BOSTON BAR ASSOCIATION – TRUSTS AND ESTATES SECTION

THE BASICS OF ESTATE PLANNING WITH RETIREMENT BENEFITS

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I. *The Basic Rules for Retirement Benefit Distributions*

A. Minimum Required Distributions during the Participant's Lifetime

1. **Required Beginning Date ("RBD")**: Generally, the Participant must begin to take distributions from any retirement account (other than a Roth account) by April 1st of the year following the year on which the Participant reaches age 70.5.

2. **Minimum Required Distribution ("MRD") Calculation:** The Participant uses the Uniform Lifetime Table to calculate his MRD each year. Generally, the table provides that some portion of the retirement account will remain after the Participant's life expectancy if the Participant takes only his MRD each year.

B. MRD Rules after the Participant's Death – In General

1. **Death before RBD**

a. **Surviving Spouse is Sole Beneficiary**

- The applicable distribution period ("ADP") is the surviving spouse's life expectancy.

- Annual distributions over the spouse's life expectancy must begin no later than December 31 of the year after the Participant's death, or if later, December 31 of the year after the Participant would have reached 70-1/2.

b. **Individual Beneficiary Other Than Surviving Spouse**

- ADP is the individual beneficiary's life expectancy.

- MRDs must begin no later than December 31 of the year after the Participant's death.

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[1] Outline adapted from Suma V. Nair, Esq. and Susan M. Kealy, Esq., "Breakout Session II – Planning with Retirement Benefits", MCLE 12th Annual Conference – New England Estate Planning (January 7, 2011).

c. **Multiple Beneficiaries**

- First, determine whether "separate accounts" rule applies (see discussion below).

- If so, determine MRDs for each separate account using the rules under this Subparagraph B(1) based on the beneficiary of such separate account.

- If not, then two special rules apply:

    - First, unless all of the beneficiaries are individuals, the Participant is deemed to have no Designated Beneficiary ("DB"), and the 5-year rule applies (see below).

    - Second, if all of the beneficiaries are individuals (or qualifying "see-through trusts" – see below), the ADP is the life expectancy of the oldest trust beneficiary.

d. **"See-Through Trust"**

- If the beneficiary is a "see-through trust" (discussed below), then the individual beneficiary(ies) of the trust is (or are) treated as the Participant's DB (for the most part).

- If there are more than one, the multiple beneficiaries rules apply.

e. **Estate, Non-See-Through Trust or Other Non-Individual Beneficiary (5-Year Rule)**

- The Participant is deemed to have no DB and all benefits must be distributed out no later than December 31 of the year that contains the 5th anniversary of the Participant's death.

- Annual distributions are not required.

2. **Death after RBD:** In all cases described below, the annual MRDs must begin no later than the end of the year after the Participant's death. In addition, an MRD for the year of death may also be required.

a. **Surviving Spouse is Sole Beneficiary**

- ADP is the surviving spouse's life expectancy, or what would have been the life expectancy of the deceased Participant, whichever is longer.

b. **Individual Beneficiary Other Than Surviving Spouse**

- ADP is the individual beneficiary's life expectancy, or (if greater) the remaining life expectancy of the deceased Participant.

c. **Multiple Beneficiaries**

- First, determine whether "separate accounts" rule applies (see discussion below).
- If so, determine MRDs for each separate account using the rules under this Subparagraph A(2) based on the beneficiary of such separate account.
- If not, then two special rules apply:
    - First, unless all of the beneficiaries are individuals, the Participant is deemed to have no DB, and ADP is the Participant's remaining life expectancy.
    - Second, if all of the beneficiaries are individuals (or qualifying "see-through trusts" – see below), the ADP is the life expectancy of the oldest trust beneficiary, or (if greater) the remaining life expectancy of the deceased Participant.

d. **"See-Through Trust"**

- If the beneficiary is a "see-through trust" (discussed below), then the individual beneficiary(ies) of the trust is (or are) treated as the Participant's DB (for the most part).
- If there are more than one, the multiple beneficiaries rules apply.

e. **Estate, Non-See Through Trust or Other Non-Individual Beneficiary**

- The Participant is deemed to have no DB and ADP is what would have been the Participant's remaining life expectancy.

f. **MRD for Year of Death**

- If the Participant had not yet taken the entire MRD for the year of death, the balance must be taken by the end of that year by the beneficiary of the account (not the Participant's estate – unless the estate is the beneficiary).

- If there are multiple beneficiaries, the MRD rules are satisfied as long as ANY beneficiary takes the balance of year-of-death distribution; it is not required that each beneficiary take a pro rata share of the year-of-death MRD.

C. The "Designated Beneficiary"

1. **Qualification:** In order for benefits to be distributable over the life expectancy of a "Designated Beneficiary," there must be a DB, and not every beneficiary qualifies as a DB. Here are the key elements to achieving DB status:

a. Only individuals can be DBs.

b. An estate cannot be a DB, even if all of the beneficiaries of the estate are individuals.

c. A trust is not an individual, but if various rules are complied with, you can look through the trust and treat the individual beneficiaries as if the Participant named them directly as his beneficiaries (see "Leaving Retirement Benefits to a Trust" below).

d. A partnership, corporation or LLC is not an individual for this purpose.

e. If there are multiple beneficiaries, all must be individuals and it must be possible to identify the oldest member of the group. You must also determine whether separate account treatment applies.

f. The beneficiary must be designated either by the terms of the plan or by the Participant. If the Participant does not fill out a beneficiary designation form, or if all of the beneficiaries named fail to survive him, there may still be a DB if the plan fills the gap by specifying to whom the benefits pass, e.g., most qualified plans provided that all benefits will pass to the Participant's surviving spouse. In many cases, however, if the Participant fails to fill out the beneficiary form, or if his named beneficiaries fail to survive him, the plan or IRA will provide that the benefits are paid to the Participant's estate.

2. **The "Beneficiary Finalization Date":** A Participant's DB will be determined based on the beneficiary(ies) designated as of the date of death who remain

beneficiaries as of September 30 of the calendar year following the calendar year of the Participant's death. Post-death planning (e.g., disclaimer or distribution) can therefore remove certain beneficiaries (e.g., non-individuals), but new beneficiaries cannot be added.

II. ***<u>Leaving Retirement Benefits to a Trust</u>***

A. Using a See-Through Trust

1. **Qualification:** If retirement benefits are left to a qualifying see-through trust, then IRS will look through the trust at the individual current beneficiaries as if they were named directly as beneficiaries. No downstream beneficiaries will be considered, including permissible appointees and catastrophe provision beneficiaries. To qualify:

   a. Trust must be valid under state law.

   b. Trust must be irrevocable or will, by its terms, become irrevocable upon the death of the Participant.

   c. Trust beneficiaries must be identifiable from the instrument as of the Participant's date of death.

   d. Certain documents must be provided to the plan administrator by October 31 of the year after the Participant's death.

   e. All trust beneficiaries must be individuals as of the Beneficiary Finalization Date, which is September 30 of the year after the Participant's death.

2. **Which Trust Beneficiaries "Count" in Determining the ADP?**

   a. If a particular subtrust is named as beneficiary of the retirement plan, it is clear that only the beneficiaries of that separate subtrust count for purposes of the trust ADP rules. If it is important that only beneficiaries of a particular subtrust be counted, the safest way to ensure this result is to name that subtrust directly as beneficiary of the plan.

   b. Any beneficiary who is paid out, disclaims or is otherwise "removed" by the Beneficiary Finalization Date will not be counted.

   c. Under the Regulations, a person will not be considered a beneficiary for purposes of determining the ADP merely because that person could become the successor to the interest of a beneficiary of an inherited plan after the death of the beneficiary. However, any person who has a right (including a contingent right) greater than just being a mere potential successor will be counted.

3. **Who is a "Mere Successor" and Who Is Not?**

a. Typical Trust Forms

- In a typical discretionary income and principal trust (such as a Credit Shelter Trust or follow-on trusts for issue), the oldest permissible beneficiary would be the surviving spouse or the oldest child, and that person's life expectancy would logically determine the ADP.

- The IRS, however, requires that such an "accumulation" trust be examined further, looking past the initial beneficiaries down the line to other takers, such as permissible appointees under a power of appointment and the beneficiaries of the catastrophe provision.

- If powers of appointment are limited to the issue of the Participant, then the oldest permissible beneficiary would still be the surviving spouse or the oldest child, but if spouses of issue or charities are also permissible appointees, the trust will fail to have a DB, and the no-DB rules discussed above would apply.

- Most catastrophe provisions, which name heirs at law or charities, would not allow the accumulation trust to qualify as having a DB.

b. Conduit Trust – One Type of See-Through Trust

- Trustee is required by the terms of the trust to distribute the MRD each year to the individual trust beneficiary or beneficiaries. The Trustee has no authority to accumulate or hold back the MRD during the lifetime of the conduit beneficiary.

- All beneficiaries other than the conduit beneficiary, including remainder and contingent beneficiaries, estates, charities, and permissible appointees) are mere successor beneficiaries, and are therefore disregarded for purposes of determining the ADP.

- This type of trust is a safe harbor, and is guaranteed to qualify as a see-through trust.

- A conduit trust is not appropriate in all situations (see below).

c. Accumulation Trust – May Qualify as a See-Through Trust

- Any trust that is not a conduit trust is an accumulation trust, since the Trustee would have authority to accumulate plan distributions in the trust.

- Some or all potential remainder beneficiaries would count.

- Only example in the regulations is that of an income only trust for Participant's spouse, with no power in any individual to appoint the principal to anyone other than Participant's spouse, and remainder to Participant's children outright. According to the IRS, in this case, no person other than Participant's spouse children have an interest in the trust.

- General rule is that if the first trust beneficiary is not entitled to outright distribution of the entire trust, we must keep looking until we find a living and of age outright beneficiary. Once there is a now-living person entitled to outright ownership of the retirement benefits, later successors in interest are disregarded.

- This type of trust is less useful when you have young beneficiaries (for example, minor beneficiaries and under-30 trusts) because you would need to count any person who could possibly take if a child died before reaching age 30.

- Actuarial likelihood of predeceasing the age of outright distribution is not taken into account at all for purposes of determining the ADP in an accumulation trust.

- Another approach is to draft your trust instrument so that you have a closed "circle" of potential beneficiaries. In such a trust, the last beneficiary standing would take the entire retirement plan outright.

B. When It Is Unnecessary to Use a See-Through Trust

1. Trust beneficiary is older than the Participant, and the Participant died after his RBD. In such a case, the Participant's remaining life expectancy is the ADP.

2. The trust is a tax-exempt charitable remainder trust.

C. Situations When Choosing a See-Through Trust Is More Complex

1. Supplemental Needs Trust Planning

a. If the beneficiary must qualify for governmental benefits, a conduit trust will not work because MRDs would need to be distributed outright to the beneficiary, and would be considered available income or assets of the beneficiary.

b. If the beneficiary has siblings living, consider using an accumulation trust that qualifies as a see-through trust.

c. Consider allocating non-retirement benefits to the share for the supplemental needs beneficiary.

d. Consider ignoring the deferral advantages in favor of cashing out the retirement benefits, paying the income tax due and reinvesting the net proceeds.

2. Issue From Prior Marriage and Surviving Second Spouse

a. If the Participant's primary goal is to provide for his second spouse, but an equally important goal is to retain the majority of the Participant's retirement benefits during the surviving spouse's lifetime to leave to issue from a prior marriage, a conduit trust will not likely work.

b. If the Participant has reached his RBD, consider foregoing the additional deferral available and simply continue using the Participant's ADP after death. The MRDs may be accumulated in the trust for the benefit of the surviving spouse, and may pass to the children at the death of the surviving spouse.

c. If the Participant has not reached his RBD, consider an accumulation trust that either goes outright to the surviving children at the death of the surviving spouse, or leave the plan to a credit shelter trust that terminates in favor of the last survivor of the surviving spouse and children.

III. <u>Leaving Retirement Benefits to a Spouse</u>

A. Spousal Rollover of Inherited Benefits

1. **Advantages of Spousal Rollover:** By rolling over benefits to her own retirement plan, the spouse becomes "the Participant" with regard to those benefits under minimum distribution rules, and gains the following deferral advantages:

a. **Postponement of MRDs:** A surviving spouse who is under the age of 70-1/2 can postpone distributions from the rollover IRA until she reaches her own RBD, as opposed to other beneficiaries must comment taking MRDs by the end of the year after the year the Participant's death.

b. **Slower Rate of MRDs (Longer ADP):** The ADP for any beneficiary (including the surviving spouse) who takes inherited benefits is the beneficiary's single life expectancy. The surviving spouse's MRDs from a rollover IRA, however, are determined using the Uniform Lifetime Table, under which the ADP is the joint life expectancy of the spouse (as Participant) and a hypothetical 10-years-younger beneficiary. This produces smaller MRDs over a longer period of time; thus, a rollover allows a longer deferral of distributions than taking the benefits as a beneficiary.

c. **New Life Expectancy Payout After Surviving Spouse's Death:** The surviving spouse (as Participant) can name her own DB for the rollover IRA. After her death, MRDs will then be based on the life expectancy of her DB. With an inherited IRA, on the other hand, the beneficiary (even the surviving spouse) takes the inherited benefits merely as the "beneficiary," and the ADP after the beneficiary's death does not change; it will still be whatever remains of the beneficiary's life expectancy.

2. **Rollover if Spouse Under Age 59-1/2:** If the surviving spouse is younger than 59-1/2, and the surviving spouse needs to access the funds before age 59-1/2, a rollover should not be performed and the benefits should remain titled in the deceased Participant's name for the benefit of the surviving spouse. The surviving spouse can take distributions from the inherited IRA without imposition of the 10% early distribution penalty. Once the surviving spouse reaches age 59-1/2, a rollover can be performed, as there is no time limit imposed on a spousal rollover. [2]

3. **Deadline for Completing Spousal Rollover:** There is no deadline for completing a spousal rollover (although once any benefits are distributed to the spouse, they must be rolled over within 60 days). However, the MRD rules can affect the surviving spouse's ability to roll over inherited benefits. MRDs cannot be rolled over, and the extent to which the MRD rules will limit the surviving spouse's rollover rights depend on the circumstances.

4. **Plans the Spouse Can Roll Benefits Into:** The surviving spouse can roll benefits into a pre-existing plan or IRA that she already owns, or to a new IRA established to receive the rollover. She can also roll a distribution from the deceased spouse's plan into an IRA in the name of the deceased spouse and payable to the surviving spouse as beneficiary.

5. **Spousal Rollover through Estate or Trust:** Surviving spouse can roll over the benefits that are paid to her as beneficiary of the estate or trust, provided the spouse has and exercises the right to demands payment of benefits to herself. If the

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[2] The 2010 case *Sears v. Commissioner*, TC Memo 2010-146, illustrates this point. In *Sears*, the surviving spouse was found liable for the 10% early distribution penalty from an IRA she inherited from her husband, because she performed a spousal rollover before taking the distribution.

spouse's receipt of the benefits depends upon the discretion of a third party, or meeting a standard for distribution, this approach does not work. For example, if the surviving spouse is the sole beneficiary and executor of the estate, the spouse can distribute the retirement benefits out of the plan to herself and roll them over to her own retirement plan. [3]

B. Election to Treat Inherited IRA as Spouse's IRA

1. **Spousal Election:** When the surviving spouse inherits an IRA as sole beneficiary, she has the option to elect to treat it as her own. The effect of such an election is similar to a tax-free rollover. Distributions from an "inherited IRA" may not be treated as tax-free rollovers, except if the beneficiary is the surviving spouse. Thus, a surviving spouse may roll over distributions she receives from the deceased Participant's IRA as if it were her own IRA.

2. **When Made:** The election may be made at any time after the Participant's death, including after the surviving spouse's own RBD.

3. **Conditions:** In order to make the election, the surviving spouse must be the sole beneficiary and have an unlimited right to withdraw amounts from the IRA.

4. **How Made:** There are three ways the surviving spouse can make this election:

- Affirmative election
- Spouse contributes to account
- Failure to take MRDs

5. **No Rollover/Election by Spouse's Executor:** The surviving spouse's rights to rollover the deceased Participant's plan or treat the deceased Participant's IRA as her own are personal to the surviving spouse and cannot be exercised by her executor.

C. Qualifying for the Marital Deduction

1. **Benefits Left Outright:** Benefits paid directly to the surviving spouse outright should qualify for the marital deduction, provided the spouse is a U.S. citizen and is entitled to withdraw all the benefits.

2. **Benefits Left to QTIP Trust**

   a. **Retirement Benefits and QTIP Trusts are Separate QTIP Items:** When a retirement plan is payable to marital trust, both the

[3] But see PLR 200944059. The beneficiary of the deceased spouse's IRA was his trust. Although the surviving spouse was the sole Trustee and had complete control of over the trust assets, distributions to the surviving spouse were subject to an ascertainable standard (maintenance, support and health). The IRS ruled that the surviving spouse was not entitled to roll the IRA over into her own name.

retirement plan benefit and the trust must meet the marital deduction requirements.

b. **Estate Tax Return:** The executor must elect QTIP treatment for both the retirement benefit and the marital trust.

c. **Drafting the Trust:** The marital trust must contain the required language, i.e., giving the spouse the right to all of the trust's and the plan's income annually.

3. **Benefits Left to General Power Trust:** Both the plan and the trust must meet the marital deduction requirements. As with a QTIP trust, in order to qualify for the marital deduction, the surviving spouse must be entitled to all of the trust's income for her life.

4. **Combination Marital Deduction-Conduit Trust:** A marital trust can also be a conduit trust (see below). This can be done in one of two ways:

a. The Trustee is required to withdraw from the plan and distribute to the spouse the income of the trust's share of the retirement plan or the MRD for such year, whichever is greater.

b. The Trustee is required to pass all plan distributions out to the spouse (as always is required under a conduit trust), but give the spouse only the right to demand the income rather than requiring the Trustee to distribute all of the income regardless of demand.

IV. ***Practical Issues/"Traps for the Unwary" That Arise When Implementing Beneficiary Designations***

A. Disclaimers

1. A Few Points Regarding "Acceptance"

a. The re-titling of account in the name of the beneficiary after the Participant's death does not, in and of itself, mean the beneficiary has accepted the account.

b. The continuation of automatic deposits of a Participant's distributions after his death into an account that is owned jointly with the beneficiary does not, in and of itself, constitute acceptance.

c. The IRS has issued a safe-harbor ruling that a beneficiary can take the MRD for the year of death and still disclaim the rest of the beneficiary's interest. If the beneficiary takes out more than just the year-of-death MRD, such excess distribution is not within the safe-harbor, but he has not necessarily accepted the whole plan. A beneficiary may disclaim part of a plan while accepting other parts of it.

2. **Post-Mortem Planning With Disclaimers**

a. Changing the DB by September 30 of the year following the year of the Participant's death

b. Funding the credit shelter trust

c. Salvaging the spousal rollover[4]

d. Pitfalls of building disclaimers into the estate plan

- No one can exercise investment authority over account pending proposed disclaimant's decision.

- Nine-month deadline requires rapid action.

- Proposed disclaimant may have been cooperative during planning stage, but may have a change of heart when the time comes.

- If estate taxes due on disclaimed property, who pays them? Tax payment clause in Will may not operate correctly.

3. **Practical Issues**

a. Keep the disclaimer short.

b. Know where the property will go before you disclaim it.

c. Consider having the disclaimer occur at the trust level, as opposed to attempting to do a formula disclaimer.

d. Consider naming different contingent beneficiaries to take in case of primary beneficiary's death or disclaimer.

B. Funding Formulas

1. **Using Formulas in Beneficiary Designations**: Avoid putting language in the beneficiary designation that places a condition on the plan administrator or requires them to make a legal judgment.

[4] For example, in PLR 200938042, the decedent had named his trust as the beneficiary of his IRA. The decedent's will left the residue of his estate outright to his spouse. The surviving spouse disclaimed her interest in the trust, and as a result, the designation of the trust as beneficiary failed and the IRA passed to the decedent's estate. As the sole residuary beneficiary of the decedent's estate, the surviving spouse was deemed the sole beneficiary of the IRA, and was therefore eligible to roll over the IRA, by means of a trustee to trustee transfer.

a. When possible, put the formula in the trust rather than the beneficiary designation.

b. If you must put the formula in the beneficiary designation, allow the plan administrator to rely on a certification of the fiduciary and put corresponding language in the trust document.

2. **Formulas in Trusts Named as Beneficiary**

a. Pecuniary funding formulas: Avoid funding a pecuniary bequest with retirement benefits. Otherwise, you may realize immediate IRD on funding, unless:

- There is no other asset available to fund the bequest; or

- The instrument or applicable state law requires that asset to be used to fund that particular bequest.

b. Seriously consider which share you want the retirement plan to fund, and name that share, rather than relying on a funding formula.

- Avoids pecuniary funding issue

- Makes determination of who the "trust beneficiaries" are easier

c. If you must use a formula, make sure it's a fractional formula, fulfillment of which does not trigger immediate realization of IRD.

C. Separate Accounts Rule

1. **General Rule:** If the retirement plan is divided into separate accounts and the beneficiaries with respect to one separate account differ from the beneficiaries with respect to the other separate accounts under the plan, such separate accounts will not be aggregated when determining whether the MRD rules are satisfied.

a. In other words, each separate account may be paid out over a different life expectancy, based upon the beneficiary or beneficiaries of that separate account only.

b. Each separate account operates as a wholly separate inherited IRA with respect to the MRD rules. This means the beneficiaries do not need to deal with one another with regard to the inherited IRAs after the separate accounts have been established.

2. **Rule When Beneficiaries Take Through a Trust:** The separate account rule is not available to multiple beneficiaries who take interests through a trust that is

named as the beneficiary of the plan, so the different accounts would be aggregated to determine the ADP based upon the oldest beneficiary's life expectancy.

a. A typical formula funding a marital and credit shelter trust would not benefit from separate account status, even if the Trustee allocated all of the retirement benefits to the Marital Trust before the Beneficiary Finalization Date.

b. If the trust instrument mandates that any retirement plans received by the Trustees be used to fund a particular share, separate account status *should*, but may not, apply. The safest option is to designate the subtrust in the beneficiary designation, and not in the trust instrument.

c. If separate account status is desired for multiple subtrusts, the beneficiary designation should name the separate trusts rather than the master trust as beneficiary.

3. Qualifying for Separate Accounts Status

a. Each beneficiary must share pro rata in post-death gains and losses. This is normally the case for fractional or percentage funding formulas, but a pecuniary formula would not qualify unless it shares in post-death gains and losses under state law or the terms of the beneficiary designation.

b. Separate accounts must be "established" by December 31 of the year after the Participant's year of death in order for the beneficiaries to use different ADPs. If accounts not established by then, still get to determine MRD based upon separate account balance, but the ADP will be determined by the oldest beneficiary of the aggregated accounts.

c. It is unclear what constitutes "establishing" separate accounts, particularly if no action is taken to physically divide the retirement plan into separate inherited IRAs. For example, it is not clear that separate accounts would be "established" automatically through a fractional bequest if separate accounts were not actually created to receive the fractional bequests by the deadline.

D. Getting an IRA from the Master Trust to Separate Share Trusts

1. **In General:** A retirement plan may be transferred intact from a terminating trust or estate to the individual beneficiaries or to new separate trusts for such beneficiaries without triggering a taxable distribution from the plan.

2. How to Effectuate Transfer

a. If the retirement plan is left to the estate of the Participant (e.g., if no beneficiary designation was ever filed), the Executor would instruct the provider to change the name of the owner of the inherited IRA from the name of the estate to the name of the "Master Trust".

b. If the retirement plan is left to the Participant's Master Trust, the Trustee would instruct the provider to change the name of the owner of the inherited IRA from the name of the Master Trust to the name of the separate trusts created under the Master Trust.

- For example, if the trust provides for a fractional funding formula for a Credit Shelter Trust and Marital Trust, the Trustee would direct the provider to divide the inherited IRA fractionally into two shares, and name the owner of one share the Credit Shelter Trust and the owner of the other share the Marital Trust. This division would have no income tax effect, unless a pecuniary funding formula or bequest is fulfilled using the retirement plan.

- At the death of the surviving spouse, if the trust instrument provides that the trust property be divided into equal shares for the children of the decedent, and distributed outright to the children, the Trustee would direct the provider to divide the inherited IRA fractionally into as many shares as there are children, and name each child as the owner of one of the shares. Again, this division would have no income tax effect.

3. Practical Difficulties

a. Many PLRs have approved transfers of an inherited IRA from a master trust to the trust beneficiaries or from a master trust to new separate share trusts for residuary beneficiaries, but because PLRs may not be relied upon as authority, some providers will not permit these types of transfers without an opinion of counsel or a PLR.

b. If faced with an uncooperative provider, you have options:

- Recommended: See if you can get through their customer service representatives to their legal departments; convince them what you are requesting is fully within the terms of the regulations.

- Recommended: Move the account to another provider who will cooperate with you.

- Recommended but may be unwieldy: Keep the estate or master trust open until the end of the ADP so that it can continue to collect the MRD, but simply act as a "flow-through" to the ultimate beneficiaries.

- Recommended but costly: Get a PLR from the IRS or provide a legal opinion.

- Not recommended: Cash out the plan and pay income tax, thereby losing any further deferral benefits.

E. Making Sure Your Beneficiary Designation Works

1. **Get To Know Your Plan Provider:** Each provider has different ways of dealing with beneficiary designations and default rules.

   a. Be aware of default rules within the contract, such as whether the issue of a predeceased named beneficiary take their parent's share, or whether the share lapses.

   b. Beneficiary designations are of no effect unless they are delivered to, and accepted by, the plan provider. Always request that a copy of the designation be counter-signed by the provider and sent back to you for your records. Some providers will refuse to counter-sign, but will send a confirmation notice to the client agreeing that they have accepted the beneficiary designation.

   c. The plan provider is not always the same as the investment advisor. Many investment advisors will invest IRAs and Roth IRAs for your client, but the plan is governed by another company's contract. Be sure you deliver the beneficiary designation to the correct company. The investment advisor's records will not be dispositive post-death if the actual custodian does not have the same beneficiary designation on file.

2. **Tips for Beneficiary Designations:** When preparing beneficiary designations for clients, be aware that each provider has different rules regarding how their beneficiary designations work.

   a. Some providers do not allow for what they call "contingent" beneficiary designations. For example, they may not accept a beneficiary designation that states "If my wife survives me, I direct 100% of this account to the Marital Trust created under Article 2 of the John A. Doe 2011 Trust, dated January 1, 2011, as amended." This makes it all the more difficult for you to be able to control where the plan ultimately lands, and whether the ADP will be adversely affected.

b. When using funding formulas in your beneficiary designation, make sure the designation states that the provider may rely upon a certification of the Participant's Executor as to the fraction of the plan that must pass to each separate share trust.

c. Beware that some providers do not accept post-mortem disclaimers, or provide that their own contractual default rules apply when a disclaimer is made. If you are relying upon post-mortem disclaimers of retirement assets, be sure to review the contract carefully for rules relating to disclaimers.

d. Try to keep your beneficiary designations succinct. The longer and more involved the designation, the more opportunity for a provider to reject some portion of it and, consequently, the entire designation.

V. Roth IRA Conversions

A. What Is a Roth IRA?

1. After-tax contributions.

2. Income tax-free distributions after age 59 ½ and 5 years after starting a Roth IRA.

3. No required minimum distributions for the owner during lifetime.

4. After death of the owner, beneficiaries must take minimum distributions over their life expectancies.

B. What Is New about a Roth IRA Conversion Beginning in 2010?

1. No income limitations for conversion of a traditional IRA or qualified plan.

2. Income limitations for contributions to a Roth IRA remain in place for 2010 and beyond, but there is a workaround while conversion is available.

C. Who Cannot or Should Not Consider a Roth IRA Conversion?

1. Those who only have qualified plans (no IRAs) and either:

a. Have not reached age 59½; or

b. Have not terminated employment with the employer sponsoring the qualified plan.

2. Those who plan to leave retirement benefits to charity (who will never need to pay income tax on distributions).

3. Those who either cannot or do not wish to pay the income taxes associated with conversion.

D. What characteristics do most candidates for Roth conversion share?

1. A desire to accumulate retirement plan assets during lifetime and leave retirement accounts to individual heirs (as opposed to charities) at death.

2. Sufficient liquidity outside of retirement accounts to pay the income tax due as a result of the conversion.

3. Do not plan to take substantial distributions from their retirement accounts for normal living expenses during retirement.

4. Believe their income tax rates will be greater in the future than they are now.

5. Have a long time horizon after conversion (e.g., 10 years or more) during with the Roth IRA can grow in value to "earn back" the tax cost of conversion.

6. Have significant excess deductions (NOLs or charitable deductions), which could allow them to convert to a Roth IRA at little to no income tax cost.

7. Have significant after-tax contributions (i.e., basis) in their IRAs or qualified plans, that would allow them to recognize significantly less income than the full amount converted.

8. Are comfortable "pre-paying" income taxes as a way to reduce their taxable estates and provide an income stream to their heirs with no income tax liability.

E. Who wouldn't do a Roth conversion?

1. Those who anticipate needing to take significant distributions from retirement accounts to pay for annual living expenses in retirement.

2. Those who do not have sufficient liquidity outside the retirement account to pay the income tax due upon conversion, and would therefore be taking money out of the converted amount to pay the tax.

3. Those who believe their income tax rates will decrease during retirement.

4. Those who do not have a long time horizon after conversion for the retirement account to "earn back" the tax cost.

F. How is a Roth IRA conversion accomplished and when are taxes due on the conversion?

1. Owner of a traditional IRA or qualified plan may request a "direct trustee to trustee transfer" from the original retirement account to a Roth IRA account, whether newly created or previously existing.

2. Custodian will provide the appropriate tax reporting information after the conversion, based upon the value of the assets converted at the time of conversion.

3. Income recognized from the conversion will be taxed at the owner's highest marginal ordinary income tax rate.

4. Some IRAs and qualified plans may have some amount of after-tax contributions (i.e., the owner contributed dollars to the plan that he already paid income tax on, and did not qualify for a deduction for having contributed those dollars to an IRA), which provide basis to the owner and will reduce the taxable amount upon conversion.

5. If the owner has several IRAs, they must be aggregated to determine whether any basis could be applied the amount converted – it is not possible for an IRA owner to simply convert only those IRAs with large, or exclusively, after-tax contributions if he has other IRAs that were funded with pre-tax contributions.

6. The aggregation rule does not apply to qualified plans.

7. Owner must recognize income from a Roth conversion in the tax year in which the conversion takes place (unless the conversion occurred in 2010).

G. Is there a do-over?

1. If an owner converts to a Roth IRA in a particular tax year and then changes his mind, he can "recharacterize" the Roth IRA into a traditional IRA.

2. Recharacterization must be done before the deadline for filing the tax return for the year of the original conversion.

3. This option may be useful if an owner converted in January, but by now, the value of the account has declined significantly (which would mean that the owner would pay income taxes on the higher value at the time of conversion, but have much less in the Roth IRA account to show for it).

H. Other considerations

1. If a client is ill and has large retirement accounts, which will be left to individual heirs or trusts for individuals, it may make sense to pre-pay the income tax with a Roth IRA conversion, thereby reducing the client's taxable estate (assuming there is an estate tax, of course).

2. Many banks and investment folks have pushed Roth IRA conversions as a “no brainer” for everyone with a retirement account – be aware that clients may be led to believe there is no down side to a Roth IRA conversion.