COORDINATING IRAs WITH THE ESTATE PLAN

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INTRODUCTION – WHY PLAN AND IRA BENEFICIARY DESIGNATIONS MATTER, AND WHY A TRUST MAY NEED TO BE NAMED AS BENEFICIARY

There is a "disconnect" between assets such as a residence, automobile, bank or brokerage account, and the other "day-to-day" assets that we own, and talk about with our clients, and non-probate assets which are governed by a beneficiary form such as life insurance, IRA accounts, and retirement plans. (Life insurance is an income-tax-favored asset, and will not be addressed in this outline.)

Retirement plans and IRAs are often a person's (or couple's) most significant, valuable assets. Once a person is comfortable with salary deferrals into a 401(k) plan, these assets are often on "auto pilot" and are more likely to grow, accumulate earnings, and still be there for the client and family when a client dies–in other words, these assets are less likely to be consumed, spent, or otherwise diminished during a client's lifetime, compared to spendable bank or brokerage accounts. The most significant other asset may be the residence–it is also not consumed, spent, or diminished because the client needs a place to live.

As an illustration, consider the following:

Your client is a married couple who do not have children of their own marriage, but they each have children from former marriages. They have been married in Washington State for many years and all of their assets are community property. They are retired, and both about the same age–late 60s. They want to "provide for the one who survives, during life, but make sure that whatever isn't needed during life will go to my own children and grandchildren, and not the other spouse's kids or grand-kids."

The asset inventory for this client looks like this, except for some small cash accounts:

1. *$478,000 motor home–the client uses this to visit children and grandchildren around the United States.*
2. *$5,800,000 IRA of husband, wife is beneficiary*
3. *$4,000,000 401(k) plan of wife, husband is beneficiary*
4. *Neither spouse has a Will or Revocable Trust estate plan*

<u>QUESTIONS</u>:

What happens upon the death of either or both of H and W? What are the tax consequences? What changes should to be made, and what documentation has to be implemented to attain the client's goals? Is a trust or trusts needed? If so, what do the trusts need to say, and what should the beneficiary designations say?

I. ESTATE AND GIFT TAX ASPECTS OF RETIREMENT PLANS AND IRAs, CHOOSING THE "CORRECT" BENEFICIARY

Estate planning advisors often see client situations in which a tax-oriented Will or Revocable Trust is of little use because it's been unfunded during life, so probate of a Pour-Over Will is required in any event, and many if not all of the non-probate assets have not been coordinated with the tax-oriented estate plan via revised beneficiary designations. So the client has not only wasted professional fees, but the estate plan is seriously flawed and assets are going where no-one intended

Retirement plans and IRAs are in this category of non-probate assets, that need to be "coordinated" with the Will and estate plan.

A. From an Estate Tax Standpoint, Who (or What) Should Be Selected as Beneficiary?

Among estate planners its axiomatic that "growth" assets should be used to "fund" a "bypass" or "exemption" trust during the surviving spouse's lifetime, and conversely more "liquid," "consumable" assets should be allocated to the surviving spouse's share of the former community property and marital deduction bequest or martial trust. The goal is to "grow" the bypass trust and "shrink" the property that will be in the survivor's taxable estate (their own property, plus the marital deduction property).

Retirement plans and IRAs are unique in that they are both "IRD" items. They are taxable as income to the recipient.

What this means is double (or triple) taxation [income tax at about 40 percent, estate tax at 40 percent = 80 percent plus Washington State estate tax (assume 10 percent) = 90 percent!]. The issues are timing and growth, because all estate assets (except those received by gift or inheritances) are "double taxed" (income tax at acquisition, gift or estate tax at transfer). The goal is to build enough flexibility in the overall plans (estate and IRA/qualified plans) to permit deferral, and select the right beneficiary to maximize and increase the length of time for income-taxable distributions out of the IRA, and also preserve the estate-tax free exemption amount.

The following choices of beneficiaries highlight the issues of income tax and appropriate beneficiary.

1. Exemption (Bypass) Trust as Beneficiary.

"IRD" is a "wasting asset," because it is subject to income tax on distribution. However, it grows income tax free until distribution. This should be compared to capital growth assets, which also grow income tax free until sale (at the much lower capital gains tax). Therefore, assets other than IRD assets should be picked first in funding the bypass trust.

Example: $2,950,000 of capital growth property, and $2,500,000 of plan/IRA benefits, paid to exemption trust:

Plan Benefit	$2,500,000
Income in Respect of Decedent (IRD)	$2,500,000
Federal Income Tax	$1,000,000
"Actual" Exemption Trust Amount (Assuming $2,950,000 of Other Property in the Trust)	$5,450,000 - $1,000,000 = $4,450,000

In contrast, if the surviving spouse were named as 100 percent beneficiary of the $2,500,000 benefit, and other, appreciating assets, were used to fund the exemption trust, the $5,450,000 trust would be fully funded, and hopefully would grow to; e.g., $7,000,000, without estate taxation in either spouse's estate. In the meantime, the surviving spouse would be taking distributions from the ongoing rollover IRA account or plan account, and paying income tax, ultimately reducing and "diluting" the size of his or her estate taxable property. This is consistent with an overall goal of estate planning; e.g., to maximize the "leverage" of the $5,450,000, and minimize the otherwise taxable estate of the surviving spouse and/or the marital deduction includible in the estate of the surviving spouse.

With the federal exemption being "portable" between spouses, it may be that fully funding a bypass trust for federal estate tax purposes [with either capital growth or income taxable assets such as an IRA] may not be a priority—however, the same analysis as described above will apply to the Washington State estate tax, and its non-portable exemption of $2,079,000.

In addition, compared to naming the spouse as beneficiary, if the bypass trust is named: (1) the trust income tax rates are higher on distributions and accumulations of IRA benefits than those for individuals; (2)distributions have to start sooner than they would to the surviving spouse (cannot wait until the participant would be 70½, or roll to the spouse's own IRA and delay until he or she attains age 70½); (3) the measuring life for income taxable distributions will be the life expectancy of the oldest trust beneficiary (the spouse); and (4) most importantly, upon the death of the main trust beneficiary (spouse), there will be no further extension of payout based on a child's or grandchild's age, as would have been the case with a spousal rollover and naming of "new" beneficiaries.

But what if there are no or few non-plan/IRA assets? Does it make sense to use "IRD" assets to at least partially fund the bypass trust? This depends on the planner's predictions about future estate tax rates, compared to the income tax "load" that these Bypass Trust assets carry.

2. Estate (or Other Entity) as Beneficiary.

This is not a good idea. The estate cannot be a "designated beneficiary" (as can a person or a trust); it has no life expectancy for long-term pay-out of benefits. The same is true for a corporation, charitable organization, or other entity.

In a worst case scenario, if the plan participant or IRA owner were under age 70½ at the date of death and benefits were payable to the IRA owner's estate, the benefits would have to be distributed under the 5-year rule, so even the life expectancy of the participant/owner would not be available.

☞***Practice Tip**: The Estate is often the default beneficiary under an IRA (or some retirement plans) if no one else is named by the decedent or the beneficiary form can't be located; so this can be a trap if not spotted prior to deat*h.

Under many private letter rulings, it may be possible for the surviving spouse to accomplish a spousal rollover, to an IRA account, even if the estate is the beneficiary.
PLR 2004-05017, PLR 2004-06048.

☞***Practice Tip**: In situations where a charity was among the named IRA beneficiaries, which would also mean that there is no "designated beneficiary" and no measuring life (similar to an estate), actual distribution of the charity's benefits, by September 30 of the year after the year of death, could permit the use of a longer life expectancy of a remaining individual beneficiary.*

3. Spouse as Beneficiary.

In general, naming the surviving spouse as beneficiary (with disclaimer optional, by him or her) is preferable. For both income tax (rollover and deferral) and estate tax (marital deduction) this is usually the best choice.

This is because the surviving spouse, through a "rollover" or direct transfer [from either a qualified plan or an IRA to a new IRA] and treating the IRA as the spouse's IRA, can get a "fresh start," with a "new" IRA, "stretching" the required income taxable distributions to a later (spouse's age 70½) starting date, and permitting younger (children) secondary beneficiaries to use their own life expectancies for remaining distributions, when the surviving spouse dies.

☞***Practice Tip**: However, leaving a plan or IRA benefit in the plan or IRA (or creating an inherited IRA if the decedent spouse were a plan participant) may be preferable to IRA rollover if the surviving spouse is under age 59½. Otherwise the spouse will have "created" a 10 percent pre-59½ tax on distributions from the rollover IRA which would not have applied to the prior plan or IRA or inherited IRA "death benefit." IRC Section 72(t)(2)(a)(ii)*

☞*Practice Tip and Update: Neither the original IRA owner nor the surviving spouse owner can do several IRA rollovers in the same year [12 months from the first distribution], using different IRA accounts, under the 1-per-year rule of IRC Section 408(d)(3)(B). This is a consequence of Bobrow v. Commissioner, TC Memo 2014-21 [which had been contradicted by the IRS's own Publication 590, but see IRS Announcements 2014-15 and 2014-32].*

☞*Practice Tip and Update: Another reason for the surviving spouse to do an actual rollover to his or her own IRA, and get a "fresh start" for required distributions to children, as opposed to continuing as beneficiary of an inherited IRA, is to maintain bankruptcy protection under the Supreme Court decision of Clark v. Rameker (June 12, 2014) which held that the 11 U.S.C. Section 522(b)(3)(C) exemption for "retirement funds" does not apply to an inherited IRA because it is different from such funds in that no further contributions can be made, the owner is required to take out minimum distributions, and the 10% penalty for distributions to a person under age 59 ½ does not apply to an inherited IRA State law could arguably protect an inherited IRA even if federal law does not do so. See RCW 6.15.020.*

4. <u>Charity or Charitable Trust as Beneficiary</u>.

In the right client situation a charity or charitable trust as IRA beneficiary can be advantageous. There are two reasons for this.

First, the actual "net cost" to individual heirs/beneficiaries of naming a charity (and especially a charitable trust) is significantly less than using other non-income-taxable assets such as real property or after-tax investment accounts for a charitable bequest. Leaving the income-taxable IRA(s) to individual beneficiaries, and especially to a trust for such beneficiaries, could be subject to both the estate tax (federal and/or State of Washington), and in any event will be subject to income tax. So there is a already a "tax cost" for individuals regarding these assets.

For example, if the income tax cost would be 40 percent for an individual or trust beneficiary when receiving an IRA, the naming of a charity or charitable trust for a $100,000 IRA would not be a 100 percent "net cost" to individual heirs, but rather a 60 percent net cost, or $60,000, compared to the same charitable bequest of $100,000 of real property, which would be a $100,000 net cost to the individual heirs. The charity receives the full $100,000 in either instance, IRA or real property, because the bequest/naming of charity as beneficiary is both income tax excludible and estate tax deductible (deductible as a charitable bequest from estate tax, and non-taxable, excludible to the charity as a tax exempt entity regarding income tax).

Additionally, it is preferable to name individuals for non-income-taxable assets such as appreciated real property and low basis after-tax investment accounts because these heirs receive these assets with a new basis which has been "stepped up" to the date of death value of the asset, so their later sale of the asset(s) will not create taxable capital gain–this is NOT the case for an income-taxable-asset such as an IRA. (IRC Section 1014(a), IRC Section 1014(c)). This step-up in basis will occur for the recipient of otherwise low-basis, non-income-taxable assets even if the property is not actually taxed in the estate, because "covered" by the federal or Washington State exemption(s).

As more fully described in Section V of this outline, a client can "get the best of both worlds" if charitably inclined, but concerned about "disinheriting" individual heirs and beneficiaries. Especially in the case of a surviving spouse, who is elderly and therefore the Minimum Required Distributions would be high during their remaining life, the naming of a Charitable Remainder Trust (CRT) can provide a fixed yearly income (annuity) to the spouse, at a level which is more closely aligned with their actual needs, and via a combination of the marital deduction and charitable deduction from estate tax (federal and Washington State) and a charitable deduction (exclusion, because the CRT is the beneficiary) from income tax, all of the IRA is available to "fund" the annuity to the surviving spouse. A modified form of this can be accomplished for a non-spouse annuitant, but the non-spousal, non-charitable portion of the CRT interests will be subject to estate tax.

With the new capability of the surviving spouse to elect to "inherit," via "portability" the decedent spouse's unused exemption amount (DSUEA—more fully described in the next section of this outline), there is no "wasting" of the federal exemption by using the IRA in this way instead of naming a Bypass Trust as beneficiary (not Washington State, which does not have portability, and therefore some of the exemption could be lost–but non-income-taxable assets should be selected for funding the Bypass Trust in Washington State, because these will grow or retain their value without the "income tax load").

<u>Note</u>: These tax and estate planning advantages need to be carefully implemented: <u>both in the way a charity is named as a beneficiary among other</u> beneficiaries (individuals), and especially in the way a charity may be included along with others within a trust which is named as IRA beneficiary. Unless this is done properly, the above tax advantages (estate and income tax) may be lost, and the other beneficiaries may have to receive the IRA benefits over a much shorter time-frame than would otherwise be the case–possibly within five years if the IRA owner were to die before his or her age 70½ required beginning date.

For a more detailed summary and analysis regarding naming of a charity or charitable trust as beneficiary of an IRA, see Section V. of this outline

B. <u>What About Portability of the Deceased Spouse Unused Exemption Amount (DSUEA); and What About the Fact That the Estate Tax Rate is About the Same as the Income Tax Rate?</u>

Estate and Gift tax laws have been a comedy of errors in recent years. We fretted about the "Sunset" of the 2001 legislation which would have done away with the $3,500,000 estate tax exemption and returned it to $1,000,000 with high rates in 2011, after a one-year repeal of the estate tax with carry-over basis in 2010. We knew that wasn't acceptable but it came close to happening until late in 2010 when Congress passed the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

Much of the 2010 law was good news by way of lower gift and estate tax rates of 35 percent, an increase in the gift tax exemption from $1,000,000 to $5,000,000, and the ability for one spouse to "inherit" the unused estate tax exemption of a pre-deceasing spouse via "portability" of the Deceased Spouse Unused Exemption Amount or "DSUEA." But this good news was only certain until the end of 2012 when we faced another "Sunset" of the new laws. Effective January 1, 2013, the situation became more settled: portability of the unused exemption between spouses, DSUEA, is retained, and the estate and gift tax rates were increased from 35% to 40%, without any further sunsetting.

Portability of the DSUEA of a first spouse to die, into the hands of the surviving spouse, is a game-changer for the following, fairly common, situation:

- Unlike the fact pattern in the Introduction, assume the client doesn't care about "trust protection" from a non-tax standpoint–they've been married for many years, the children are of this marriage and no prior marriages, and they would be fine with the "simplicity" of giving everything to the surviving spouse, outright.

- Their estate plan inventory is heavily weighted with qualified plan or IRA benefits, compared to non-IRD assets such as real property, life insurance, after-tax investment/brokerage accounts, etc.

Portability works well for these clients.

Assume that husband client has an $8,000,000 rollover IRA in his name, and the couple has a $3,000,000 residence, all community property. As described above they have children of only this marriage, they've been married for many years, and they aren't concerned about remarriage of the surviving spouse or otherwise wanting to "control" their half of the community property.

Under pre-2010 federal estate tax laws they would have had no choice but to "distort" this simple estate plan by: (1) taking income taxable distributions from the IRA or do a Roth conversion and use these assets to "fund" a bypass/exemption trust, or (2) leave the assets in the IRA and provide in its beneficiary designation that his 50 percent of the IRA will be "an asset" of the bypass trust, and in wife's Will, she will say the same thing regarding her 50 percent of the IRA, if she were to die first (in practical terms, this situation for wife's 50 percent creates real problems of documentation, timing, of distributions, and income tax).

In contrast, via portability, the estate plan can be all to survivor, via Will distribution of the residence, and naming the survivor in the beneficiary designation of the husband so the survivor could roll both halves of the IRA to her own IRA and name the children as beneficiaries, and re-title the residence in her name–wife would do the same regarding the residence in her Will, and in her Will state that her community property interest in her husband's IRA would be given to him outright. He would then re-title the residence and be the owner of the IRA, naming the children as beneficiaries.

☞***Practice Tip****: Wife's bequest of her community property interest in her husband's IRA to him, in her Will, is often missed by practitioners. It is the counterpart to what he is doing for her if he dies first, and it reduces the uncertainty about where her interest in this asset is supposed to go, if she says nothing about it in her Will–children from her prior marriage might argue that it should go under the residuary provisions of her Will to a residuary trust [especially if they are not made whole via non-pro-rata selection and trust funding for their benefit to account for the IRA value] which is different than the husband thought would happen and even though she never intended this result. See: RCW 6.15.020 which confirms the authority to dispose of a community property interest in the IRA by Will. However, it may be advisable to accompany the bequest with the authority of the surviving spouse to disclaim to the estate of the deceased spouse, which could increase the amount of "non-IRD" assets available to fund the bypass trust, particularly under state estate tax laws (such as Washington law), via non-pro-rata selection by the Personal Representative. [See Section III of this outline.]*

The cause of the pre-2010 distortion was that the estate tax exemption of the first spouse to die would be "wasted" in an "all to spouse" estate plan. The survivor would later die with a "back-loaded" estate of $11,000,000 of which only $5,450,000 would be covered by his or her own exemption. So if estate tax savings were a priority,, there would have to be income-taxable distributions to husband to create more non-IRA assets, or more likely the husband would name a bypass or exemption trust as the beneficiary of his half of the IRA and the residence, and the wife would do the same regarding her half of these assets. They would do this so as to fund a trust that utilized their exemption so it would not be wasted at their death.

There would be a significant income tax cost to doing this, however, in addition to the complexity that they didn't want in the first place–a trust as a beneficiary of an IRA, compared to a surviving spouse, can't delay the commencement of distributions beyond the year following the year of the IRA owner's death, the table used to determine the amount of required payments under the required minimum distribution rules (RMDs) is about 10 years shorter than for a surviving spouse, and most importantly the spouse's remaining life expectancy will govern distributions to children after the survivor's death, instead of the much longer life expectancy of the children as new beneficiaries of a new IRA set up by the surviving spouse.

With portability these funding of trust problems (complexity and "faster" income-taxable RMDs) are solved or minimized. The surviving spouse can be 100 percent owner of all assets but still <u>have both the $5,450,000 exemption of her husband and her own $5,450,000 exemption</u>, at her death. The personal representative (surviving spouse in Washington, for community property) would need to prepare and file a federal estate tax return which would operate as an election to leave the "unused" exemption amount to the surviving spouse.

The new 40 percent estate and gift tax rates are virtually the same as the maximum income tax rates–so perhaps "stretch the IRA via spousal rollover and use portability for estate tax" will be the new standard operating procedure for many clients because income taxes in some form are a virtual certainty, and many believe that income tax rates may go up in the future, not down, whereas the survivor's estate may not be subject to federal estate tax because covered by his or her exemption [plus the first spouse's exemption via portability], and the survivor can change and improve his or her estate tax situation via the survivor's use of gifting or other estate-reduction techniques during his or her lifetime.

☞***Practice Tip****: There are at least four (4) problems with this: :*

- *It doesn't account for the Washington (or other state) estate tax, which has a lower exemption and no "portability"–so a bypass trust is still needed to avoid "wasting" the predeceasing spouse's exemptions [Unless the surviving spouse moves to another state after the first spouse's death, and the new state of residence does not have an estate tax.]*

- *The Federal generation-skipping tax (GST) exemption is not "portable," but rather there needs to be a bypass trust to which the predeceasing spouse's GST exemption can be allocated.*

- *A funded bypass trust is always exempt from estate tax in the survivor's estate, and is not subject to changes in the law (such as a reduced exemption)–as is the exemption which is given to the surviving spouse via portability. In addition, re-marriage by the surviving spouse (and death of the second spouse) could reduce or eliminate the exemption given to her by the original spouse via portability. And a mandatory funded bypass trust can save estate taxes on the death of the survivor <u>even if no 706 return was filed on the first death, no disclaimers or partial QTIP elections were made, and no other "actions" were taken</u> at that time, because there is still a legal obligation to fund the bypass trust, [even after the death of the surviving spouse].*

- *Perhaps the most important problem is the fact that, whatever the tax consequences may be, many clients want 100% of their property to be assured of 1) being "available to help and support" the surviving spouse, and then 2) pass, eventually, to their children—whether children of the current or a prior marriage,* *guarding against remarriage or another situation which could result in their assets going to someone outside their bloodline, outside their own family. A trust, or trusts, are required to accomplish these goals. The client may be OK with a 100% QTIP marital deduction trust for the surviving spouse, coupled with a portability election, because the couple's assets are well below $10,9000,000 and they prefer to get a "second" step up in basis for the QTIP property—but they are assured in this 100% QTIP trust format that their assets will ultimately go where they want them to go. See: Section IV of this outline.*

C. "Gift Tax Trap" in Completing IRA Beneficiary Designations.

There is a "gift tax trap" regarding IRA beneficiary designations. The "gift tax trap" can be illustrated by the following:

Assume that husband is the owner of a community property IRA. If someone other than the surviving spouse is named as beneficiary of the IRA, and the surviving spouse (who "owns" 50 percent of her husband's IRA, as her community property) "permits" the 50 percent community property interest that she "owns" to go to the third party beneficiary, upon husband's death, is there a taxable gift by her to this extent? Can this occur even if the spouse "consented" to the third-party beneficiary in writing, on the IRA beneficiary form? By analogy to the following Treasury Regulation, dealing with life insurance, a taxable gift could be the result under these circumstances (Reg. Section 25.2511-1(h)(9):

> *Where property held by a husband and wife as community property is used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under the State law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of the husband's death of half the amount of the proceeds of such insurance.*

Presumably the surviving spouse doesn't expect to have gift tax liability in order to carry out the goal of getting the IRA benefits to the third-party beneficiary. There is authority for "aggregating" policies of life insurance (and by analogy IRA accounts) to determine if a gift is made, taking into account all insurance which either names the surviving spouse, or does not. *Kaufman v. United States*, 462 F2d. 439 (5th Cir. 1972). Or the spouses might agree in a community property agreement that all insurance and IRAs are to be treated in the aggregate with each spouse having a community interest in all the policies as a 50 percent interest in the total of death benefits, not each separate policy or IRA. However, this would not solve the problem of a single, large policy or IRA.

As is done with proper funding and maintenance of an Irrevocable Life Insurance Trust (ILIT) the "trap" of an unexpected gift by the surviving spouse can be avoided by way of a Separate Property Agreement, converting the non-IRA-owning spouse's interest from community property to separate property ownership by the IRA owner. At the death of the IRA owner, as a result, there would be no gift of any interest by the survivor, who had given up his or her interest by way of a marital gift, covered by the marital deduction for gift tax purposes. [Separate legal counsel should be consulted by each spouse in connection with this conversion from community to separate property.]

What about income tax taxability for IRA accounts–would the same "trap" exist if an IRA owner of a community property IRA were to name a third party as beneficiary? Section 408(g) of the Internal Revenue Code states that IRA rules set forth in Section 408 shall be applied "without regard to any community property laws." This has been interpreted to mean that the income tax consequences of IRA accounts are governed by IRC Section 408(d) which imposes tax on the account owner or beneficiaries as "payees." Therefore, a taxable gift seems to be more of a problem, than income being taxable to the surviving spouse.

Qualified Plans are in a different category. As described elsewhere in this outline, the Employee Retirement Income Security Act (ERISA) preempts state law, and the Boggs line of decisions and other case-law authority make it clear that the community property interest of a pre-deceasing non-participant spouse essentially disappears at his or her death, with protection for the non-participant spouse being limited to spousal rights under federal law regarding the naming of a non-spouse beneficiary in the first place, without the written consent of the non-participant spouse (IRC Section 401(a)(11)), or the division of a qualified plan in connection with divorce via a Qualified Domestic Relations Order (QDRO) under IRC Sections 401(a)(13) and 414(p). Accordingly, an unexpected gift should not be a problem in connection with a third party beneficiary of a qualified plan benefit of a married participant in a community property state.

II. INCOME TAX ASPECTS OF RETIREMENT PLANS AND IRAs

There are two (2) questions which need to be asked upon the death of an IRA owner or plan participant: (1) When do the Required Minimum Distributions (RMDs) have to commence, and (2) Over what time-frame, or number of years (for calculation of the RMD fraction to be applied to the account balance) do the RMDs have to be paid.

RMDs have to commence by December 31 of the calendar year following the calendar year in which the individual died, and so long as there is a "designated beneficiary" (DB herein) the time-frame will be the life expectancy of the DB.

A. Importance of DB Status.

It might be assumed that a DB is just what it says–someone who is "designated" by the individual who fills out a beneficiary form, or if this doesn't occur there should be some "default" DB(s) spelled out in the IRA or plan document. But unfortunately it's not that simple. An estate planner should use the following guide/question in testing a DB's status: "Is the DB an individual or a qualifying trust leading to an individual who has a life expectancy which can lead to the life-expectancy table time-frame calculation for the RMDs, and does the DB have this status without any taint or complications caused by companion or residuary/contingent beneficiaries that do not qualify as a DB or make it questionable if this DB is the appropriate person (companion or residuary/contingent beneficiaries could be a charitable organization or the estate of the decedent, or a permissible beneficiary who is older than the DB)?"

✏ ***Practice Tip****: Don't permit a charitable organization to be included in a group of beneficiaries, such as "equally to my three children and the University of Washington." The result would be that none of the individuals' life expectancies could be used to determine the time-frame for the RMDs.*

This is "fixable" via segregation of shares into separate accounts or pay-out to the charitable organization, if done in time. But it is preferable to create completely separate IRAs and plans either for individuals or qualifying trusts, and charities, but not for both. If a TRUST is named as beneficiary, with this mix-up of individuals and a charitable organization, the situation is even worse and possibly not fixable, except by payout to the charity prior to September 30 of the year after death.

B. Consequence of Non–DB Status if Death Occurs before the Required Beginning Date.

For death both prior to and following the RBD of an individual, IF THERE IS A QUALIFYING DB, then the time-frame of the life expectancy of that DB individual or oldest trust beneficiary can be used by consulting single-life tables, and making sure that distributions commence by December 31 of the year following death (except for a surviving spouse DB–he or she can wait to commence distributions until December 31 of the year the decedent would have attained age 70½). Much more needs to be said about a trust qualifying as a DB–but for now we can note that DB status is the "goal" and that it provides for a long payout time-frame (the DB's life expectancy), whether the death of the IRA owner or plan participant occurs before or after the age 70½ required beginning date.

✏ ***Practice Tip**: As noted previously, the surviving spouse of the IRA owner or plan participant is (in terms of maximum "stretch" and flexibility) the best of all individual (not trust) DBs because the surviving spouse can "start over" and get a "fresh start" by way of a spousal rollover to the spouse's own IRA account. Note: See IRS Notice 2014-19 interpreting the Windsor Supreme Court ruling to apply this rollover capability to same-sex married couples, based on the "state of celebration" of the marriage.*

✏ ***Practice Tip**: If the surviving spouse as DB has been the DB of his or her deceased spouse's IRA (an "inherited IRA") for many years, possibly waiting until the decedent would have attained age 70½, to commence distributions, the "fresh start" via naming new beneficiaries and using their life expectancies (children, grandchildren) IS NOT available in the spousal inherited IRA. The surviving spouse can name "successor beneficiaries" (children or grandchildren) but this only clears up where remaining IRA assets go upon the surviving spouse's death–they will continue to be paid out over the surviving spouse's life expectancy. In this situation--recommend/discuss with your client a spousal rollover to a new IRA for which the surviving spouse will be the owner not just the beneficiary, to get a "fresh start" via new DBs in the new IRA.*

There is no time limit to do this (60 days after death of deceased spouse, etc.)–and it is usually a good idea unless the surviving spouse is under age 59½ and wants to avoid the 10 percent penalty by not rolling to a new IRA, but rather taking advantage of the "death benefit" exception for payments from an inherited IRA of a decedent. This circumstance can be addressed by "blending" the rollover–rolling some to the new IRA and leaving some in the inherited IRA for pre-age 59½ distributions.

If the surviving spouse is DB of a qualified plan, the same blending can be accomplished by one rollover to a spousal-owned IRA, and another transfer to an inherited IRA for the spouse's benefit. This will get the benefits out of the administratively restricted qualified plan, permit the spouse to take pre-59½ distributions from the inherited IRA, get a maximum stretch for the rollover IRA, and if done within a year of the participant's death, avoid any five-year default distribution election which might be in the qualified plan.

But what happens if, prior to attaining age 70½, a plan participant or IRA owner dies having named his or her estate as beneficiary (not a qualifying DB), or a trust that doesn't qualify as a DB, and these non-DB situations cannot be remedied?

There is a five-year distribution requirement in this situation whether the decedent was an IRA owner or a plan participant. See, Reg. Sections 1.401(a)(9)(B)(ii), 1.401(a)(9)-3, A-4, and A-2. This is going to create a spike in income taxation to the non-DB trust or estate, which are both entities subject to virtually no run-up in rates, with maximum income tax payable at, e.g., $12,400. The five-year distribution period is not a required equal-payment, per year, RMD method–distributions could be delayed until the end of the period but this is little comfort.

A longer "default" payout is permitted when death occurs after attaining age 70½ (see below section of this outline) than death before age 70½. Therefore, it is particularly important to be sure about qualifying DB status for a younger plan participant or IRA owner.

There is a trap awaiting a spouse of a younger plan participant (not IRA owner): A plan can require that a beneficiary elect between the life expectancy payout or the five-year rule and if no election is made within a certain time the five-year method will be the pay-out period. The trap is for the surviving spouse who could normally do a spousal rollover at any time, see above regarding spousal inherited IRA–but the trick is that once the benefits become RMDs (meaning they have to be paid under the five-year default method as RMDs), they can no longer be rolled over, even to a spousal IRA, because RMDs are not eligible for any type of rollover--they must be paid on time under the method that applies–in this case five years. Reg. Section 1.401(a)(9)-3, A-4(c).

Another trap awaits if an IRA owner fails to designate a beneficiary at all, or the form can't be located at the decedent's death. The "default" beneficiary would be described in the IRA document, and it's often the decedent's estate which doesn't qualify as a DB, so the five-year rule would apply.

Note: Roth IRAs don't have a required beginning date for the IRA owner (because all of the income tax has already been paid regarding the Roth IRA) so it's presumed under the RMD guidelines that the five-year rule applies in all cases for a Roth IRA, whenever the Roth IRA owner dies (unless of course there is a DB).

Especially for younger plan participants and IRA owners, based on the above: (1) be sure that the participant or IRA owner has a valid DB, and (2) after the death of the individual, especially if the DB is the surviving spouse of a plan participant, look into the situation right away (within a few months of the date of death) to preserve possible rollover treatment for the spouse (and other "fixes" such as disclaimer (nine-month deadline) and/or creating separate accounts, distributing to non-DB beneficiaries (such as charitable organizations) [September 30 or December 31 deadline in the year following the year of death]).

C. Consequence of Non-DB Status if Death Occurs after the Required Beginning Date.

The five-year rule applies only if death of the plan participant or IRA owner occurs prior to the required beginning date. After that time, the IRA owner or plan participant's single life expectancy will apply as the non-DB default payout period.

This is typically better (longer) than the five-year rule: for example, the payout period for a decedent who recently attained age 70½ would be 5-17 years.

Qualified plans are administered for employees to provide retirement income, usually via a requested lump-sum payment and IRA rollover when the plan participant retires and terminates employment. Generally, plan administrators and trustees don't want to retain plan benefits and deal with death beneficiaries, trusts, etc. and pay out benefits over some long-term life expectancy for a DB (could be a trust for a three-year-old grandchild). Even the life expectancy of the plan participant in a non-DB situation would be an administrative headache. In contrast to lifetime benefits, which can be left with the plan by a terminating plan participant, plans are not required to retain and pay out benefits to death beneficiaries, if they don't want to. It is true that, like IRA accounts, plans are required to pay out the RMDs to plan participants starting at age 70½ but this is a minimum and it relates to the participant/employee, not a death beneficiary. Qualified plans are "not in the estate planning business."

In fact, a plan can provide that the only form of death benefit is a lump-sum payment. Reg. Section 1.401(a)(9)-3, A-4(b).

This is a qualified plan problem, not an IRA problem. The decedent could name a child, grandchild, or trust for either as beneficiary of an IRA, and that IRA could commence to make distributions over the life expectancy of the child or grandchild. This is called an "Inherited IRA," and brokerage firms and other IRA custodians are amenable to setting up the new IRA, as follows: "X, deceased, fbo Y, beneficiary," and paying out long-term payments. In this sense, the original IRA owner, though deceased, is still the IRA owner, but there is a "new" IRA that acknowledges the death of the IRA owner, and the measuring life (the designated beneficiary, either the person named, or the person (oldest person) beneficiary of a trust that is named).

Retirement plans are not this flexible. As noted, a lump-sum payment may be the only option, which causes a real "spike" in income:

> *Example: A $2,000,000 401(k) benefit, payable to child, fully taxable in one year as income, upon receipt. The plan sponsor (Employer) is under no obligation to "hold onto" the benefits and offer a "stretch out" form of payment of death benefits, and (unlike a surviving spouse) the child cannot "roll" or transfer the plan benefits to his or her own IRA.*

However, IRC Section 402(c)(11) was amended by the 2006 Pension Protection Act (PPA) to permit such beneficiary (or trust for such beneficiary) to do a "direct transfer" (not rollover–no benefits should be distributed to the beneficiary) from the Plan to an IRA, an "inherited IRA," which can make distributions over the life expectancy of the beneficiary.

This is a very positive development: the decedent can permit a trust to safeguard assets for a beneficiary, without immediate income tax; the individual or trust beneficiary can avoid one-year compression of income; and the Plan sponsor can still get rid of the plan benefits, because the sponsor did not want to hold on to the benefits over the lifetime of the beneficiary of a deceased employee, which was why they had a lump sum as the only death benefit option. The direct transfer to IRA alternative meets these needs, and saves a lot of immediate income tax for the beneficiary.

Caution: Don't delay in getting the non-spousal rollover (transfer) completed. The plan may have a five-year default rule which could carry over to the transferee IRA, unless the transfer is completed by December 31 of the year following the year of death. Notice 2007-7, A-17(c)(2).

D. Who Gets Remaining Benefits and Over What Time-Frame when the DB or Non-DB Dies?

Whether the payout period is based on a DB's life expectancy, or the deceased participant or IRA owner's life expectancy, what happens to unpaid benefits when the beneficiary later dies?

Clients and IRA custodians often look to the "contingent" or "alternate" beneficiary that may be named in the beneficiary form or the IRA document for the answer, but this is incorrect, the contingent, alternate, or "second" beneficiary would receive benefits only if the first-named beneficiary did not survive the participant or IRA owner and that is not the case. The correct term to use here is "successor" beneficiary to the original DB or non-DB, after this original beneficiary dies. It is the original beneficiary who needs to actually "name" his or her successor for remaining benefits on his or her death. IRA custodians should permit this, using standard forms but filled out by the first beneficiary rather than the IRA owner.

What about the time-frame for these "successor" beneficiary payments? The time-frame doesn't change–it's still whatever was in effect on the death of the first beneficiary. There is no "fresh start" with a new life expectancy. What if no successor beneficiary is named–the typical IRA document will state that remaining benefits be payable to the estate of the first beneficiary in this way incorporating the first beneficiary's selections of individuals. The estate as beneficiary in this situation does not mean that the benefits have to be accelerated in the pay-out schedule, or paid out of the IRA before the probate estate is closed. Rather, the "right to receive" the benefits, under the remaining time-frame, is distributed out of the estate to the appropriate heirs, and they can continue to receive benefits under the same schedule. This is still an inherited IRA which is in the name of "X, deceased, fbo _______." So the "fbo" portion is what is changed, from the first beneficiary, to the estate, to the heir(s). See: Exhibit A with sample provisions acknowledging this "transfer" of this continuing right to distributions, not a lump-sum distribution upon termination of the trust or estate.

III. COMMUNITY PROPERTY AND BENEFICIARY DESIGNATIONS: WHAT ABOUT THE OTHER HALF?

In a community property state, like Washington, spouses often want to: (1) use plan or IRA benefits to "fund" the bypass/exemption trust in their Wills, because there are little or no other assets, and/or (2) protect these same assets against remarriage (or other diversion).

> ☞ ***Practice Tip**: Clients are often surprised to discover that the community property interest of the non-participant spouse does not exist for estate-planning purposes. (See Boggs v. Boggs, 520 US 833 (1997).*
>
>> *Example: An executive employee retires, "leaving" a $4,000,000 401(k) plan benefit in his plan, and his wife is in poor health. This is a second marriage couple and there are no children of this marriage, but children of prior marriages who are residuary beneficiaries of their trusts (in Wills) for the surviving spouse. The $2,000,000 community property interest of the non-participant spouse cannot be "accessed" via the Will of the non-participant, and she and her family are essentially disinherited regarding this significant asset, a situation which could be remedied by getting the plan benefits into an IRA in the name of the participant spouse. (See below.)*

The situation is different for an IRA. If an IRA-owning (named owner) spouse dies first, he or she can name the other spouse with regard to such spouse's community property 50 percent interest, and this surviving spouse can roll that 50 percent interest into their own IRA account, with the deceased spouse's 50 percent going to a trust (bypass/exemption or QTIP) based on the IRA owner's beneficiary designation so directing this other 50 percent. This would all be accomplished via the IRA-owning spouse's beneficiary designation.

What if the non-IRA-owning spouse dies first? Can their community property interest be given to a trust under their Will (bypass/exemption or QTIP). The answer is yes: See RCW 6.15.020. And see Section I.B. of this outline for a discussion about the non-IRA owner naming a trust as "beneficiary" of his or her community property interest in the OTHER spouse's IRA.

This situation raises several questions and complexities: The surviving spouse as owner of the IRA in their name will be subject to a probate court order [or TEDRA agreement] confirming the pre-deceasing spouse's one half (½) interest and bequest to the trust. The court order or agreement will confirm the one half (½) interest of the deceased spouse, and to the extent there are distributions to the surviving spouse, and to the extent that IRA assets remain in the IRA account at the date of the survivor's death, the trust should receive one half (½) of the distributions and one half (½) of the remaining IRA account. But under the income tax guidelines applicable to IRA accounts, which states that they shall be applied "without regard to community property laws," [IRC 408 (g)] the surviving IRA owner may be taxable on distributions to the trust even though he or she did not receive them. To address this, the trust could be obligated to pay or reimburse the surviving spouse for such taxes. See Exhibit A, Section 3.

In the Tax Court case of Andrew *Wayne Roberts v. Commissioner*, 141 T.C. No 19 (2013), it was held that the actual recipient instead of the IRA owner was taxable on IRA distributions during the IRA owner's life. The court noted that the terms "payee" or "distributee" are not defined by statute or regulation, and in contrast to the 2000 tax court case of *Bunney v. Commissioner*, 114 T.C. at 262 [also involving an IRA which was part of a divorce situation] decided that the actual recipient spouse [the non-IRA owner] was taxable on what was actually received by such spouse. However, the *Wayne Roberts* case involved forgery by a spouse in a divorce setting [which divorce setting under IRC Section 408(d)(6) can result in a new IRA of the non-owner spouse if done "incident to divorce"], and the IRA owner did not receive any benefit from the distributions. In contrast, when a trust is the designated beneficiary of the pre-deceased non-owning spouse, the distributions to the trust will not be in a divorce context, the trust will most likely benefit the surviving IRA owner, and presumably there will be no nefarious, somewhat unusual facts that existed in the Wayne Roberts case, such as forgery by the trustee-- therefore the IRA owner will likely be taxable on benefits that are paid to the trust.

What if a retiree has a rollover IRA of $4,000,000, and other assets (home, etc.) are also $4,000,000. The retiree and his spouse therefore have $8,000,000 community property, and they want either spouse to be able to "fund" a bypass trust primarily for Washington State estate tax, when either spouse dies.

A. Get the Qualified Plan Benefit Out of the Plan and Into an Individual Retirement Account (IRA).

Although there has been some speculation to the contrary, it is generally believed that the Boggs decision, and subsequent line of cases, applies only to the qualified, ERISA-governed plan benefits which are subject to displacement, for estate planning purposes, by ERISA preemption.

Accordingly, if a participant has attained age 59½, is a participant in a profit sharing plan providing for "in service" withdrawals, at any age, or in some other manner (termination of employment, termination of the plan itself, etc.) can access the benefits in a qualified plan, much more control can be exercised over the post-distribution rollover IRA.

In general, the control over post-distribution rollover IRAs, by each spouse, can be accomplished by disclaimer or disposition of the community property interest [depending on who dies first], followed by a non-pro-rata allocation of the IRA to the surviving spouse.

B. Disclaimer/Distribution and Non-Pro-Rata Allocation.

Based on PLR 199925033 and PLR 199912040 (and other subsequent PLRs), there appear to be no assignment of income, sale or exchange, or other triggering events that will be an impediment to the selection of non-IRA assets as the community property half of a predeceasing non-IRA owning spouse, or the IRA-owning spouse for that matter.

The implications of these rulings are important, although it may still be wise to obtain a prospective ruling in facts or circumstances which differ significantly from those of the cited rulings or, more conservatively, in order to give a client taxpayer the assurance of similar treatment, since Private Letter Rulings are not primary authority for other than the applicable taxpayer. This developing law means, essentially, that, for example in an estate consisting of $4,000,000 of non-IRA assets and a $4,000,000 IRA asset, the following could occur:

1. If the non-IRA owing spouse dies first, his or her community property interest in an IRA would automatically be governed by the non-owner's will through probate administration. Accordingly, without consent or agreement of any beneficiaries, the personal representative (presumably the surviving spouse) would be able to use non-intervention non-pro-rata distribution authority to "select" the non-IRA $4,000,000 of other assets as the community "one-half" of the pre-deceasing spouse.

✏ ***Practice Tip**: See Section I.B. for a description of outright bequest/disclaimer procedures which are recommended to implement this type of planning.*

If there are no other assets, and/or the non-IRA owning spouse wants to tie up their community property interest in the IRA-owning spouse's IRA, pursuant to provisions in this spouse's Will, a court order or TEDRA Agreement can implement and protect this bequest to, for example, an exemption/bypass trust. See, Washington authority for such a court order, RCW 6.15.020(6).

2. If the IRA-owing spouse dies first, then the surviving spouse could, if the beneficiary designation is prepared in a manner similar to the above-cited Private Letter Rulings, disclaim the IRA-owing spouse's one-half community interest, and similarly to the foregoing proceed with non-pro-rata allocation of assets to allocate non-IRA assets to the community one-half of the decedent's estate. In either case, the surviving spouse will be treated as owning 100 percent of the previously community property IRA, and the exemption trust will be funded with non-income assets and, accordingly, the exemption trust will not be diluted by payment of income taxes, over time.

☞ *Practice Tip and Update:* No matter which spouse dies first, disclaimer which results in even momentary ownership and allocation of the "right to receive" the IRA in lieu of other property by the estate of the IRA owner or non-owner causes concern regarding taxable income or at least IRC Section 401(a)(9) required minimum distribution status of the ultimate beneficiary as a qualifying designated beneficiary [an estate cannot be a designated beneficiary]. However, there are several private letter rulings [cited above] which have permitted this momentary estate [or trust] ownership, in view of the fact that this process amounts to a division of property between co-owners, not a sale or exchange of property subject to income taxation, <u>even if a spousal rollover "through" an estate or trust is one of the steps taken in accomplishing the division.</u> The focus is on actual receipt/rollover by the surviving spouse even if the control of the surviving spouse doesn't rise to the level of access via a power of withdrawal or revocation—see PLR 200634065, PLR 200915063, PLR 201606032.

See Exhibit A, for sample provisions in a Will or Revocable Trust which will assist in providing flexibility in the division of community property, non-pro-rata selection of community assets, timing of distributions, and complying with the "designated beneficiary" requirements for a trust.

IV. USING TRUSTS FOR THOSE YOU DON'T AND "CORRECTING" FAULTY BENEFICIARY DESIGNATIONS

Many clients prefer knowing that their community and separate property will not be at risk via a subsequent marriage of the surviving spouse, decisions to give too much (in the client's view) to charity, etc. Accordingly, instead of outright distribution of the residence, investment accounts, and the like, these assets are often held in trust for the surviving spouse in a combination of the Bypass Trust and a Marital Trust (often, a QTIP trust).

Note: Even with "portability" under recent legislation, clients may prefer this "trust" format as "protection" to ensure that the residuary beneficiaries (children) will receive their estate.

There is no reason that a client should feel differently about his or her IRA or retirement plan account–he or she may want this payable to a trust or trusts for the survivor, "taking care" of him or her, but not distributed outright. As noted, a retirement plan may not permit this type of "stretch" in payments, or even permit a trust to be a beneficiary in the first place. IRA account documents are more flexible.

As described in the following sections a trust can be named as an IRA death beneficiary, but the advisor needs to be careful in drafting both the beneficiary designation (and attachments) ["outgoing"] and the trust in the Will or Revocable Trust ["incoming"].

A sample Will/Trust provision is attached to this outline (Exhibit A). The following are points that need to be considered and then addressed in accomplishing this "coordination" between the IRA and the Will/Trust.

A. A Decision Needs to Be Made Between a Conduit Trust or Discretionary Trust as a Qualifying "See-Through" Trust

The IRS is concerned (overly so in the opinion of many) that the oldest trust beneficiary in a qualifying DB trust might die or otherwise lose beneficiary status, and some older beneficiary (or entity such as a charity) will take his or her place and be able to use the slower pay-out period of the first beneficiary. Estate planners are not trying to play this game, but nevertheless the DB status of a trust is a challenging goal because of guidelines and restrictions set forth in Treasury Regulations.

1. How Does a Trust "Qualify" as a "Designated Beneficiary"?

It is important that a trust which is named as a beneficiary of a plan or IRA qualify as a "Designated Beneficiary" under the age 70½ minimum distribution rules. Otherwise, all of the plan benefits would have to be paid to the trust either: (1) within five (5) years after death of the participant or IRA owner if death is before the required beginning date; or (2) over the remaining life expectancy of the decedent if death occurs after the required beginning date. This would reduce benefits otherwise available via stretched out distributions to the trust over the (younger, usually) trust's beneficiary's lifetime.

In order to be a “Designated Beneficiary,” a trust must meet the following requirements:

(1) The trust must be valid under state law;
(2) The beneficiaries of the trust must be “identifiable” in the trust document;
(3) The trust is irrevocable or becomes irrevocable on the death of the participant or IRA owner;
(4) The trust or other documentation must be given to the plan administrator or IRA custodian.

2. <u>What Are the Problems with Naming a Trust a Beneficiary; For Example, Can a Special Needs or Supplemental Care Trust Qualify as a “Designated Beneficiary” so that Plan or IRA Benefits Can be Stretched Out Over the Trust Beneficiary’s Lifetime?</u>

Under Regulations, it is the second requirement, above, that is the most difficult to satisfy. The IRS has stated that “possible” older or permissible beneficiaries (such as a residuary, out-of-sequence Uncle, or charity) can result in the trust not being a “designated beneficiary,” with the resulting compression of income-taxable payments, over a shorter time frame, unless such a beneficiary is a “mere potential successor.”

As an example of these problems, and looking at the above requirements, will a typical “Special Needs Trust” qualify as a “Designated Beneficiary”?

(a) <u>Valid Under State Law</u>. This requirement will most likely be satisfied.

(b) <u>Beneficiaries are Identifiable</u>. This requirement would seem to be satisfied, because the person who is a lifetime beneficiary of the trust is clearly identified by name, <u>but often this person has a general power to appoint another person</u> (also could be older, with a shorter life expectancy) to receive the trust assets at his or her death. Accordingly, under the Regulations, the trust would not be a Designated Beneficiary. There is a potentially older “Contingent Beneficiary” in the trust.

(c) The Trust is irrevocable or will be on the death of the IRA owner or plan participant: this requirement will be satisfied.

(d) The Trust document will be given to the plan trustee or IRA custodian: this will be satisfied.

Because of the problems with the number 2 requirement, the advisor preparing a Special Needs Trust which may (or will) be a beneficiary of a significant plan or

IRA benefit is in the position of deciding between: (a) shorter IRA payout period and higher income tax to the trust, or (b) ensuring DB status by using either a (i) "conduit trust" which requires that all RMDs be paid each year to the beneficiary (which would result in disallowance of public benefits intended to be protected by the trust because paying out all RMDs to the beneficiary would violate the "special needs" limitations of the trust's main operative provisions), or (ii) maintain the discretionary trust provisions of the trust, but prohibit ultimate distribution to non-qualifying (older or entity) beneficiaries, or otherwise ensure DB status.

If more flexibility than the conduit trust is desired, in other words, a "see-through" <u>discretionary</u> trust, it will be necessary to have separate trusts, which cannot have older (even "possible") beneficiaries, which is often the case for young beneficiaries (grandchildren) whose "heirs" may be their parents. [See: this result in PLR200610027, brothers or sisters would be favorable residuary beneficiaries, if they are close in age to the lifetime beneficiary.]

Similar concerns exist for a typical Bypass or QTIP trust. A "conduit" approach guarantees DB status, but may result in little or no residuary benefits if the spouse lives to full-life expectancy. A discretionary "see-through" trust (accumulations permissible so long as RMDs are distributed to the trust and taxed as income) will be preferred. Unfortunately, there is no absolute assurance that contingent beneficiaries (such as charities) won't stand in the way of DB status, unless, under Reg. Section 1.401(a)(9)-4, A-5(c), and PLR 2004-38044, at the death of the first spouse, if the surviving spouse were to die, the residuary beneficiaries (children) were all old enough to be outright (not trust) beneficiaries. <u>This may be the case</u>, or it may not. There are several drafting methods of obtaining DB status for a discretionary (non-conduit) trust: (1) The trust could provide that living residuary individual beneficiaries (grandchildren) will receive trust benefits upon the death of lifetime beneficiaries (or to a UTMA account for such residuary beneficiaries); (2) The trust could provide that only individual (not entity) beneficiaries born after (not before) a certain date will receive residuary trust benefits; (3) The trust could provide that benefits will not be distributed to any non-individual beneficiary, or to any beneficiary who is older than the oldest lifetime beneficiary. See Exhibit A.

3. <u>What About a "Trusteed IRA" or "Individual Retirement Trust (IRT)?"</u>

Instead of having a standard custodial IRA which names a trust as beneficiary, a combined IRA and trust can be used–these are called "Trusteed IRAs" or "Individual Retirement Trusts (IRTs)." A trust company or IRA custodian with a trust department provides a document which includes IRA provisions and which also is completed with trust provisions similar to those discussed in a situation in which a trust is named as beneficiary. IRTs are available in prototype form from IRA providers, or can be custom-drafted based on IRS Form 5305.

Upon the death of the IRA owner the trustee of the IRT continues to hold the IRA benefits in accordance with the terms of the trust, such as for the spouse, and then children.

The IRT can provide benefits for a disabled IRA owner during his or her lifetime, instead of having to rely on a power of attorney with a traditional IRA.

There are at least two (2) downsides to IRTs: there are significantly higher fees than are charged for a standard custodial IRA, and the IRT has to be a conduit trust, which means that the trust can't accumulate RMDs, post-tax, under discretionary maintenance and health standards so that there will be (or may be) fewer benefits in the trust for a future, residuary beneficiary.

B. <u>An "Erroneous" Beneficiary Designation May Be "Corrected" if Timely Actions Are Taken</u>

Here's an example of an erroneous IRA beneficiary designation, which could be an income–tax problem of a 5–year mandatory payout if the IRA owner dies before reaching age 70½:

"Equally to my three (3) children and the University of Washington."

This is not a "trust" beneficiary with the complexity described above in which a contingent future beneficiary such as the University of Washington could jeopardize qualifying designated beneficiary status permitting the use of life expectancies of individual beneficiaries. It is a "class" of beneficiaries, only one of which cannot be a qualifying designated beneficiary, but if not corrected the entire class will forfeit designated beneficiary status. Reg. 1.401(a)(9)-4, A-3.

If the University of Washington can be persuaded to execute a valid disclaimer of its benefits (within 9 months of the date of the IRA owner's death) the taint of the non-individual would be removed–but this is not likely to happen. So, what steps can be taken to fix this unintended acceleration of income tax consequences?

1. <u>Establish Separate Accounts with the Plan Trustee or IRA Custodian by December 31 of the Year Following the Year of the IRA Owner's Death</u>

If separate accounts (including pro-rata sharing of gains or losses) are established for each member of the class by December 31 of the year following the IRA owner's death, then <u>each beneficiary</u> will be able to use their own age for determining the required distributions over their lifetime, and the taint of the University of Washington as a non-individual will be removed. Reg. 1.401(a)(9)-8, A-2(a)(2).

What if (1) there is a "pecuniary" (e.g., $120,000) share for a beneficiary instead of percentage or fractional shares? or (2) the beneficiary designation was to a trust which named the class as beneficiaries of the trust? In these situations, the separate account rule won't work, unless <u>both</u> the beneficiary form and the trust are set up for "separate account" treatment at the outset when the documents were prepared (see below).

But it might still be possible to fix even these situations, if done in time.

2. <u>Pay Out the Benefit of the "Defective" Beneficiary Prior to September 30 of the Year Following the Year of the IRA Owner's Death</u>

September 30 of the year following the year of the death of an IRA owner or plan participant is the "beneficiary finalization date" for the minimum distribution rules. Reg.1.401(a)(9)-4, A-4(a). So, in the above example if the University of Washington were named as a $100,000 beneficiary, or were a beneficiary along with other individuals of a trust which was named as a beneficiary–the University of Washington would not be likely to give up the benefit via disclaimer to "fix" this situation, but would be amenable to receive the benefit as soon as possible–no later than September 30 of the year following the year of death.

This would take the University of Washington off the table and the remaining beneficiaries could take the benefits based on the oldest trust beneficiary's life expectancy (not separate shares–which aren't possible under the circumstances of a trust as beneficiary), or if separately named as a class and after the University of Washington has been paid off–based on their separate life expectancies if separate shares are then created after the payment is made to the non-individual beneficiary and before December 31.

<u>Note</u>: "Separate share" treatment can be accomplished <u>even with</u> a <u>trust as beneficiary</u>, if both the designation of beneficiary and the trust are written <u>so that the separate share requirement occurs at the "plan" IRA level not just the "trust" level</u>. Instead of saying ". . . to the trust to be divided into shares . . .," the designation of beneficiary should say:

> . . . this IRA shall be divided into equal shares and accounts that are separately designated to the separate subtrusts for each beneficiary named in the (bypass) trust arising at my death.
> PLR 2005-37-044.

<u>Note</u>: The <u>difference</u> between the two "fix by" dates of December 31 and September 30 of the year following death. It would be a mistake to think that the deadline is December 31 for a trust with non-individual beneficiaries, because after September 30 this would not be a fixable situation: the date for pay-out, and removal, of the non-individual beneficiary would have passed.

3. Reformation (Correction) of Faulty Designation of Beneficiary (Example: Use of Washington Trust and Estate Dispute Resolution Act (TEDRA)).

What about re-doing the (faulty) beneficiary designation via an agreed reformation? For example, what if there is no "default" (alternate) beneficiary named, the first beneficiary (spouse) is deceased, and under the IRA document the estate of the IRA owner is "default" beneficiary? Or, what about agreed (via TEDRA) re-written provisions to qualify a bypass trust as a "see-through" beneficiary?

In early rulings the IRS permitted reformation (PLRs 2006-16-039, 040) when the defect was due to transfer between custodians and "new" forms were defective, and/or disclaimer or other actions were taken soon after death (PLR 2006-16-041).

More recently, and in cases of reformation which dealt with the original IRA and/or individuals were being "added" rather than "removed" (which is counter to Reg. Section 1.401(a)(9)-4, Q&A 4 requiring that a DB was named as a DB at the date of death, until the September 30, next year, determination date), the IRS has prohibited reformation as a way of correcting a faulty original designation, or default designation. PLR 2007-42-026, PLR 2010-21-038.

V. **CHARITABLE PLANNING WITH IRAS**

What is the most common "mistake" that clients make in "including" a charity in their estate plan, regarding IRA accounts? "Including" is the mistake. Clients believe they can simply "add" the charity into the "mix" of heirs or trusts/beneficiaries, and somehow everything will work out OK: (1) the non-charitable beneficiaries will still be able to use their own life expectancies for the age 70 ½ minimum distributions (incorrect); (2) at least the "oldest" beneficiary of a trust including charities can use his or her life expectancy for IRA distributions to the trust (incorrect); and (3) the estate or trust will be able to secure not only an estate tax deduction for the charity that was "included" but also an income tax deduction for the charitable portion (incorrect). Note: With regard to (1) and (2), see Sections I, II, and IV of this outline, and Exhibit A.

What is the most assured method for avoiding the above "mistake?" It may not be "convenient" for a typical client, but the most certain way to avoid these problems is for the client to "carve out" and "create" a completely separate, stand-alone IRA account or accounts which name(s) ONLY a charity as beneficiary. This has obvious drawbacks: the "amount" in the IRA will be a moving target, and it may not meet the client's goals of providing an income stream for the surviving spouse or others, followed by a deductible charitable bequest to a charity as residuary beneficiary (use of a Charitable Remainder Trust (CRT) for example). In addition, the client "may not be that charitably inclined;" in other words, the client may want a charity to be a "wipe-out" or "contingent" beneficiary of a long-term family trust, where the charity will only receive estate or trust benefits if all other family members either pre-decease the client, or after the trust is begun, all individual trust beneficiaries die before final distribution of the trust at certain ages (example: one third at age 25, one third at age 30, and one third at age 35).

Assuming that a separate, stand-alone IRA account or accounts is not a viable option, how can a client "include" a charity or charities in the estate plan, regarding IRA accounts, and obtain the (1) maximum estate and income tax deductibility, and (2) minimum interference with long-term, flexible IRA payout/distribution schedules for other, individual heirs and beneficiaries?

A. <u>Don't Name a Charity as "Co-Beneficiary" Along with Individual Beneficiaries, or if This Will Be Done, Advise That "Corrective" Steps Need to Be Taken Shortly After Death of the IRA Owner</u>

Your client might decide to "simplify" his charitable intentions by saying "Whatever the size of my IRA at my death, I only want my three children to receive one-fourth of it, so let's say on my beneficiary designation that 'This IRA shall be distributed in equal shares to my three children, or their surviving children by right of representation if deceased, and to Charity X."

See, the above Section IV.B. of this outline. This type of "Co-Beneficiary" designation means that <u>neither the individual children's life expectancies, or the oldest child's life expectancy can be used for the applicable distribution period for required distributions</u>. Rather, either the 5-year rule applies, or the remaining life expectancy of the IRA owner applies, depending on whether the IRA owner was under or over the age 70½ Required

Beginning Date at the date of death. Again, a <u>separate IRA should be set up for the charity</u>, with either one or more IRAs for the individual beneficiaries. If this is inconvenient, it is still possible to "fix" the situation, <u>but only if, shortly after death of the IRA owner (by September 30 or December 31 of the year following the year of death), the IRA share for the charity is distributed to the charity, or separate shares are created, respectively</u>.

B. <u>Don't Name a Non-Charitable Trust as Beneficiary Which Has a Charitable Beneficiary Along with Individual Beneficiaries, or if This Will Be Done, Advise That the Trust Needs to Permit the Charity's Benefit to Be Distributed to Charity By September 30 of the Year Following the Year of Death of the IRA Owner, and Also Advise That This Distribution Must Actually Be Made By This Date</u>

It is even more difficult to keep the "measuring lives" of individual beneficiaries in place for their required minimum distributions if a <u>trust with a charitable co-beneficiary</u> is named as IRA beneficiary. This is because the IRS views the charity as even more "aligned" with the individuals, so their life expectancies cannot be used in view of the fact that a trust beneficiary does not have any "applicable distribution period" because the charitable trust beneficiary is not a qualifying "designated beneficiary." See, the above Section IV.B. of this outline.

<u>Note</u>: The "separate share" route is not available to correct this situation–only the "pay out" by September 30 of the following year. So, the trust needs to permit such a payout in the first place, and then it has to actually occur, in order to avoid the 5-year rule, or the remaining life expectancy of the IRA owner, as the applicable distribution period.

C. <u>Don't Name a Non-Charitable Trust as Beneficiary Which Has Individual Beneficiaries, Followed By a Charitable Residuary Beneficiary, Unless the Trust Will Only Receive Non-IRA Assets, or the Trust Will Be a Conduit Trust With an Individual Beneficiary Applicable Distribution Period</u>

This is more difficult than the situation in B, above, because it would be difficult, or impossible, to "pay out" the charity's residuary interest by the September 30 deadline in the year after the IRA owner's death. It would be impossible to know the likelihood of such a residuary bequest even occurring based on sequences of earlier deaths, etc., <u>and the individual beneficiaries would no doubt be resistant to making such a determination and payment to the charity, which would reduce their trust benefits</u>. The only way to accomplish this goal would be to provide in the trust document, and in the IRA beneficiary designation form, that there will be two sub-trusts–one which contains only non-IRA assets and which has the charity as residuary heir, and one which is to receive only IRA assets, and which has only individual beneficiaries. See, Exhibit A.

An alternative would be to permit IRA assets to be distributable to the trust with a charitable residuary beneficiary, but provide that with respect to any IRA assets naming such trust as beneficiary, all required minimum distributions will be distributed not only from the IRA to the trust, but also from the trust to the individual trust beneficiary or beneficiaries, who are the intended individuals who will use their life expectancies as the applicable distribution period(s). As noted elsewhere in this outline, conduit trusts cut down on the discretion of the trustee to make varying distributions based on need, standards for education and personal needs, etc., and can result in most or all of the IRA benefits being paid to the initial as opposed to residuary beneficiaries (so, this would not be advisable for a Bypass or QTIP trust for which residuary beneficiaries are children from a prior marriage).

D. <u>A Charitable Trust (Such as a CRT) Is a Preferable Designated Beneficiary of an IRA Account if Benefits for Individual Non-Charitable Beneficiaries Are Desired, and the Client Is Willing to Accept Reduced Benefits to Such Individuals Than Would Otherwise Be the Case</u>

The advantage to naming a Charitable Remainder Trust (CRT) as beneficiary of an IRA account is that the individual, fixed-annuity beneficiaries will still receive lifetime or fixed term benefits, while the estate will receive a measurable charitable deduction from estate tax (which would not be true for the situations described in Sections B and C, above), and the distribution from the IRA to the CRT will not be subject to income tax. As a result, most if not all of the "minimum required distribution" concerns for individual beneficiaries become irrelevant. Note: however, that especially with a lifetime annuity payout for the non-charitable, non-spousal beneficiary: (1) the estate tax deduction is a "moving target" based on the age of such beneficiary at the date of the IRA owner's death because only the non-individual actuarial interest (the charitable remainder interest) is deductible from the taxable estate, and (2) in the event of the "premature" death of the individual beneficiary, the "economics" of the situation are not favorable to the family (life insurance in an irrevocable life insurance trust for such beneficiary can be a wealth substitute, if available and affordable).

There are other CRT limitations which need to be considered, and which may not "fit" with a client's other goals: (1) the annuity payout needs to be "fixed" and cannot be accelerated for other needs, in comparison to a more typical family/Bypass trust with discretionary distributions for Health, Maintenance, Education and Support, (2) although the distribution from the IRA to the CRT is not taxable as income, there are two countervailing income tax factors to consider: (a) actual trust income tax attributes will be passed on to the individual trust beneficiary, under a "worst/first" model based on trust income categories and trust distributions, and (b) the otherwise available income tax deduction for estate taxes paid on the IRA account under Section 691(c) will not be available to the trust beneficiary or the trust because the trust "principal" is accounted for in such a way as to prevent its use. PLR 1999-01023.

There are at least two (2) client situations in which a CRT as IRA designated beneficiary may be an attractive alternative: (1) for a surviving spouse of a charitably inclined individual, as an alternative to outright distribution or a QTIP trust with a residuary charitable beneficiary–there is "control" over the use of the IRA compared to outright distribution to the spouse, and the income tax drawbacks of naming a high-taxpayer trust are avoided; (2) fixed-income, permanent, partially estate tax deductible benefits would be available for an older, non-spouse beneficiary who is concerned about “outliving” the benefit which would also be taxed on large required minimum distributions (because of the individual’s age), but this goal needs to be counterbalanced with the fact that the fixed distributions cannot be accelerated for unexpected maintenance, support, health, etc. needs which may occur.

EXHIBIT A

Will/Trust Provisions Dealing with Plan/IRA Assets

ARTICLE ___
RETIREMENT BENEFITS

__.1 **Retirement Benefits Defined**. For the purposes of this Article **__**, the term "Retirement Benefits" shall mean and refer to any plan or account which is subject to the minimum distribution rules of IRC Section 401(a)(9), or property interests in such plan or account.

__.2 **Non-Pro Rata Division/Division of Trust(s) for Beneficiaries**. My Personal Representative and any Trustee under this Will shall have the full and complete power to agree with my spouse to an equal division, on a non-pro rata basis, of our former community property (both probate and non-probate). In this regard, it is my intent that, to the extent practicable and advisable under federal tax law, any Retirement Benefits be allocated to my spouse as my spouse's share of our former community property.

My Personal Representative and my Trustee shall further have the power and authority to create a separate trust, trusts, or subtrust(s) for Retirement Benefits received, or to be received, on behalf of any beneficiary hereunder, and to divide Retirement Benefits into separate shares for any Retirement Benefits received or to be received by an individual, individuals, or group of individuals as beneficiary or beneficiaries hereunder.

__.3 **Retirement Benefits Allocated to Trust for Spouse**. To the extent Retirement Benefits remain payable to any trust for the benefit of my spouse after any non-pro rata division of our former community property, it is my intent that required minimum distributions ("RMD") be calculated with reference to the life expectancy of my spouse.

If any income or other taxes are incurred by my spouse (or my spouse's estate) with respect to distribution of Retirement Benefits to someone other than my spouse (or my spouse's estate) such as a Trust or Sub-trust under this Will, then the recipient of such distribution will be obligated to pay or reimburse my spouse (or my spouse's estate) for such taxes (in advance of the due date for payment of the taxes) as a condition of receiving such Retirement Benefits. This paragraph is included in this Section of this Will because as of the date of this Will the law on this matter is unclear. It is not meant to imply that some or all of the taxes referred to will in fact be incurred by my spouse (or my spouse's estate).

__.4 **Retirement Benefits Payable to Trust for Descendant**. To the extent any Retirement Benefits are payable to a Trust for a descendant of mine, it is my intent that RMDs be calculated with reference to the life expectancy of such descendant, and my Personal Representative and Trustee are hereby authorized and directed to create a separate subtrust or subtrusts for such purposes, as described herein

__.5 **Retirement Benefits Payable to Trust/for Spouse or Descendant**. If a Retirement Benefit is payable to any Trust or Subtrust under this Will, it is my intent that said Trust be considered a "qualified trust" or "see-through trust" under Reg. 1.401(a)(9) with a trust beneficiary whose life expectancy is or will be used to determine the timing and amount of post-death distributions of such Retirement Benefits. Any provision of this Will which would result in said Trust failing to so qualify, shall not apply and any provision needed for said qualification which has been omitted from this Will, shall be added under Washington State's Trust and Dispute Resolution Act. In any event, the following provisions and limitations shall apply to any such Trust or Subtrust:

A. Individual Beneficiaries. Unless otherwise provided in this Will or other instrument, it is my intent that all Retirement Benefits held by or payable to any Trust or Subtrust-trust under this Will shall be distributed to or held for individual beneficiaries within the meaning of the minimum distribution rules, and accordingly the trustee of any such Trust or Subtrust-trust shall not distribute any such Retirement Benefits to or for the benefit of my estate, any charity, or other non-individual beneficiary. Further, unless otherwise provided by this Will or other instrument, after September 30 of the year following the calendar year of my death (or earlier determination date under the minimum distribution rules), the trustee of any such Trust or Subtrust shall not use Retirement Benefits for payment of any debts, taxes, expenses of administration or other claims against or relating to my estate.

B. Adopted/Young Issue. For purposes of any Retirement Benefits payable to any Trust or Subtrust, an individual's child or issue shall not include an individual who is such individual's child or issue by virtue of adoption if such individual is adopted after my death and is older than the oldest individual who was a beneficiary of any such Trust or Subtrust at my death. With respect to any individual beneficiary who has not yet attained twenty-one (21) years of age at the time he or she is to receive Retirement Benefits, whether as an individual beneficiary or as a beneficiary of a trust receiving Retirement Benefits, his or her Retirement Benefits shall be distributed to a custodian under the Washington Uniform Transfers to Minors Act until such individual attains age twenty-one (21).

C. Contingent Beneficiaries. Unless otherwise provided in this Will or other instrument, it is my intent that any Retirement Benefits payable to any Trust or Subtrust under this Will shall be distributed using the Trust or Subtrust beneficiary or beneficiaries at the date of my death for purposes of life expectancy or expectancies under the minimum distribution rules, and accordingly any such Trust or Subtrust shall not make distributions to or for the benefit of any non-individual beneficiary, or any individual who is older than the oldest individual who was a beneficiary of any such Trust or Subtrust at the date of my death, unless under Reg. 1-401(a)(9) such beneficiary is a beneficiary of a conduit trust as described in Reg. 1-401(a)(9)-5, A-7(c)(3), is a mere potential successor as defined in Reg. 1.401(a)(9)-5, A-7(c)(1), or because of post-mortem planning the beneficiary is removed from consideration as a beneficiary under Reg. 1.401(a)(9)-4.

D. Trust Terminations and Estate Transfers. Upon termination of any Trust or Sub-trust to which Retirement Benefits are payable, the Trustee is authorized and directed to arrange for the transfer of the right to receive such Retirement Benefits from the Trust or Subtrust to an Individual Retirement Account (IRA) for the benefit of the applicable beneficiary so that the beneficiary holds the powers over investment and withdrawals formerly held by the Trustee, without necessarily causing a distribution of Retirement Benefits to the beneficiary at the termination of the Trust or Sub-trust. My Personal Representative is similarly authorized and directed to arrange for such transfer in the event that my estate is the beneficiary of any Retirement Benefits.

__.6 **Copy of Will to Custodian/Administrator**. My Personal Representative and/or Trustee shall provide a copy of this Will to the plan administrator or custodian of the Retirement Benefits payable to a Trust under this Will within the time period required under Reg. 1.401(a)(9) which, as of the time of this Will is no later than October 31 of the calendar year following the calendar year of my death.

__.7 **Power to Deal with Plan Administrator/Custodian**. My Personal Representative and Trustee shall each have full power and authority to request information from and provide information to the custodian or plan administrator of any Retirement Benefit.

__.8 **RMD for Year of Death**. If, as of my death, I have not taken the full RMD for the calendar year of my death, (i) said RMD shall be taken no later than the December 31st of the calendar year of my death, (ii) my Personal Representative shall have the power to cause such RMD, and (iii) said RMD shall be the property of the beneficiary of the Retirement Benefit.

__.9 **2006 Pension Protection Act; Direct Transfers**. Pursuant to the provisions of the Pension Protection Act of 2006, my Personal Representative and/or Trustee shall have full power and authority to instruct the Administrator or Custodian of any Retirement Benefit to make a direct transfer of such Benefits to an inherited IRA of any beneficiary or trust for a beneficiary under this Will, or under the beneficiary designation applicable to such Retirement Benefit, if, in the opinion of my Personal Representative and/or Trustee, such direct transfer will be beneficial for tax purposes, and/or will permit a longer period of payments under the minimum distribution rules of IRC Section 401(a)(9).

__.10 **General Principles**. This Article shall govern the Trustee's accounting for Retirement Benefits. In general, a Retirement Benefit shall be deemed an asset of any Trust or Subtrust-trust named as a beneficiary of Retirement Benefits, increases or decreases in its value shall be allocated to income or principal of the Trust as provided herein, and distributions from the Retirement Benefit shall be accounted for as provided herein.

__.11 **Certain Individual Account Plans**. With respect to any Retirement Benefit which is an individual account plan, for which the Trustee receives such reporting of the investment activity in the account that the Trustee can readily determine the "income" and "principal" of the Trust's interest in the plan in accordance with traditional principles of income and principal, the Trustee shall account for the Trust's interest in the Retirement Benefit as if the applicable plan assets were owned by the Trust or Subtrust directly.

__.12 **All Other Retirement Benefits**. With respect to any other Retirement Benefit, the Trustee shall treat the inventory value of the trust's interest in the Retirement Benefit as principal, and allocate any subsequent increases in value (or charge decreases in value) in such interest to income or principal in accordance with any reasonable method selected by the Trustee that is consistent with traditional principles of income and principal and is consistently applied to the Trust's interest in such plan, including:

A. A method specified in any Uniform Principal and Income Act (UPIA) or other state law governing trust accounting for retirement benefits or deferred compensation, but only if such law provides for a reasonable apportionment, each year, between the income and remainder beneficiaries of the total return of the trust for such year. The "10 percent rule" of UPIA Section 409(c), or any other state law that determines income with respect to Retirement Benefit by reference to the amount of the retirement plan's required distributions rather than by reference to the return on the applicable investments or other traditional principles of income and principal, or that otherwise departs fundamentally from traditional principles of income and principal, may not be used to determine "income" for any purpose of the Trust or Subtrust.

B. In the case of a plan similar to the type of plan specified in paragraph __.11 above, the method specified in said paragraph __.11 adapted as necessary.

C. Any method used in the Code or Treasury regulations to distinguish between "ordinary income" and "return of principal" (or corpus) with respect to similar assets.

__.13 **Treatment of Distributions**. When a distribution is received from or under a Retirement Benefit, and, at the time of such distribution, under the foregoing rules, the trust's interest in the Retirement Benefit is composed of both income and principal, such distributions shall be deemed withdrawn first from the income portion.

__.14 **Definition of Inventory Value**. In the interpretation of this Article, the "inventory value" of an interest in a Retirement Benefit shall mean:

A. In the case of an interest that becomes payable to (or is owned by) the Trust as of the date of my death, its "fair market value" determined in accordance with the rules applicable for valuing such interests for purposes of the federal estate tax (as in effect at my death, or, if such tax does not then exist, as last in effect); or,

B. In the case of an interest that becomes payable to the Trust as of the date after the date of my death (for example, by transfer from another fiduciary), its "fair market value" shall be its value as of my death determined as provided in the preceding subparagraph, adjusted as necessary for distributions, expenditures, and receipts that occurred between the date of my death and the date of transfer to the Trust; or, if the trustee cannot determine its value in that manner, its "fair market value" shall be its value as of the date it becomes an asset of the Trust, determined as provided in the preceding subparagraph, provided, in the case of an interest transferred to the trust from another fiduciary (such as my Personal Representative) accrued income so transferred shall be treated as income and shall not be included in "inventory value."