IRA may generate substantial federal estate tax upon the death of a client. This usually occurs when the client has no surviving spouse. It can also occur at the death of a married client, however, if the client does not use the unlimited marital deduction (e.g., spouse disclaims, executor does not make a 100% QTIP election).

Client's executor pays the estate tax at death. Note that the probate estate probably will not be the beneficiary of the IRA, because the probate estate is not a permissible "designated beneficiary" for purposes of the minimum distribution rules. Although federal law does not give the executor any reimbursement rights against the IRA, state law might provide for apportionment against non-probate assets unless the will waives the apportionment rights.

Should client's will direct the executor to obtain apportionment for death taxes generated by the IRA?

1. If not, the estate could be rendered insolvent by death taxes.

2. If the executor does obtain apportionment from the IRA, who receives the gross income on the distribution from the IRA to the executor? Possibilities include

    - The probate estate

    - The beneficiary of the IRA (most likely)

    - The Internal Revenue Service? (unlikely)

    Because of the uncertainty in this area, many attorneys recommend that the will should instruct the executor not to seek apportionment against the IRA. This avoids the problem, and it also keeps all of the assets in the IRA for maximum income tax benefit. With this approach, the will and the IRA should have the same beneficiaries.

IV. BENEFICIARY DESIGNATIONS FOR QUALIFIED PLANS

The above discussion of beneficiary designations for IRA accounts also generally applies to naming a beneficiary for the client's individual account in a qualified employee benefit plan. For example, the minimum distribution rules in Code §401(a)(9) and the estate tax marital deduction issues in Rev.Rul. 2006-26 apply both to an IRA account and to an individual account in a qualified plan.

There are, however, three basic respects in which QPs differ from IRAs in terms of estate planning for a client's qualified plan. These differences are when the participant must begin receiving distributions, a possible lump sum distribution at death, and who may be named as a beneficiary.

A. When Participant Must Begin Receiving Distributions

A participant in a QP does not need to begin receiving required distributions from the QP until April 1 of the calendar year following the later of

1. the calendar year in which the participant attains age 70½; or
2. the calendar year in which the participant retires (except five-percent owners of the employer). See Code §401(a)(9)(C).

By comparison, the owner of an IRA must begin receiving minimum distribution from the IRA at age 70½.

B. Possible Lump Sum Distribution at Death

The QP document may require that the deceased employee's account must be distributed in a lump sum after his or her death. For administrative convenience, the employer wants to get rid of the employee's account in the QP after the employee is dead. Before the year 2007, this often created an income tax problem for a nonspouse beneficiary who received the lump sum distribution from the QP.

- If the employee named the surviving spouse as outright beneficiary of the QP account, the spouse can defer income taxation on the lump sum distribution by rolling over the distribution to the spouse's IRA.

- If someone else (e.g., a child, a trust) was the beneficiary of the QP account, however, the spousal IRA rollover was not available. The lump sum distribution from the QP often created a severe income tax problem for the nonspouse beneficiary of the QP account.

  Before the year 2007, to avoid immediate income taxation on the lump sum distribution, sometimes an employee would name a qualified charitable remainder trust as the beneficiary of his or her account in the QP.

The Pension Protection Act of 2006 established Code §402(c)(11), which enables a nonspouse designated beneficiary of the QP accrued benefit to

- establish an inherited IRA in the name of the deceased employee, and
- have the employee's QP assets transferred from the QP to the inherited IRA in a direct trustee-to-trustee transfer.

This direct transfer is treated as an eligible rollover distribution, and it avoids immediate income taxation on the lump sum distribution. [Currently QPs may, but need not, allow such nonspouse rollovers. The Worker, Retiree, and Employer Recovery Act of 2008 changed this so that starting in the year 2010, QPs are required to allow such nonspouse rollovers.]

After the rollover occurs, the distribution provisions of the QP document (e.g., lump sum distribution upon death of employee, or distribution within five years) do not apply to the inherited IRA. Rather, the inherited IRA is subject only to the minimum distribution rules. Notice 2007-7, part V.

To roll over to an inherited IRA, the nonspouse beneficiary must be a "designated beneficiary" for minimum distribution rule purposes. See Article II, B, 1 (d), *supra*. A trust may roll the employee's QP assets over to an inherited IRA, if the trust is the named beneficiary of the QP and the trust's beneficiaries are designated beneficiaries. Notice 2007-7, V, Q & A-16. Direct rollovers by nonspouse beneficiaries apply to qualified plans under Code §401 and also to annuity plans under Code §403(a),(b) and to eligible governmental plans under Code §457(b).

Even if the qualified plan document does not require decedent's account to be distributed in a lump sum, in the decades following death an inherited IRA is easier to administer than an account in a qualified plan. With an inherited IRA, the beneficial owner usually has more investment choices, can withdraw property from the IRA on demand, and can move the IRA to a different financial institution on demand.

C. Who May Be Named as Beneficiary

Another major difference between IRAs and QPs is that a client has less freedom in naming a beneficiary for his or her interest in a QP. The terms of the qualified plan document and federal law restrict the client's flexibility and thus influence the selection of a beneficiary for the QP interest.

The Retirement Equity Act of 1984, Pub.L. No. 98-397, 98 Stat. 1426, limited the client's freedom in designating a beneficiary for his or her QP account. See Code §§401(a)(11), 417; Employee Retirement Income Security Act of 1974, Pub.L. No. 93-406, §205, 88 Stat. 829. These statutes provide the client's surviving spouse with a joint and survivor annuity and a qualified preretirement survivor annuity, unless the spouse waives his or her right to these benefits.

1. <u>Spouse Must Be the Beneficiary</u>. Many defined contribution plans require that the client's spouse must be the outright beneficiary of the client's QP account unless the spouse

consents in writing to another beneficiary designation. These QPs impose this restriction in order to satisfy Code §401(a)(11)(B)(iii) and thus avoid the requirement of paying QP accounts in the form of a joint and survivor annuity.

If the client participates in such a QP and wants to designate a non-spouse beneficiary, the client must obtain the written spousal waiver described in Code §417.

2. Joint and Survivor Annuity. If the client's qualified plan does not require that the client's spouse be the outright beneficiary of the client's QP account unless the spouse consents in writing, the QP must still provide that the client's QP account must be paid in the form of a joint and survivor annuity unless the spouse consents otherwise in writing.

3. Spousal Waiver; Dual Representation. Because of these considerations, the client does not have much flexibility in designating a beneficiary of his or her QP account unless the client can persuade his or her spouse to sign a spousal waiver. Especially in second marriage situations, the client's spouse might not meekly agree to do so.

NOTE: An attorney should exercise extreme caution if he or she represents both the client and the spouse who is signing the spousal waiver.

V. ROTH IRAs

The above materials discuss beneficiary designations for traditional IRAs under Code §408. A client may have a Roth IRA under Code §408A. Importantly, after the death of a Roth IRA owner, distributions from the Roth IRA are not subject to income tax once the five-year holding period is satisfied. Code §408A(d)(2)(A)(ii). Thus, a Roth IRA is not income in respect of a decedent.

Most clients currently do not have large balance Roth IRAs. Roth IRAs have existed only since the Taxpayer Relief Act of 1997. Many wealthy clients have not made annual contributions to Roth IRAs because of the income limitations in Code §408A(c)(3). Clients usually have not converted their traditional IRAs to Roth IRAs because of the income limitation in Code §408A(c)(3)(B)(i) and a reluctance to pay income tax on the conversion amount.

In the future, more clients may have large balance Roth IRA accounts.

- Starting in the year 2005 more clients became eligible to convert a traditional IRA to a Roth IRA. Required minimum distributions from a traditional IRA are no longer included in client's gross income for purposes of determining his or her conversion eligibility.

- Also, beginning in the year 2006, qualified plans under Code §401(k) and §403(b) may allow participants to make after-tax contributions to a Roth account in the plan. Code §402A. There are no income limitations on these Roth contributions, so higher income employees are eligible to make contributions to these so-called "Roth 401(k)" accounts in the QP. The Roth 401(k) accounts may accumulate large balances, and upon retirement the employee usually will roll over the account balance to a Roth IRA. Code §408A(e).

- In addition, beginning in the year 2010, there is no income limitation on converting a traditional IRA to a Roth IRA. The Tax Increase Prevention and Reconciliation Act of 2005 (P. L. 109-222) repeals the income limitation. It also provides special 2-year income averaging for conversions in the year 2010 (the income on the conversion is recognized not in the year 2010, but rather ratably in years 2011 and 2012). Code §408A(d)(3)(A)(iii).

Beneficiary Designations for Roth IRAs.

Who should be the beneficiary of a client's Roth IRA? The above material discussing beneficiary designations for traditional IRAs also generally applies to naming a beneficiary for a client's Roth IRA. For example, the minimum distribution rules in Code §401(a)(9) and the QTIP estate tax marital deduction issues in Rev.Rul. 2006-26 apply to Roth IRAs. However, note some general observations:

1. Naming the surviving spouse as the outright beneficiary of the Roth IRA gives the best tax results. The surviving spouse can roll over the decedent's Roth IRA to his or her own Roth IRA. Indeed, Item 3 of Article V of the IRS model custodial account agreement (Form 5305-RA) provides that if the spouse is the sole beneficiary, the decedent's Roth IRA shall automatically be treated as the surviving spouse's Roth IRA.

In addition, there are no required minimum distributions from the surviving spouse's Roth IRA during his or her lifetime. After the death of the spouse, required minimum distributions from the spouse's Roth IRA can be made over the life expectancy of the designated beneficiary of the Roth IRA (*e.g.,* the spouse's child).

2. If the client wants to QTIP the Roth IRA, the above discussion on QTIPing a traditional IRA also applies to a Roth IRA.

3. If the client needs to use the Roth IRA to fund a credit shelter bypass trust, the above discussion applies, but planning is simpler because the Roth IRA is not income in respect of a decedent.

   - A Roth IRA can be a good asset to give to the bypass trust – it can increase in value more rapidly than other assets because its capital gains and accumulated income are free of income tax.

   - On the other hand, the income tax benefits of giving a Roth IRA to the surviving spouse may be so great that the Roth IRA owner might decide to give the Roth IRA to the spouse and not fund the bypass trust fully. See Article III, A, 3, *supra*.

4. The beneficiary of a Roth IRA should be a designated beneficiary for minimum distribution rule purposes. If there is no designated beneficiary, all of the property must be distributed out of the Roth IRA within five years after the death of the Roth IRA owner. The client probably wants the Roth IRA to remain in existence for decades after his or her death, to continue to generate tax-free income and capital gains for the client's family.

EXHIBIT A

For distribution only
to attorneys and NT staff

March, 2009

NORTHERN TRUST

Popular Beneficiary Designations
for
large Individual Retirement Accounts

I. Married Client

A. First Spouse

1. Client does not need to use IRA to fund the credit shelter Bypass Trust.

Beneficiary: Client's spouse, outright. This beneficiary designation provides the most flexibility for tax purposes.

2. Client has to use IRA to fund the Bypass Trust in part or in whole.

Beneficiary:

a. Disclaimer approach. Primary beneficiary is client's spouse, outright. If spouse disclaims, the beneficiary of the disclaimed part of the IRA is: The Bypass Trust created under client's revocable trust or will. Spouse disclaims just enough of the IRA to fund the Bypass Trust fully.

b. The client's revocable trust, or the trust created under client's will. The trust contains a fractional share formula and establishes a Bypass Trust and an outright marital share.

B. Second Spouse, and Children by First Marriage

1. Client does not need to use IRA to fund the Bypass Trust.

Beneficiary: The QTIP trust created under client's revocable trust or will.

2. Client has to use IRA to fund the Bypass Trust in part or in whole.

Beneficiary: The client's revocable trust, or the trust created under client's will. The trust contains a fractional share formula and establishes a Bypass Trust and a QTIP marital trust.

II. Unmarried Client

A. All children receive their inheritances outright.

Beneficiary: Client's children who survive her, in equal shares, except that the then living descendants of a deceased child shall take by representation the share which the child would have received if living.

B. One or more children receive their inheritances in trust.

Beneficiary: Client's children who survive her, in equal shares, except that the then living descendants of a deceased child shall take by representation the share which the child would have received if living, and except further that if client's revocable trust agreement or will creates a separate trust for a child or descendant, his or her share of the IRA shall be allocated to that trust.

C. Also consider charitable giving with IRAs.

The beneficiary designation (or the IRA agreement) should clearly provide that:

Beneficiary/owner may withdraw any part or all of his or her share of the IRA at any time or times. Ownership of IRA is vested in beneficiary at death of client.

If a trust is the beneficiary of the IRA, consider using one of the following traditional techniques:

1. (a) The trust should not contain a gift to a charity. (b) The trust should not have primary responsibility for paying the decedent's administration expenses, debts, death taxes, or other obligations of the decedent's probate estate. Rather, the trust should have only secondary responsibility, or no responsibility at all, for paying those items. The will should give the probate estate primary responsibility for paying those items, even if the client hopes to avoid probate at death. (c) The spouse should be the oldest of all of the beneficiaries of the trust (including both present and future beneficiaries). (d) If the trust includes a power of appointment, all possible objects of the power of appointment should be permissible "designated beneficiaries" and the spouse should be older than all of the objects of the power of appointment.

2. The trust instrument contains a boilerplate provision which states that upon and after the death of the client, the trustee of the trust may not use an IRA to satisfy any charitable gift, to pay the obligations of the IRA owner's probate estate, or to benefit any trust beneficiary who is older than the spouse. If the trust includes a power of appointment, see #1(d).

The goal is to ensure that the IRA will have a "designated beneficiary" for purposes of the minimum distribution rules. Under the 2002 minimum distribution rule regulations, another possible, less cumbersome approach to attaining this goal might be to rely on the "cash out" technique in finalized Treas. Reg. §1.401(a)(9)-4(A-4)(a). [E.g., the revocable trust contains a gift to charity, but the trustee satisfies the charitable gift in full before September 30 of the year following the year of client's death, so the charity is "cashed out" and is not considered as a beneficiary of the trust for minimum distribution rule purposes on the September 30 date.]

EXHIBIT B

BENEFICIARY DESIGNATION

Primary: Spouse
<u>Secondary: Descendants, by representation</u>

To: Northern Trust, as
trustee/custodian of the John
Doe Individual Retirement
Account #01-23456 (the "IRA")

Article _____________ of the John Doe Individual Retirement Account gives me the rights to name a beneficiary of my IRA and to direct how the IRA shall be distributed after my death.

1. I revoke all prior beneficiary designations and designate the following as beneficiary and equitable owner of my IRA upon my death:

a. PRIMARY BENEFICIARY: My wife, Mary Doe, if she survives me.

If my wife survives me but disclaims a part or all of the IRA, the beneficiary of the disclaimed part of the IRA shall be: The then acting trustee of the Bypass Trust established under the revocable trust agreement executed by me on _________________, 20____, and under which Northern Trust is named as successor trustee.

b. SECONDARY BENEFICIARY: If my wife does not survive me, the beneficiary of my IRA shall be: My children who survive me, in equal shares, except that the then living descendants of a deceased child of mine shall take by representation the share which the child would have received if living.

My wife shall be deemed to have survived me if the order of our deaths cannot be proved.

2. The beneficial interest in, and equitable ownership of, my IRA shall vest in my beneficiary upon my death. Accordingly:

a. My beneficiary may withdraw any part or all of the property in the IRA at any time or times by written notice delivered to the trustee/custodian. This right of withdrawal includes (but is not limited to) the beneficiary's right to elect to receive the greater of (i) all of the income of the IRA and (ii) the minimum amount required to be distributed from the IRA under Internal Revenue Code Section 401(a)(9).

b. Upon the death of an individual beneficiary, his or her beneficial interest in, and equitable ownership of, the IRA shall pass to such one or more beneficiaries as the beneficiary shall designate by a writing filed with the IRA custodian/trustee, or to the extent not effectively disposed of, it shall pass as an asset of the beneficiary's estate.

c. Any successor-in-interest to a beneficiary's vested beneficial interest in, and equitable ownership of, the IRA (by reason of death of the beneficiary, distribution of the interest by a trust or estate, or otherwise) shall succeed to all of the beneficiary's rights with respect to that IRA interest, including the rights to withdraw property from the IRA and have a vested interest in it.

* * * *

I reserve the right to amend or revoke this beneficiary designation.

Dated this _________ day of _____________________, 20___.

____
John Doe

The trustee/custodian acknowledges receipt of this document.

Northern Trust,
as trustee/custodian

By ______________________________

EXHIBIT C

BENEFICIARY DESIGNATION

Primary: Revocable QTIP Trust
Secondary: Descendants, by representation

Use the beneficiary designation form in Exhibit B, but substitute the following for the primary and secondary beneficiaries:

a. PRIMARY BENEFICIARY: If my wife, Mary Doe, survives me, the beneficiary of my IRA shall be: The then acting trustee of the QTIP Marital Trust established under the revocable trust agreement executed by me on ________________, 20____, and under which Northern Trust is named as successor trustee.

   If my wife survives me but disclaims a part or all of the IRA, the beneficiary of the disclaimed part of the IRA shall be: The then acting trustee of the Bypass Trust established under my revocable trust agreement.

b. SECONDARY BENEFICIARY: If my wife does not survive me, the beneficiary of my IRA shall be: My children who survive me, in equal shares, except that the then living descendants of a deceased child of mine shall take by representation the share which the child would have received if living.

My wife shall be deemed to have survived me if the order of our deaths cannot be proved.

EXHIBIT D

QTIP Trust is Beneficiary of an IRA

Simple Approach:
Pay All Income Out of IRA to the Surviving Spouse

The marital trust may be the beneficiary of an individual retirement account or a defined contribution retirement plan. The simple way to qualify the IRA for the marital deduction is for the QTIP trust instrument to direct the QTIP trustee to withdraw all of the income from the IRA and pay it to the surviving spouse, as income of the QTIP trust. If this is desired, the second paragraph may be inserted into the provisions of the marital trust:

* * * *

Marital Trust Provisions

Section 1: Commencing with my death the trustee shall pay the income from the Marital Trust in convenient installments, at least quarterly, to my wife during her lifetime.

If the Marital Trust is beneficiary or owner of an individual account in any employee benefit plan or individual retirement plan, the income of the individual account shall be income of the Marital Trust, and at least quarterly the trustee shall withdraw all of the income from the individual account and pay it to my wife.

The trustee may also pay to my wife such sums from principal as the trustee deems necessary or advisable from time to time for her health and maintenance in reasonable comfort, considering her income from all sources known to the trustee.

(over)

Alternatively, the trust document may contain the following administrative provision in the trustee powers section.

SECTION 3: <u>Principal and Income</u>. The allocation of receipts and disbursements between income and principal shall be determined as provided by this agreement and applicable state statute or in cases not covered by statute by the trustee, except that

(a) if the trust is beneficiary or owner of an individual account in any employee benefit plan or individual retirement plan, income earned after death in the account shall be income of the trust, and if the trustee is required to pay all trust income to a beneficiary, the trustee shall collect and pay the income of the account to the beneficiary at least quarterly (and to the extent that all income cannot be collected from the account, the deficiency shall be paid from the principal of the trust),

(b) reserves for depreciation shall be established out of income only to the extent that the trustee determines that readily marketable assets in the principal of the trust will be insufficient for any renovation, major repair, improvement or replacement of trust property which the trustee deems advisable, and

(c) income received after the last income payment date and undistributed at the termination of any estate or interest shall, together with any accrued income, be paid by the trustee as income to the persons entitled to the next successive interest in the proportions in which they take that interest, except that upon my death the undistributed income shall be added to principal.

EXHIBIT E

QTIP Trust is Beneficiary of an IRA

More Complicated Approach:
Surviving Spouse May Withdraw the Income from the IRA

The marital trust may be the beneficiary of an individual retirement account or a defined contribution retirement plan. There is a way to qualify the IRA for the marital deduction which is

- more complicated than the approach in Exhibit D, but
- may provide more income tax deferral than Exhibit D in some years (i.e., years in which the income earned by the IRA is more than the required minimum distribution from the IRA for the year).

In this more complicated approach, the QTIP trust gives the spouse the right to compel the QTIP trustee to withdraw from the IRA all of the income earned by the IRA assets, and to pay that income to the spouse. If this is desired, the boldface text may be inserted into the provisions of the marital trust:

* * * *

<u>Marital Trust Provisions</u>

Section 1: Commencing with my death the trustee shall pay the income from the Marital Trust in convenient installments, at least quarterly, to my wife during her lifetime.

The trustee may also pay to my wife such sums from principal as the trustee deems necessary or advisable from time to time for her health and maintenance in reasonable comfort, considering her income from all sources known to the trustee.

Section 2: If the Marital Trust is beneficiary or owner of an individual account in any employee benefit plan or individual retirement plan, the income of the individual account shall be income of the Marital Trust. My wife shall have the right to compel the trustee to withdraw that income from the individual account and pay it to her as income of the Marital Trust.

During her lifetime, my wife shall have the continuing right to compel the trustee to withdraw that income from the individual account and pay it to her. To the extent that the income subject to withdrawal is not paid to my wife during her lifetime, then upon her death that income shall be distributed to or in trust for such appointee or appointees

(including the estate of my wife), with such powers and in such manner and proportions as she may direct by her will making specific reference to this power of appointment. Upon the death of my wife any part of that income not effectively appointed shall be added to the principal of the individual account.

In a calendar year, if amounts must be distributed from the individual account to the Marital Trust in order to satisfy the minimum distribution rules under Internal Revenue Code Section 401(a)(9), those distributions shall be satisfied first from the income of the individual account for the current year, and next from the income of the individual account for prior years over which my wife has a withdrawal right. Such distributions of income shall be paid to my wife.

The trustee's powers to invest trust principal shall also apply to investing the income over which my wife has a withdrawal right.

SECTION 3: The personal representative of my estate (or if no representative is acting, the trustee) may elect to have a specific portion or all of the Marital Trust, herein referred to as the "marital portion," treated as qualified terminable interest property for federal estate tax purposes. If an election is made as to less than all of the Marital Trust, the specific portion shall be expressed as a fraction or percentage of the Marital Trust and may be defined by means of a formula. I intend that the marital portion shall qualify for the federal estate tax marital deduction in my estate.

If the marital portion is less than all of the Marital Trust, the trustee in his discretion may divide the Marital Trust into two separate trusts representing the marital and non-marital portions of the Marital Trust. The two separate trusts shall be held and disposed of on the same terms and conditions as the Marital Trust, except that the trustee shall make no invasion of the principal of the non-marital portion trust so long as any readily marketable assets remain in the marital portion trust.

SECTION 4: Upon the death of my wife the Marital Trust shall be added to or used to fund the Bypass Trust, except that, unless my wife directs otherwise by her will or revocable trust, the trustee shall first pay from the principal of the marital portion, directly or to the personal representative of my wife's estate as the trustee deems advisable, the amount by which the estate and inheritance taxes assessed by reason of the death of my wife shall be increased as a result of the inclusion of the marital portion in her estate for such tax purposes. The trustee's selection of assets to be sold to pay that amount, and the tax effects thereof, shall not be subject to question by any beneficiary.

EXHIBIT F

"Conduit Trust"

Spouse is the "sole designated beneficiary" of the IRA

and

Beneficiary of IRA is: QTIP Marital Trust

QTIP Marital Trust Provisions

Section 1: Commencing with my death the trustee shall pay the income from the Marital Trust in convenient installments, at least quarterly, to my wife during her lifetime.

If the Marital Trust is beneficiary or owner of an individual account in any employee benefit plan or individual retirement plan, the income of the individual account shall be income of the Marital Trust, and at least quarterly the trustee shall withdraw all of the income from the individual account and pay it to my wife. **In addition, all other distributions and withdrawals from the individual account to the Marital Trust shall be paid to my wife upon receipt by the trustee of the Marital Trust.**

The trustee may also pay to my wife such sums from principal as the trustee deems necessary or advisable from time to time for her health and maintenance in reasonable comfort, considering her income from all sources known to the trustee.

Section 2: Upon the death of my wife the Marital Trust shall be added to or used to fund the Bypass Trust, …

etc.

NOTES:

In addition to a marital trust, other types of trusts (e.g., child's trust, grandchild's trust, bypass trust) may be drafted to be conduit trusts for minimum distribution rule purposes.

The bold text is based on finalized Treas. Reg. §1.401(a)(9)-5(A-7)(c)(3)(Example 2)(i).

EXHIBIT G

IRA Itself Is a QTIP Trust

Beneficiary Designation
and
Payment Direction

To: Northern Trust, as
trustee of the _________________
____
Individual Retirement Account Trust
No. 01-23456 (the "IRA")

Article _____ of the ____________ Individual Retirement Account Trust gives me the rights to designate a beneficiary of my IRA and to direct how the IRA shall be distributed after my death. In exercise of those rights, I revoke all prior beneficiary designations and payment directions and direct that after my death the trustee shall distribute my IRA trust as follows:

Section 1: If Mary Doe, herein referred to as "my wife," survives me, then commencing with my death, the trustee shall pay the income from the IRA trust in convenient installments, at least quarterly, to my wife during her lifetime.

The trustee may also pay to my wife such sums from the principal of the IRA trust as the trustee deems necessary or advisable from time to time for her health and maintenance in reasonable comfort, considering her income from all sources known to the trustee.

During each calendar year, the trustee shall also distribute to my wife from the principal of the IRA trust the smallest additional amount (if any) required to satisfy the minimum distribution rules under Internal Revenue Code §401(a)(9).

Section 2: The personal representative of my estate (or if no representative is acting, the trustee) may elect to have a specific portion or all of the IRA trust, herein referred to as the "marital portion," treated as qualified terminable interest property for federal estate tax purposes. If an election is made as to less than all of the IRA trust, the specific portion shall be expressed as a fraction or percentage of the IRA trust and may be defined by means of a formula. I intend that the marital portion shall qualify for the federal estate tax marital deduction in my estate. My wife shall be deemed to have survived me if the order of our deaths cannot be proved. My wife shall have the right by written notice to require the trustee to convert unproductive property in the IRA trust to productive property within a reasonable time.

If the marital portion is less than all of the IRA trust, the trustee in its discretion may divide the IRA trust into two separate trusts representing the marital and nonmarital portions of the IRA trust. The two separate trusts shall be held and disposed of on the same terms and conditions as the IRA trust, except that the trustee shall make no invasion of the principal of the nonmarital portion trust as long as any readily marketable assets remain in the marital portion trust.

<u>Section 3</u>: Upon the death of my wife, or upon my death if my wife does not survive me, the beneficial interest in, and equitable ownership of, the IRA trust shall be allocated among and vest in my descendants who are then living, by representation. Each share of the IRA trust created for a descendant shall be held as a separate share and disposed of as hereinafter provided.

<u>Section 4</u>: A descendant may withdraw any part or all of the property in his or her share of the IRA trust at any time or times by written notice delivered to the trustee.

The trustee may also pay to or for the benefit of a descendant such sums from his or her share as the trustee deems necessary or advisable from time to time for his or her health, maintenance in reasonable comfort, education (including postgraduate), and best interests, considering the income of the descendant from all sources known to the trustee.

During each calendar year the trustee shall also distribute to the descendant from his or her share the smallest additional amount (if any) required to satisfy the minimum distribution rules under Internal Revenue Code §401(a)(9).

<u>Section 5</u>: Upon the death of a descendant, his or her beneficial interest in, and equitable ownership of, his or her share of the IRA trust shall be owned by the beneficiaries named by the descendant, or if none, by the descendant's estate. Any successor in interest to the descendant's beneficial interest in, and equitable ownership of, his or her share shall succeed to all of the descendant's rights with respect to the share, including the rights to withdraw property from the share and have a vested interest in it.

*　　*　　*　　*

I reserve the right to amend or revoke this beneficiary designation and payment direction.

Dated this ____________ day of __________, 20__.

____
[client]

RECEIVED:

Northern Trust,
as trustee of the ____________
IRA Trust Agreement

By ______________________________

EXHIBIT H

Release and Disclaimer
by
Trustee of Revocable Trust
to Help Ensure That
______[Insert name of individual]______
Is the Designated Beneficiary
of Decedent's IRA
for Minimum Distribution Rule Purposes

To: Northern Trust,
as trustee/custodian of the IRA of John Doe, deceased xx-xx-20xx

From: The trustee of
the John Doe Revocable Trust Agreement dated xx-xx-19xx

Background:

The John Doe Revocable Trust is the beneficiary of the individual retirement account ("IRA") of John Doe, deceased. The trustee of the revocable trust desires that for minimum distribution rule purposes

a. decedent's IRA shall have a designated beneficiary, and
b. the oldest of all of the designated beneficiaries of the IRA shall be ___________,

so that after the death of the decedent, required minimum distributions from the IRA will be made over the life expectancy of that individual. The trustee of the revocable trust has been informed that making this release and disclaimer may help to ensure that result.

Release and Disclaimer:

The trustee of the revocable trust hereby irrevocably releases and disclaims the trustee's power and ability, after September 29 of the year immediately following the death of the IRA owner, to use the assets of decedent's IRA to make any payments or distributions under the following articles of the revocable trust agreement:

1. Article Second (entitled "Taxes – Expenses")
2. Article Fourth (entitled "Distributions to Charities")
3. Article Fifth (entitled "Distributions to Settlor's Parents")

4. Article Sixth, A (which is a residuary distribution of ___% to the charity AIC)
5. ___________________________________
6. ___________________________________

This release and disclaimer is done pursuant to __________[Insert the authority for the release and disclaimer, such as the Illinois Termination of Powers Act (765 ILCS 325), the Illinois Probate Act (755 ILCS5/2-7) and *Estate of Ware v. Commissioner*, 480 F.2d 444 (1973).]____________ .

The trustee of the revocable trust intends that this release and disclaimer shall satisfy the requirements of Treas. Reg. Section 1.401(a)(9)-(4)(A-4)(a) and also the requirements of state law for a valid release and disclaimer.

This release and disclaimer does not preclude the trustee from using other (non-IRA) assets of the revocable trust to satisfy the above payments and distributions.

The trustee of the revocable trust certifies to the IRA trustee/custodian that the trustee will comply with the terms of this release and disclaimer. The IRA trustee/custodian need not see to the application of property distributed from the IRA to the trustee, and it may honor the trustee's withdrawals from the IRA without question.

Dated this _______ day of ________________ , 20 ____ .

____
the trustee of the John Doe Revocable Trust

RECEIVED this _______ day of ________________ , 20 ____ :

Northern Trust,
as trustee/custodian of the John Doe IRA

By ______________________________

EXHIBIT I

BENEFICIARY DESIGNATION

Primary: Descendants, by representation,
with shares added to trusts
created under client's revocable trust or will

Use the beneficiary designation form in Exhibit B, but substitute the following for the primary and secondary beneficiaries:

> PRIMARY BENEFICIARY: My children who are living at my death, in equal shares, except that the then living descendants of a deceased child of mine shall take by representation the share which the child would have received if living at my death.
>
> However, if any share of this IRA is allocable to a child or other descendant of mine for whom a separate trust is established under the revocable trust agreement executed by me on ________________, 20____, and under which Northern Trust is named as successor trustee, then notwithstanding the foregoing, the share of this IRA for that child or descendant shall be allocated to the then acting trustee under that revocable trust agreement as in effect at my death, to be added to the trust to be held for that child or descendant.

* * * *

Note: There is no secondary beneficiary designation for this beneficiary designation.

Exhibit J

CUSTOM DRAFTED BENEFICIARY DESIGNATION
WITH
BENEFICIARY INFORMATION
FOR IRA CUSTODIAN

To: Mutual Fund Company, as
custodian of the John
Doe Individual Retirement
Custodial Account #123456 (the "IRA")

DESIGNATION OF IRA BENEFICIARY

1. I, John Doe, revoke all prior beneficiary designations and designate the following as beneficiary of my IRA upon my death:

a. PRIMARY BENEFICIARY: My wife, Mary Doe, if she survives me.

If my wife survives me but disclaims a part or all of the IRA, the beneficiary of the disclaimed part of the IRA shall be: The then acting trustee of the Bypass Trust established under the revocable trust agreement executed by me on ________________, 20____, and under which Northern Trust is named as successor trustee.

b. SECONDARY BENEFICIARY: If my wife does not survive me, the beneficiary of my IRA shall be: My children who survive me, in equal shares, except that the then living descendants of a deceased child of mine shall take by representation the share which the child would have received if living.

My wife shall be deemed to have survived me if the order of our deaths cannot be proved.

2. My beneficiary or beneficiaries shall own my IRA upon my death. Accordingly:

a. My beneficiary may withdraw any part or all of the property from the IRA at any time or times by written notice delivered to you.

b. Upon the death of an individual beneficiary, his or her share of the IRA shall pass to such one or more beneficiaries as the beneficiary shall designate by a writing filed with you, or to the extent not effectively disposed of, it shall pass as an asset of the beneficiary's estate.

c. Any successor-in-interest to a beneficiary’s share of the IRA (by reason of death of the beneficiary, distribution of the interest by a trust or estate, or otherwise) shall succeed to all of the beneficiary's ownership rights with respect to that IRA interest, including the right to withdraw property from the IRA.

* * * *

I reserve the right to amend or revoke this beneficiary designation and payment direction.

In addition, I provide the following current information about my beneficiary(ies):

Spouse: Mary Doe
Address: ______________________
Date of birth: ______________________
Soc. Sec. No.: ______________________

I have three children now living, namely:

Child: John Doe, Jr.
Address: ______________________
Date of birth: ______________________
Soc. Sec. No.: ______________________

Child: Dorothy Doe
Address: ______________________
Date of birth: ______________________
Soc. Sec. No.: ______________________

Child: David Doe
Address: ______________________
Date of birth: ______________________
Soc. Sec. No.: ______________________

I am the current trustee of my revocable trust agreement dated xx-xx-20xx. The Northern Trust Company, 50 S. LaSalle St., Chicago, IL 60603, phone #312-630-6000, is the successor trustee of the trust. The trust currently uses my Social Security number as its taxpayer identification number, but after my death the bypass trust will be given a different taxpayer identification number.