RETIREMENT ACCOUNTS IN FIRST AND SECOND MARRIAGES: THE FUN BEGINS

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RETIREMENT ACCOUNTS IN FIRST AND SECOND MARRIAGES: THE FUN BEGINS

I. Types of Qualified Retirement Plans

A. Section 401(a) - Employer pension, profit sharing and stock bonus plans

Employers that administer a qualified pension, profit sharing or stock bonus plan (a "qualified retirement plans" or "QRP"), must comply with the myriad of provisions contained in Section 401(a) , enacted as part of the Employee Retirement Income Security Act of 1974 (ERISA). For married couples, two of the most important provisions are requirements that:

(1) a plan participant's interest in a QRP may not be divided in a divorce, unless the court order meets the requirements of a qualified domestic relations order (QDRO - a federal statute). Sec. 401(a)(13)(B). By comparison, IRAs are subject to state laws, including a state's community property law.

and

(2) regardless of who an employee named as the beneficiary of a QRP account, the mandatory beneficiary of any married employee's QRP account is the surviving spouse, unless the surviving spouse executed a valid waiver. Whereas 401(k) plans are subject to this ERISA provisions, IRAs are not.

B. Section 408 - IRAs

Individual retirement accounts ("IRAs") are retirement accounts that an individual establishes with a financial institution selected by that person, rather than with an employer. To be eligible to contribute to an IRA, a person must have earned income – either a paycheck or self-employment income. Since there is no supervision by an employer, IRAs are generally exempt from many of the ERISA provisions. For married couples, two of the most important distinctions between IRAs and employer plans are that (1) an individuals's IRA can be divided during a divorce without all of the formalities of a QDRO, and (2) if someone other than the spouse was named as the beneficiary of an IRA (e.g., a child from a prior marriage), then generally that person will inherit the IRA assets rather than the surviving spouse.

C. Section 403(b) - School and charity employers

A 403(b) plan (sometimes referred to as a "tax-sheltered annuity plan") is a retirement plan offered by schools and other types of tax-exempt Section 501(c)(3) charities. In addition to employer contributions, a 403(b) plan can operate like a 401(k) plan and permit employees to defer some of their salary into individual accounts. Also, like a 401(k) plan, a 403(b) plan may offer Roth accounts.

D. Section 457(b) plans - Government and tax-exempt employers

A 457(b) plan operates like a 401(k) plan and can be established by state and local governments and by any type of tax-exempt organization (chambers of commerce, social clubs, etc). By comparison, a 403(b) plan can only be offered by an organization that is tax-exempt under Section 501(c)(3) (a charity). Like a 401(k) plan, a 457(b) plan can permit employees to defer some of their salary into individual accounts.

E. Government and church plans - Special rules

If a church or government establishes an employer plan, it is exempt from some of the ERISA provisions that apply to plans operated by private employers. Advisors with clients who participate in church and government plans should be alert to the different rules that may apply.

This outline will focus on private employer plans and IRAs and will not highlight all of the nuances that apply to 403(b), 457(b), church, and government plans. Practitioners who are dealing with a 403(b), 457(b), church, and government plan should be aware that there could be different rules.

II. Lifetime Divisions - Divorce and Separation

A. QDRO for Sec. 401 plans - a federal statute

ERISA provides that an employee's account at a qualified retirement plan may not be assigned to others or be alienated by creditors. This creditor protection generally extends to a divorce proceeding, unless a former spouse, child or other eligible party obtains a qualified domestic relations order (QDRO).

A generic domestic relations order (DRO) is a court order issued under a state's domestic relations law that recognizes that someone other than the plan participant has a right to some or all of the assets in a qualified retirement plan (such as 401(k) plan) because of child support, alimony, or marital property rights. In order for the DRO to qualify as a QDRO, the DRO must contain certain information (such as the amount to be paid) and must not contain other matters.[1] For example, a DRO will not qualify as a QDRO if the DRO states that a 401(k) plan must pay an annuity to a former spouse, but that 401(k) plan does not offer an annuity to any plan participant or any beneficiary.

[1] Secs. 401(a)(13)(B) and 414 (p). A QDRO must specify: (A) the name and the last known mailing address of the participant and each alternate payee,(B) the amount (or percentage) of the participant's benefits to be paid to each alternate payee, (C) the number of payments or period to which such order applies, and (D) each plan to which such order applies. A DRO will fail to qualify as a QDRO if it (A) requires a plan to provide any type or form of benefit, or any option, not otherwise provided under the plan, (B) requires the plan to provide increased benefits, or (C) requires payments a new alternate payee that were previously allocated to another alternate payee under a prior QDRO.

If a QDRO orders a distribution from the employer plan to a former spouse, then the distribution will be taxed to the former spouse. If, instead, the benefits are paid to a child or some other dependent, then the distributions will be taxed to the plan participant. All distributions from a QRP pursuant to a QDRO are exempt from the 10% penalty that usually applies to distributions made to an individual who is under the age of 59 ½.[2]

B. IRAs - No federal statute, but state laws (e.g., community property)

Since IRAs are not governed by ERISA, a generic DRO under a state's domestic relations law will usually be sufficient to divide an IRA. The state's laws, such as community property laws, will govern the ownership of the IRA assets.

Splitting an IRA under a decree of divorce or under a written separation instrument is usually not a taxable distribution. Instead, the spouse who receives the interest may treat the IRA as his or her own IRA.[3] Whereas a distribution from a QRP pursuant to a QDRO is exempt from the 10% penalty for early distributions,[4] there is no exemption from the 10% penalty if a distribution is made from an IRA that was acquired during a divorce proceeding to an individual who is under the age of 59 ½.

III. Lifetime Distributions - Eligibility, Taxation, and Penalties

A. Eligibility

1. Employer plans - usually must separate from service

Since the purpose of an employer's qualified retirement plan is to provide retirement income after an employee separates from service, the tax laws generally prohibit an employer from making a distribution from a qualified plan to an employee while the employee is still employed. For example, Section 401(k)(3) provides that a plan participant's account balance in a 401(k) plan "may not be distributable to participants or other beneficiaries earlier than"—

(i) severance from employment, death, or disability,
(ii) termination of the 401(k) plan,
(iii) the attainment of age 59½,
(iv) a financial hardship of the employee, or
(v) when a qualified reservist is called to active duty.

Thus, usually the only permissible way for a 401(k) participant to be able to access his or her account balance while still employed (and, only if the plan document allows "in-service distributions" or loans) is by attaining age 59 ½, incurring a financial hardship, or obtaining a loan from the plan by using the account as collateral. Even if an employee can demonstrate a financial hardship, the distribution to the employee will usually be subject to the 10% early distribution penalty if the employee has not

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2 Sec. 72(t)(2)(c).

3 Sec. 408(d)(6).

4 Sec. 72(t)(2)(c).

attained age 59 ½. Only a medical hardship is exempt from the 10% early distribution penalty. Sec. 72(t)(2)(B), described below in Part III.C.1.

2. IRAs - no prohibition on early withdrawals

There is no comparable legal prohibition that prevents a person from withdrawing assets from an IRA. Since an IRA is an account that an individual established at a financial institution, a person can withdraw amounts from the account at anytime. The only law that specifically discourages an IRA owner from withdrawing amounts before retirement is the 10% early distribution penalty that applies to most taxable distributions from IRAs and QRPs that are made before an individual has attained the age of 59 ½.

B. Taxation

1. General rule - ordinary income

Distributions from qualified plans and from IRAs are generally taxed as annuity income (“ordinary income”), rather than at lower tax rates. Secs. 402(a)(QRP) and 408(d)(1)(IRAs). Even though most of the income earned inside a QRP or an IRA is investment income, all distributions, no matter how large, are exempt from the 3.8% surtax that is imposed on the net investment income of affluent individuals. In addition, some distributions of employer stock from an employer’s qualified retirement plan can qualify for long-term capital gain treatment.

2. Exemption from 3.8% surtax

Although the income earned inside a retirement plan account is investment income (interest, dividends, and capital gains), distributions from a QRP or an IRA to an individual, a trust, or an estate are completely exempt from the 3.8% surtax that is imposed on net investment income. Section 1411(a)(1) imposes a surtax of 3.8 percent on the lesser of:

i. an individual’s net investment income
   or
ii. the amount by which the individual’s modified adjusted gross income[5] exceeds the threshold amount of $250,000 (married joint returns; $125,000 if file separately) or $200,000 for all other returns (single or head of household).

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[5] Sec. 1411(d) defines *modified* adjusted gross income to be adjusted gross income increased by the excess of (1) the amount excluded from gross income under the foreign earned income exclusion of Sec. 911(a)(1), over (2) the amount of any deductions (taken into account in computing adjusted gross income) or exclusions disallowed under Sec. 911(d)(6) with respect to the amount excluded from gross income under Sec. 911(a)(1).

The statute and regulations specifically exclude from the definition of net investment income any distribution from a qualified retirement plan. Sec. 1411(c)(5) , Reg. § 1.1411- 8. The exemption applies to qualified plans described in Secs.:

401(a) – qualified retirement plans, including pension plans, profit-sharing plans, stock bonus plans, ESOPs and Section 401(k) plans
403(a) – qualified annuity plans
403(b) – tax-sheltered annuities for employees at charities
408 – Individual Retirement Accounts (IRAs)
408A – Roth IRAs
457(b) – state and local government deferred compensation plans

Consequently, a Roth IRA conversion (a taxable distribution from a traditional qualified retirement plan into a Roth IRA) will not be subject to the 3.8% net investment income tax ("NIIT"). However, a large Roth IRA conversion might cause a person whose adjusted gross income ("AGI") would otherwise be less than $200,000 ($250,000 on a joint return) to have AGI above those thresholds, thereby subjecting that taxpayer's net investment income from interest, dividends, rents and capital gains to the 3.8% NIIT.

3. Special rules - NUA, Roth, and return of non-deductible contributions

i. NUA - Net unrealized appreciation

One situation when a retirement plan distribution is not taxed as ordinary income can occur when a QRP distributes appreciated stock of that employer as part of a lump sum distribution. The recipient can usually sell that stock and recognize a long-term capital gain on the NUA amount ("NUA"- net unrealized appreciation) rather than ordinary income. The NUA amount is the built-in gain that represents the difference between the value of the stock at the time that it was distributed by the QRP over the value of the stock at the time that it was added to the employee's account.[6]

The recipient does not have to hold the NUA employer stock for more than a year to qualify for long-term capital gain treatment. Furthermore, the capital gain attributable to the NUA will be exempt from the 3.8% NIIT since the capital gain is attributable to a distribution from a qualified retirement plan.[7]

ii. Roth distributions

An eligible distribution from a Roth IRA, a Roth 401(k), a Roth 403(b) or a Roth 457(b) is completely excluded form taxable income. It will also be exempt from the 3.8% net investment income surtax. However, distributions of investment income received before age 59 ½, or received less than five years after the Roth account was established, could be taxable. More specifically, in order for a

[6] Sec. 402(e)(4)(B); Reg. § 1.402(a)-1(b)(2)(i).
[7] Reg. § 1.1411- 8(b)(4).

distribution of the investment income earned by a Roth IRA, 401(k), 403(b) or 457(b) to be excluded from gross income, the distribution must meet two tests:

a. the distribution must be made after the individual attained age 59 ½, with exceptions if the individual became disabled, acquired a first home, or died.[8]

-- and --

b. the distribution must be made more than five years after the taxpayer made his or her first contribution to the Roth account, or conversion to a Roth account.[9]

iii. Return of non-deductible contributions - A return of a non-deductible contribution is excluded from income. Section 72(b).

4. Exception: 60 day rollovers

With a *60-day rollover*, a check is issued from a QRP to the plan participant or from an IRA to the account owner. Typically the recipient deposits the check into his or her personal checking account and commingles it with other cash. Then, within 60 days of the distribution, he or she writes a check and deposits the amount into a new IRA (or QRP) to complete the rollover. That way the person will not be taxed on the distribution.[10] A 60 day rollover will also avoid the 10% penalty that would otherwise apply if a taxable distribution is received from a QRP or IRA before the recipient had attained the age of 59 ½.[11]

Instead of a 60-day rollover, the superior way to transfer assets from one retirement plan account to another is to use a *trustee-to-trustee transfer*. With a trustee-to-trustee transfer, sometimes referred to as a "direct rollover," a person fills out forms with a new QRP or IRA administrator. Then that new QRP or IRA administrator contacts the administrator of the existing QRP or IRA and arranges for the assets to be deposited into a new account with the new administrator.

There are three main reasons to prefer a trustee-to-trustee transfer over a 60-day rollover. First, there is no income tax withholding on a trustee-to-trustee transfer whereas there can be a mandatory 20% income tax withholding requirement with a 60-day rollover.[12] Second, a taxpayer is limited to one

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[8] Secs. 408A(d)(2)(A)(iv), 408A(d)(5) and 72(t)(2)(F).

[9] Sec. 408A(d)(2)(B); Reg. § 1.408A-6, Q&A-2 (Roth IRA); Sec. 402A(d)(2)(B); Reg. § 1.402A-1, Q&A-4 (Roth 401(k)).

[10] Sec. 402(c) (QRPs) and Sec. 408(d)(3) (IRAs).

[11] Sec. 72(t).

[12] There is a mandatory 20% income tax withholding requirement for distributions from a QRP, including a distribution from a 401(k) plan. Sec. 3405(c)(1). A person who requests a cash distribution of his or her entire balance in a QRP will only receive 80% of the account balance. He or she will have to use cash from other sources to complete the rollover in order to avoid having taxable income and incurring a potential 10% penalty. IRAs have a general 10% withholding policy, but an IRA owner can elect to have a different amount withheld by the IRA administrator. By comparison, there is no tax withholding requirement for a trustee-to-trustee transfer. Sec. 3405(c)(2).

60-day *IRA* rollover per year; a second rollover attempt will trigger taxable income.[13] Third, a trustee-to-trustee transfer completely eliminates the risk of triggering taxable income because of a time delay. This is a much better situation than a rollover, where missing the 60-day deadline will usually cause the distribution to be taxable income.

If a person misses the 60-day deadline, he or she is presumed to have a taxable distribution. A person can apply to the IRS for a waiver, but that requires paying the IRS a $10,000 fee.[14] An important development in 2016 is that the IRS will now permit a taxpayer *self-certify* to the retirement plan administrator that the delay was caused by any one of eleven reasons.[15] The parties can operate as if the transfer had been a valid rollover.[16]

C. Penalties

1. 10% penalty for distributions before age 59 ½; exceptions

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[13] If a taxpayer attempts a second IRA rollover within 12 months of a prior 60-day IRA rollover, the second distribution is not eligible to be rolled over and will result in taxable income and a potential 10% early withdrawal penalty. Sec. 408(d)(3)(B), as interpreted by IRS Announcement 2014-15, 2014–16 I.R.B. 973 and IRS Announcement 2014-32, 2014-48 I.R.B. 90, following the Tax Court decision of *Bobrow v. Commissioner*, T.C. Memo. 2014-21. By comparison, there is no limit on the number of times each year that an IRA owner can change IRA administrators with trustee-to-trustee transfers. Revenue Ruling 78-406, 1978-2 C.B. 157.

[14] Rev. Proc. 2016-8, 2016-1 I.R.B. 243, at 246.

[15] Rev. Proc. 2016-47, 2016-37 I.R.B. 346. The eleven eligible reasons for missing the 60-day deadline are:
(1) an error was committed by the financial institution receiving or making the contribution;
(2) the check was misplaced and never cashed;
(3) the distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
(4) the taxpayer's principal residence was severely damaged;
(5) a member of the taxpayer's family died;
(6) the taxpayer or a member of the taxpayer's family was seriously ill;
(7) the taxpayer was incarcerated;
(8) restrictions were imposed by a foreign country;
(9) a postal error occurred;
(10) the distribution was made on account of an IRS levy and the levy proceeds were returned to the taxpayer; or
(11) the retirement plan that made the distribution delayed providing information that the receiving plan or IRA required to complete the rollover, despite the taxpayer's reasonable efforts to obtain the information.

[16] The IRS reserves the right to investigate and reverse the outcome if it concludes that the actual facts do not fit one of the eleven situations.

Generally, there is a 10% penalty imposed on all taxable distributions made from qualified plans and IRAs to individuals who are under the age of 59 ½.[17] A 60-day rollover will prevent the imposition of the penalty since the distribution will not be included in taxable income.

Other situations where a person under the age of 59 ½ may receive a taxable distribution but avoid the 10% penalty, are distributions:[18]

1. ***made to a beneficiary at any age (or to an estate or trust) after the death of the employee (distributions from inherited accounts are exempt from the 10% penalty),***

2. made to a plan participant who is disabled (that is, unable to engage in *any* substantial gainful activity by reason of any medically determinable physical or mental impairment),

(3) that are part of a series of substantially equal periodic payments made for the life (or life expectancy) of the plan participant (or the joint lives (or joint life expectancies) of the participant and his or her designated beneficiary),

– there is no age or employment requirement periodic payments from IRAs.

– for a plan participant to qualify for this exemption for distributions from a QRP, the employee must have separated from service from the employer.[19]

(4) made from a QRP (but not from an IRA) to a plan participant who separated from service after attaining the age of 55,[20]

(5) made from an ESOP of qualified dividends described in Section 404(k),

(6) made on account of a Section 6331 IRS levy on the retirement plan,

(7) made under certain types of phased retirement annuities,[21]

(8) made on account of medical expenses, to the extent that the plan participant would have been able to deduct the medical expenses under section 213 (determined without regard to whether the employee itemizes deductions for such taxable year). [Note: ***a medical hardship is the only hardship distribution that a person who is under age 59 ½ can receive from a qualified plan and avoid the 10% penalty.***],

(9) made from a QRP (but not from an IRA) to an alternate payee pursuant to a qualified domestic relations order (QDRO),[22]

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17 Sec. 72(t)(1). The 10% early distribution penalty only applies to taxable distributions.

18 Sec. 72(t)(2).

19 Sec. 72(t)(3)(B).

20 Sec. 72(t)(3)(A).

21 Sec. 72(t)(2)(A)(viii). Eligible phased retirement annuities are described in Sec. 8366a(a)(5) or 8412a(a)(5) of title 5, United States Code, or as composite retirement annuities under Sec. 8366a(a)(1) or 8412a(a)(1) of title 5.

22 Sec. 72(t)(2)(c). QRPs are subject to a requirement of a QDRO to divide a retirement plan account, but IRAs are not subject to such a requirement. Sec. 401(a)(13)(B).

(10) made from an IRA (but not from a QRP) to an unemployed person to pay health insurance premiums,

(11) made from an IRA (but not from a QRP) to pay certain higher education expenses,[23]

(12) made from an IRA (but not from a QRP) of up to $10,000 to a qualified first-time home-buyer,[24]

(13) made from an IRA or from a 401(k) plan to a qualified reservist called up to active duty,[25] or

(14) made from a retirement plan (up to $5,000) in the year of a birth or adoption. Sec. 72(t)(2)(H)(2019).

2. 50% penalty for failure to receive RMD

a. General Rule

There are two times that distributions are required from QRPs and IRAs. The first is when the QRP plan participant or the IRA owner attains age 72. Then the individual must receive a required minimum distribution ("RMD") each year for the rest of his or her life. The second time is after death: the QRP account or IRA must be liquidated to the beneficiary over a specific time period, and RMDs must occur every year over that time period (unless the account is to be liquidated in five years, in which case all that is required is that the account be empty at the end of the fifth year following death).[26] If a plan participant or beneficiary receives less than the RMD for that year, there is a 50% penalty imposed on the deficiency.[27]

There is no future credit for larger distributions. For example, if a 75 year old person withdraws 6% of the account balance when the minimum RMD for that year is 4.07%, the person cannot carryforward the extra 2% withdrawal to the next year. Instead, the RMD in the following year will be the same 4.22% that applies to all 76 year old individuals.

b. Multiple IRAs may be aggregated

If an individual has accounts at several QRPs, then generally each plan must distribute the minimum RMD for that year. By comparison, there is relief when a person has multiple IRAs. A person can calculate the total RMDs that would be required from each IRA, and can then satisfy the requirement with a distribution from just one or more of the IRAs.[28] For example, if a 75 year old has an IRA that holds an illiquid asset worth $100,000 and another IRA has liquid assets worth $200,000, the requirement is satisfied if $12,210 (the RMD of 4.07% times $300,000) is withdrawn entirely from the IRA that holds the liquid assets. This aggregation rule also applies to multiple *inherited IRAs* as long as they are inherited from the same person.

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23 Secs. 72(t)(2)(E) and (t)(7).
24 Secs. 72(t)(2)(F) and (t)(8).
25 Sec. 72(t)(2)(G).
26 Secs. 401(a)(9), 403(b)(10), 408(a)(6), 408(b)(3), and 457(d)(2).
27 Sec. 4974.
28 Sec. 408(d)(2).

IV. Transfers at Death - Spousal rights

A. Overview - General rules for non-spouse and a spouse

Federal law gives a surviving spouse rights to assets in a QRP that superseded the laws of any state. For example, regardless of who a plan participant named as a beneficiary of a 401(k) plan, the surviving spouse is entitled to 100% of the assets in the account unless that spouse executed a waiver.[29] By comparison, IRAs are generally subject to state laws, including general divorce and community property laws.

B. Section 401(a) plans

1. Defined benefit plans - QJSA and QPSA

A defined benefit plan is required to pay benefits to every married plan participant in the form of a qualified joint and survivor annuity (QJSA) at retirement. If the plan participant dies while still employed and before retirement, the plan is required to pay the surviving spouse a qualified pre-retirement survivor annuity (QPSA).[30]

A QJSA pays the retirement benefit first as a life annuity to the plan participant and then as a survivor annuity over the life of the participant's surviving spouse. It is possible to have a survivor annuity paid to a former spouse, child or dependent who is treated as a surviving spouse under a qualified domestic relations order. The amount paid to the surviving spouse must be no less than 50% and no greater than 100% of the amount of the annuity paid during the participant's life.

A spouse can waive the right to a QJSA. For example, a spouse might waive the right to a QJSA to permit the plan participant to receive larger payments that will terminate upon the death of that participant (a single life annuity).[31]

2. Defined contribution plans

a. General rule - spouse entitled to 100%

A QRP that does not offer annuities is required to pay 100% of the assets in a deceased plan participant's account to the surviving spouse if the individual was married at the time of his or her death.[32] This provision applies to most 401(k) plans. Such plans typically reduce their operating costs by not offering annuities, since that would subject them to the complicated and cumbersome QJSA rules.

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29 Sec. 401(a)(11)(B)(iii); Egelhoff v. Egelhoff, 532 U.S. 141 (2001).

30 Secs. 401(a)(11) and 417.

31 Secs. 401(a)(11)(A) and 417(a)(2).

32 Sec. 401(a)(11)(B)(iii).

Consequently, as a matter of federal law, it will not matter who a married plan participant named as the beneficiary of a QRP account. In that case the retirement assets will be distributed to the individuals, trusts or estate that were named as the beneficiaries of the QRP account.

b. Exception - waiver by spouse

A surviving spouse may waive the privilege to receive the entire account balance by executing a qualified waiver.[34] Such a waiver is also required for other transactions that might reduce a surviving spouse's benefit at death, such as a rollover from a QRP to an IRA.[35]

The consent must acknowledge the effect of the waiver and must be witnessed by a plan representative or by a notary public.[36] A beneficiary designation generally cannot be later modified without a new consent from the spouse.[37] However, it is possible for a spouse to sign a "general consent"[38] or to name a "class of beneficiaries"[39] in the consent so that changing amounts to beneficiaries within the defined class does not require a new consent.

It may be possible for a spouse who failed to execute a written consent before the employee's death to execute one afterward. This may permit the taxable distribution to be paid to the specified beneficiary pursuant to a Section 2518 "qualified disclaimer" by the surviving spouse without triggering a taxable gift by the surviving spouse.

c. Prenuptial agreements usually ineffective

This federal law has generated a significant amount of litigation in second marriages, where children from a prior marriage were named as beneficiaries of the retirement account but the plan administrator informed them that their step-parent was entitled to the assets instead.[40]

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[34] Secs. 401(a)(11)(B)(iii) and 417(a)(2).

[35] With an IRA, a surviving spouse will usually not receive the assets unless he or she was specifically named as the beneficiary. Thus, if a 401(k) account is rolled over into an IRA, a surviving spouse loses the protection that he or she would have had if the assets had remained in the 401(k) plan. Charles Schwab & Co. v Debickero, 593 F.3d 916 (9th Cir. 2010).

[36] Sec. 417(a)(2)(A).

[37] Reg. § 1.401(a)-20, Q&A-31(a).

[38] Reg. § 1.401(a)-20, Q&A-31(b).

[39] Reg. § 1.401(a)-20, Q&A-31(a). Usually the class is the children of the employee.

[40] Egelhoff v. Egelhoff, 532 U.S. 141 (2001); Reg. § 1.401(a)-20, Q&A-28.

d. Community property laws - *Boggs*

Unlike IRAs, QRPs are governed by ERISA, which contains one of the most powerful federal preemption laws on the books. This preemption was demanded by employers that operated businesses in multiple states. They wanted uniform administration of employer plans in all states, without state-by-state variations that might exist under the laws of the various states. Congress granted them this preemption.[41] consequently, the U.S. Supreme Court concluded in *Boggs v. Boggs* that a state's community property law has no impact on a plan participant's account in a QRP.[42]

C. Section 408 - IRAs

1. General rule - no federal law trumps beneficiary designation

Since IRAs are governed by Section 408, they are not subject to the ERISA provisions that govern QRPs described in Section 401. For example, an IRA can be divided in a divorce without the necessity of a QDRO.[43] Furthermore, upon the death of an IRA owner, the IRA will generally be paid to whoever was named as the beneficiary of the IRA. The QRP provision that requires the account of an employee who was married on the date of death to be paid to the surviving spouse, regardless of who was named as the beneficiary, does not apply to an IRA.

2. State community property laws

Whereas the Supreme Court concluded in *Boggs v. Boggs* that a state's community property law cannot apply to a QRP account since it is instead subject to ERISA, there is no federal preemption for IRAs. A state's community property law can apply to an IRA. However, the IRS concluded that byzantine income tax consequences can occur when a state's community property law is applied to an IRA, described below.

3. PLR 201623001 - IRS will tax original beneficiary when surviving spouse receives distributions under state community property law

In PLR 201623001 (March 3, 2016), an IRA was payable to a married couple's child, but the surviving spouse exercised her community property rights after her husband died, and a state court concluded that she was entitled to it. The IRS, however, concluded that even though the surviving spouse would receive the distributions from the IRA pursuant to the state court order, the IRS would continue to view the child as the beneficiary. Thus, distributions to the surviving spouse will be taxed to child.

In PLR 201623001, it appears that the child was the biological child of the two parents. But if it had been a child from a prior marriage who was paying the income tax on the distributions to the step-parent .... whoa!

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[42] *"We can begin, and in this case end, the analysis by simply asking if state law conflicts with the provisions of ERISA or operates to frustrate its objects. We hold that there is a conflict, which suffices to resolve the case.*" Boggs v. Boggs, 520 U.S. 833, 117 S. Ct. 1754, at 1760-61 (1997).

[43] Sec. 408(d)(6).

Here is the crucial excerpt from the PLR [emphasis added by Hoyt]:

"Section 408(g) provides that section 408 shall be applied without regard to any community property laws, and, therefore, section 408(d)'s distribution rules must be applied without regard to any community property laws."

"Accordingly, because [widow] was not the named beneficiary of the IRA of Decedent and because we disregard [widow]'s community property interest, [widow] may not be treated as a payee of the inherited IRA for [child] and [widow] may not rollover any amounts from the inherited IRA for [child] (and therefore any contribution of such amounts by [widow] to an IRA for [widow] will be subject to the contribution limits governing IRAs)."

"Additionally, because [child] is the named beneficiary of the IRA of Decedent and because we disregard [widow]'s community property interest, ***any "assignment" of an interest in the inherited IRA for [child] to [widow] would be treated as a taxable distribution to [child].*** *Therefore, the order of the state court cannot be accomplished under federal tax law."*

V. Tax Planning for Required Distributions

A. Tax-planning objectives

The tax planning strategy that most advisors recommend is to keep the balance in the retirement account as large as possible.

* For a traditional retirement account, retaining a large balance permits the individual to earn investment income on the deferred income taxes.

* If the account is a Roth account, the distribution is usually not subject to income tax. However, the investment income earned on the withdrawn assets will be taxable.

EXAMPLE: If $100,000 was withdrawn from a traditional retirement account, income taxes would be due. In this example, $40,000, assuming a 40% rate of federal and state income taxes. By leaving amounts in the plan, a person can earn investment income on the $40,000 of deferred taxes (e.g., receive $10,000 per year rather than $6,000 assuming a 10% yield, or $5,000 rather than $3,000 assuming a 5% yield, etc. etc.). If the account had been a Roth account, the $100,000 withdrawal would not be taxable. However, once the assets are out of the Roth account, the investment income (e.g., $10,000 or $5,000) is taxable. It would have been tax-exempt if earned inside the Roth account.

	Principal	10% Yield		5% Yield	
Amount in IRA	$100,000	10%	$ 10,000	5%	$ 5,000
Income Tax on Distribution (40%)	40,000				
Amount Left to Invest	$ 60,000	10%	$ 6,000	5%	$ 3,000

B. Required minimum distributions after age 72

1. General rule

There is a 50% penalty tax imposed on a retirement account owner if he or she does not receive a required minimum distribution ("RMD") after attaining the age of 72 or retiring, whichever occurs later.[1] The amount of each year's RMD is determined by a uniform lifetime distribution table, with no distinction based on gender or other factors. That table appears on the next page.

TWO SIMPLE STEPS: **Step 1:** Find out the value of the investments in the retirement plan account on the last day of the preceding year. For example, on New Years Day -- look at the closing stock prices for December 31. **Step 2**: Multiply the value of the investments by the percentage in the table that is next to the age that the account owner will be at the end of that year. This is the minimum amount that must be distributed that year to avoid a 50% penalty.

Example: Ann T. Emm had $100,000 in her only IRA at the beginning of the year. She will be age 80 at the end of this year. She must receive at least $4,950 during the year to avoid a 50% penalty (4.95% times $100,000).

[1] Sec. 4974; Reg. Sec. 54.4974-2. If there is reasonable cause for the failure, the penalty can be waived. Reg. Sec. 54.4974-2, Q&A 7. In addition, a qualified retirement plan could be disqualified for failing to make the required distributions. Sec. 401(a)(9). Individuals who own 5% or less of a business can defer the imposition of the penalty if they are still employed after age 70 ½, but they still must take RMDs from their IRAs. IRAs are governed by Sec. 408 rather than Sec. 401.

--UNIFORM LIFETIME DISTRIBUTION TABLE –

Age	*Payout*						
70 ½	-0-%	***80***	***4.95%***	90	8.27%	100	15.63%
71	-0-%	81	5.19%	91	8.78%	101	16.95%
72	3.67%	82	5.44%	92	9.26%	102	17.86%
73	3.79%	83	5.69%	93	9.91%	103	19.24%
74	3.93%	84	5.96%	94	10.53%	104	20.41%
75	4.07%	85	6.25%	95	11.24%	105	21.74%
76	4.22%	86	6.58%	96	12.05%	106	23.26%
77	4.39%	87	6.95%	97	12.83%	107	24.39%
78	4.57%	88	7.36%	98	13.70%	108	25.65%
79	4.77%	89	7.76%	99	14.71%	109	27.03%

[Table computed from Table A-2 of Reg. Sec. 1.401(a)(9)-9 (*updated in 2021)* -- (rounded up)]

2. Smaller RMDs when spouse is more than 10 years younger

The uniform lifetime distribution table was computed based on a hypothetical joint life expectancy of the account owner and someone who was ten years younger. An exception to this uniform table applies when an account owner is in fact married to a spouse who is more than ten years younger than the account owner, if that spouse is the sole beneficiary of the account. In that case, smaller RMDs apply, determined by the joint life expectancy of the account owner and the younger spouse. These tables can be found in IRS Publication 590.

C. Inherited accounts – Maximum time period for liquidation of an account: ten years, five years, or a remaining life expectancy

Failure to receive the required minimum distribution ("RMD") for that year from an inherited retirement account triggers a 50% penalty on the shortfall. The maximum time period over which a decedent's account may be liquidated without such a penalty after the year of death is either:

1. **(#1) ten years**, if only "designated beneficiaries" ("DBs") (or a "look-through trust" with 100% DBs) are the beneficiaries of the account (there is no RMD until the 10th year),
2. **(#2) the remaining life expectancy of an eligible designated beneficiary ("EDB")**, based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent, disabled, chronically ill, or someone who is not more than ten years younger than the decedent (there is an RMD every year),
3. **(#3) five years**(there is no RMD until the 5th year)**,** if the account owner died before the required beginning date ("RBD") and there is even just one non-DB on the "determination date" (generally, September 30 following the year of death), or
4. **(#4) the life expectancy of someone who was the account owner's age** (a/k/a a **"ghost life expectancy")** if the account owner died after the RBD and there is even just one non-DB on the "determination date." There will be RMDs in each of those years.

For a surviving spouse, the best income tax consequences usually occur with a rollover to a new IRA for the surviving spouse.

a. Life expectancy table for eligible designated beneficiaries and "ghost life expectancy"

Whereas the general rule is that an inherited account must be liquidated over ten years, there are two exceptions that use a measuring period of a remaining life expectancy. This table contains that life expectancy time period. As described above, they are:

(#2) the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent, disabled, chronically ill, or someone who is not more than ten years younger than the decedent (there is an RMD every year),

and

(#4) the life expectancy of someone who was the account owner's age (a/k/a a **"ghost life expectancy")** if the account owner died after the RBD and there is even just one non-DB on the "determination date." There will be RMDs in each of those years.

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Expectancy
0	84.5	20	65.0	40	45.7	60	27.1	80	11.2
1	83.7	21	64.0	41	44.7	61	26.2	81	10.5
2	82.7	22	63.0	42	43.8	62	25.3	82	9.9
3	81.7	23	62.0	43	42.8	63	24.5	83	9.2
4	80.8	24	61.1	44	41.8	64	23.6	84	8.6
5	79.8	25	60.1	45	40.9	65	22.8	85	8.1
6	78.8	26	59.1	46	39.9	66	22.0	86	7.5
7	77.8	27	58.2	47	39.0	67	21.2	87	7.0
8	76.8	28	57.2	48	38.0	68	20.4	88	6.6
9	75.8	29	56.2	49	37.1	69	19.5	89	6.1
10	74.8	30	55.3	50	36.1	70	18.7	90	5.7
11	73.8	31	54.3	51	35.2	71	17.9	91	5.3
12	72.8	32	53.4	52	34.3	72	17.1	92	4.9
13	71.9	33	52.4	53	33.1	73	16.3	93	4.6
14	70.9	34	51.4	54	32.4	74	15.6	94	4.2
15	69.9	35	50.5	55	31.5	75	14.8	95	3.9
16	68.9	36	49.6	56	30.6	76	14.0	96	3.7
17	67.9	37	48.6	57	29.7	77	13.3	97	3.4
18	66.9	38	47.6	58	28.8	78	12.6	98	3.2
19	66.0	39	46.6	59	27.9	79	11.9	99	3.0

Table A-1 of Reg. Sec. 1.401(a)(9)-9 ("single life "), required by Reg. Sec. 1.401(a)(9)-5, Q&A 5(a) & 5(c) and Q&A 6. *(updated for 2021)*

c. Surviving spouse can rollover to own IRA

A surviving spouse is the only person who can rollover a distribution from an inherited IRA or QRP account into a new IRA that treats the surviving spouse as the new account owner.[2] No other person can rollover an inherited retirement plan distribution; he or she must report each distribution as taxable income in the year that it is made from the deceased's account.[3]

2. Non-spouse beneficiary
 a. General rules
  i. Ten year liquidation

Although the statute provides that the general rule is that a deceased's retirement account must be empty ten years after death,[4] there are three important exceptions. First, if the decedent died after the required beginning date ("***RBD***", which is usually April 1 following the year the individual attained age 72), the liquidation period could instead be the remaining life expectancy of someone who was the decedent's age in the year of death, which could be more than five years.[5] Second, if the individual died before the RBD, the account might have to be liquidated in just five years if on the determination date there is even just one beneficiary that is not a "designated beneficiary" (i.e., is not a human being). Third, if the beneficiary is an "eligible designated beneficiary ("EDB"), the maximum distribution period is the remaining life expectancy of the EDB (e.g., the "stretch IRA" where payments are stretched over the EDB's remaining life expectancy).

  ii. "Stretch" over life expectancy of an EDB

A ***designated beneficiary ("DB")*** is a human being, and an ***eligible designated beneficiary ("EDB")*** is one of five individuals who qualify for distributions payable over her/his remaining life expectancy rather than just five or ten years.[6] An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent (though upon attaining majority age, the ten year rule applies), disabled, chronically ill, or someone who is not more

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2 Sec. 402(c)(9) for inherited QRP accounts and Sec. 408(d)(3)(C)(ii)(II) for inherited IRAs.

3 The general prohibition against rolling over an inherited IRA is described in Sec. 408(d)(3)(C).

4 Sec. 401(a)(9)(H). There is no minimum amount each year. Instead, the requirement is that the account be empty at the end of the tenth year.

5 Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)(2)(death after RBD).

6 Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-4, Q&A 1 (*"DB"*); Sec. 401(a)(9)(E)(ii) (*"EDB"*)

than ten years younger than the decedent

The RMD for the year is usually determined by placing the DB's remaining life expectancy in the denominator of a fraction, and then reducing the denominator by one in each subsequent year. For example, a 66 year old has a remaining life expectancy of 22 years, to age 88. Thus at age 66, the RMD is 1/22. At age 67 it will be 1/21; at age 68 it will be 1/20; etc. In this example, the inherited account will have to be empty when the EDB attains age 88.

Although a charity or a probate estate can be a beneficiary of an IRA or QRP account, neither will qualify as a DB since neither has a life expectancy.[7] Having a single non-DB as a beneficiary might cause the inherited account to fail to qualify for a ten-year liquidation, and instead trigger the five year rule. In many cases ten-year treatment can be preserved if the non-DBs are eliminated as beneficiaries before the "determination date", which is September 30 in the year *following* the year of death.[8] There are basically three ways that a beneficiary can be eliminated before the determination date: (1) disclaimer by a beneficiary, (2) cash-out of a beneficiary's entire interest (advisable for a tax-exempt charity)[9] and (3) establishing a separate account for each different beneficiary before the September 30 date.[10]

Although a trust is not a DB, if certain criteria are met, a trust may be the beneficiary of an IRA or QRP and RMDs will be determined based on the beneficiaries of that trust (a "see-through" or a "look -through" trust").[11] This exception is examined below in Part "c".

b. Employer plans can impose faster distributions; IRA options

The federal tax laws permit an inherited retirement account to be liquidated over the remaining life expectancy of a designated beneficiary. But no employer wants to be responsible for keeping track of the whereabouts until age 85 of every grandchild of every employee who ever worked at the business. Consequently, many employer plans provide that the accounts of deceased employees will be liquidated over a much shorter time span,

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7 Reg. Sec. 1.401(a)(9)-4, Q&A 3.

8 Reg. Sec. 1.401(a)(9)-4, Q&A 4.

9 See, for example, Private Letter Ruling 200740018 (July 12, 2007) for an illustration of how a cash-out of one beneficiary before September 30 meant that the beneficiary was not considered for purposes of minimum distributions.

10 Reg. Sec. 1.401(a)(9)-8, Q&A 2 and 3

11 Reg. Sec. 1.401(a)(9)-4, Q&A 5 and 6.

perhaps within one year after the employee's death.[12] That could push a lot of taxable income onto the income tax returns of the beneficiaries.

There are two tax laws that give beneficiaries income tax deferral possibilities. First, if the beneficiary is the surviving spouse, he or she can rollover the retirement assets into a new IRA or other qualified plan account.[13] The surviving spouse will be considered the owner of the account rather than just the beneficiary of an inherited IRA. No other beneficiary can get such rollover treatment of an inherited account.[14]

Second, a non-spouse beneficiary can compel the employer plan to make a trustee-to-trustee transfer of the deceased employee's account balance to an IRA that will operate as an inherited IRA.[15] Although not as good as a rollover to the beneficiary's own IRA, this outcome permits deferral of income taxes under the stretch rules, described above.

c. Trusts as beneficiaries - "look-through" options

If certain criteria are met, a trust can be named as a beneficiary of either an IRA or a QRP account and each of the individuals who are beneficiaries of the trust will be considered beneficiaries of the IRA or QRP. Reg. Sec. 1.409(a)(9)-4, Q&A 5 and 6 permit beneficiaries of the trust to be treated as beneficiaries of the retirement account for purposes of determining minimum mandatory distributions if the following conditions are met:

(1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
(2) The trust is irrevocable or will become irrevocable upon the death of the employee.
(3) The beneficiaries of the trust are identifiable from the trust instrument, and

(4) Either one of the following documents has been provided to the plan administrator:
(a) a document that contains:
(i) a list of all of the beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions on their entitlement sufficient to establish whether or not the spouse is the sole beneficiary) entitled to receive retirement assets;
(ii) a certification that the list is correct and complete and that the preceding 3 requirements have been met to the best of the retirement account owner's knowledge),

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12 Reg. Sec. 1.401(a)(9)-3, Q&A 4.

13 Sec. 402(c)(9) for inherited QRP accounts and Sec. 408(d)(3)(C)(ii)(II) for inherited IRAs.

14 The general prohibition against rolling over an inherited IRA is described in Sec. 408(d)(3)(C).

15 Sec. 402(c)(11).

(iii) a statement that if the trust instrument is amended at any time in the future, the retirement account owner will provide corrected certifications to the plan administrator, and
(iv) a statement that the retirement account owner agrees to provide a copy of the trust instrument to the plan administrator upon demand.

(b) A copy of the entire trust instrument, together with a statement that the account owner will provide copies of future amendments.

d. Terminology – RBD, DB, and determination date

Required Beginning Date ("RBD") - The first date that a distribution must be made from an IRA, QRP or 403(b) account to the account owner in order to avoid the 50% penalty tax.[16]

IRAs**:** The RBD for an IRA is April 1 following the calendar year that the IRA account owner attains age 72.[17]
QRP or 403(b): The RBD for a qualified retirement plan or a tax-sheltered annuity is the *later* of (a) April 1 following the calendar year that the account owner attains age 72 or (b) April 1 following the calendar year that the employee separates from service (e.g., somebody who works past age 72).[18] Individuals who own 5% or more of a business are not eligible for this later RBD: their RBD is April 1 following the calendar year that they attain age 72.

"Beneficiaries" versus "Designated Beneficiary" ("DB") - A beneficiary is any person or entity that is entitled to receive benefits from a QRP or IRA account after the account owner's death. By comparison, a *designated beneficiary* is an individual who is entitled to the benefits of the IRA or QRP account upon the death of the employee / participant / IRA owner (hereafter "account owner").[19] Neither a charity nor the decedent's estate will qualify as a DB since neither has a life expectancy. If certain criteria are met, a trust may be the beneficiary of an IRA or QRP and distributions will be based on the beneficiaries of that trust (a "look-through trust").

"Eligible Designated Beneficiary" ("EDB") - An EDB qualifies for an exception to the general ten liquidation rule. An EDB may receive distributions over his or her the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a

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16 Sec. 4974; Reg. Sec. 54.4974-2, Q&A 1 and 2.

17 Sec. 408(a)(6); Reg. Sec. 1.408-8 Q&A 3.

18 Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-2, Q&A 2.

19 Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-4, Q&A 1.

surviving spouse, a minor child of the decedent (though upon attaining majority age, the ten year rule applies), disabled, chronically ill, or someone who is not more than ten years younger than the decedent

Determination Date - The date when the beneficiaries must be determined is September 30 of the calendar year that follows the calendar year of the account owner's death.[20] Example: Sarah died on June 15, 2021, the determination date for her IRA and QRP accounts will be September 30, 2022. The minimum distributions will be computed based only on the beneficiaries who still have an interest on the determination date. If a beneficiary's interest is eliminated between the time that the account owner died and the determination date – for example by a cash out or a disclaimer -- then that beneficiary will not impact the required minimum distributions. PLR 200740018 (July 12, 2007).

There are basically three ways to eliminate some of the beneficiaries before the determination date:
(1) disclaimers,
(2) cash-out of a beneficiary, and
(3) separate accounts for different beneficiaries.

e. DISCLAIMERS -- What happens when a person disclaims an interest in an inherited retirement plan account? That is, upon the employee's death, the primary beneficiary makes a "qualified disclaimer" within the applicable 9 month period so that the property passes to a contingent beneficiary, such as a charity. *The IRS will allow a primary beneficiary to disclaim all or part of an inherited retirement account even if he or she received a mandatory distribution from the account in the year of the account owner's death.* Rev. Rul.2005-36, 2005-26 IRB 1368 (by comparison, any acceptance of benefits will normally disqualify a disclaimer). The estate can then claim an estate tax charitable deduction for the amount that was transferred to a charity by way of the disclaimer.[21]

EXAMPLE WITH A CHARITY: Assume that Mother's estate is comprised of a $1.1 million retirement account and $1 million of other assets. Mother named Daughter as the primary beneficiary and named Charity as a contingent beneficiary of her retirement account. Upon Mother's death, Daughter could make a qualified disclaimer of just $100,000, generating a $100,000 charitable estate tax deduction. Mother's taxable estate would be just $2 million, thereby avoiding the estate tax. Daughter would not have to recognize any taxable income nor would she be treated as having

[20] Reg. Sec. 1.401(a)(9)-4, Q&A 4.

[21] Reg. Sec. 20.2055-2(c)(1).

made a gift.[22]

CAUTION #1: Disclaimers of property that pass to a ***private foundation*** pose tax problems. A solution that has been approved by the IRS is to make a disclaimer to a ***donor advised fund*** of a community foundation rather than a private foundation. [23]

CAUTION #2: Generally avoid this strategy for transferring assets to a *charitable remainder trust*. A person (except for a surviving spouse) cannot make a valid disclaimer to a trust if he or she will also be a beneficiary of that trust.[24]

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[23] Rev. Rul. 2005-36, 2005-26 I.R.B 1368

[23] A problem exists if a parent names a child as a beneficiary of an estate and through the child's disclaimer the property passes to a private foundation where the child is a director. The child's participation in the private foundation's selection of charitable grant recipients could prevent the disclaimer from being a qualified disclaimer. This is because the child would be normally involved in selecting the ultimate charitable beneficiaries of the private foundation, which could violate the requirement that the interest in property passes "without any direction on the part of the person making the disclaimer." Reg. Sec. 25.2518-2(d)(1) & (2); 25.2518-2(e)(1)(I). *One solution* to deal with this is for the private foundation to amend its bylaws so as to prohibit the child and the child's spouse from participating in the selection of grant recipients from amounts that are attributable to the disclaimed property. See PLRs 200649023 (Aug. 23, 2006), 9317039 (Feb. 2, 1993) and 9141017 (July 10, 1991). This is a fairly clumsy solution that interferes with a parent's desire to allow children to be involved with a private foundation. *A better solution* may be to have a child disclaim property to an advised fund of a community foundation. The IRS concluded that the advisory nature of a child's or grandchild's grant recommendations did not pose a problem. PLRs 200518012 (Dec. 17, 2004) (disclaimers by grandchildren) and PLR 9532027 (May 12, 1995) (disclaimers by children).

[24] Reg. Sec. 25.2518-2(e)(3).

f. REQUIRED MINIMUM DISTRIBUTIONS FROM IRAs AND QRPs AFTER THE ACCOUNT OWNER'S DEATH, BASED ON THE BENEFICIARIES AS OF THE "DETERMINATION DATE"

BENEFICIARY	DEATH BEFORE RBD	DEATH AFTER RBD
"No designated beneficiary" ***("No DB")"*** - if there is even just one non-human beneficiary (e.g., probate estate or a charity)	Five Years *[No RMD until the 5th year]*	Remaining life expectancy of someone who was the *decedent's age* in the year of death ("ghost life expectancy") *[RMDs must be made each year]*
NON-SPOUSE DESIG. BENIF.		
General Rule if all beneficiaries are individuals ("DBs")	Ten Years *[No RMD until the 10th year]*	- Same: Ten Years - * * An argument can be made that the term can be the "ghost life expectancy," if that is more than ten years
Rollover option?	Not available to anyone but a surviving spouse.**	** - Possible to transfer decedent's account from a company plan (but not from an IRA) to an IRA payable over ten years (or life expectancy of an EDB)
Eligible Designated Beneficiary ("EDB")	Remaining life expectancy of the *EDB*,* fixed as of the year *after* death. Distributions must begin before the end of the year that follows the year of death. *[RMDs must be made each year]*	– Same Rule – * - (if the EDB is older than the deceased, use life expectancy based on the deceased's age)
Beneficiaries include both EDBs and non-EDBs	Unless separate shares are established, generally Ten Years (or Five Years). Special rules benefit accumulation trust for disabled & chronically ill.	Remaining life expectancy of someone who was the *decedent's age*, unless separate accounts for the beneficiaries.
SPECIAL RULES		
"Look-through" trust/ "See-through" trust	"Look through" to identity of DBs and EDBs of the trust to determine RMDs.	– Same Rule --
Remainder beneficiary	A remainder beneficiary is counted as a beneficiary of an *accumulation trust*, but not of a *conduit trust*	– Same Rule –

BENEFICIARY	**DEATH BEFORE RBD**	**DEATH AFTER RBD**
SPOUSE IS THE BENEFICIARY		
Rollover Option?	Yes, available	Yes, available
Leave in deceased's account and spouse is the sole beneficiary?		
-- General Rule	**Minimum distributions over the surviving spouse's remaining life expectancy, *gradually extended* each year as the spouse ages.**	***– Same Rule --***
-- IRAs only: elect to treat as own IRA	***Surviving spouse can elect to leave assets in deceased's IRA but treat that IRA like a rollover IRA.***	***– Same Rule --***
-- Decedent died before age 72?	***Can defer first distribution until the year that the deceased spouse would have been age 72.***	***Not applicable***
MULTIPLE DBs; ONE IS THE SPOUSE		
Both spouse and another DB are the beneficiaries	Generally ten years, unless separate shares are established.	– Same Rule --
Both spouse and a charity are beneficiaries	Five Years, unless separate accounts are established for the beneficiaries.	Remaining life expectancy of someone who was the decedent's age, unless separate accounts for the beneficiaries.
"Look-through" trust / "See-through" trust	Generally ten years, since "look through" to identity of the beneficiaries. If payable to a conduit trust, then the remaining life expectancy of the spouse.	– Same Rule --
Remainder beneficiary	A remainder beneficiary is counted as a beneficiary of an *accumulation trust*, but not of a *conduit trust*	– Same Rule –

g. GLOSSARY

Designated Beneficiary ("DB") - A designated beneficiary is an individual who is entitled to the benefits of the IRA or QRP account upon the death of the employee / participant / IRA owner (hereafter "account owner").[25] Neither a charity nor the decedent's estate will qualify as a DB since neither has a life expectancy.[26] If certain criteria are met, a trust may be the beneficiary of an IRA or QRP and distributions will be based on the beneficiaries of that trust (an "eligible trust").[27]

"Eligible Designated Beneficiary" ("EDB") - An EDB qualifies for an exception to the general ten liquidation rule. An EDB may receive distributions over his or her the remaining life expectancy of an eligible designated beneficiary ("EDB"), based on the EBD's age at the end of the year that follows the account owner's death. An EDB is a beneficiary who is: a surviving spouse, a minor child of the decedent (though upon attaining majority age, the ten year rule applies), disabled, chronically ill, or someone who is not more than ten years younger than the decedent

Determination Date - The date when the beneficiaries must be determined is September 30 of the calendar year that follows the calendar year of the account owner's death.[28] Example: Sarah died in 2022 the determination date for her IRA and QRP accounts will be September 30, 2023. The minimum distributions will be computed based only on the beneficiaries who still have an interest on the determination date. If a beneficiary's interest is eliminated between the time that the account owner died and the determination date – for example by a cash out or a disclaimer -- then that beneficiary will not have any impact on the required minimum distributions. PLR 200740018 (July 12, 2007).

Five Year Rule - If an account is subject to the five year rule, then the entire account must be distributed by the end of the calendar year which contains the fifth anniversary of the date of the employee's death.[29] For example, if an employee died on January 11, 2020, the entire interest must be distributed by December 31, 2025.

Ineligible Trust - If a trust is not an eligible trust, then the IRA is deemed to have no DB.[30]

Life expectancy / remaining life expectancy - The maximum number of years that a deceased account

[25] Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-4, Q&A 1.

[26] Reg. Sec. 1.401(a)(9)-4, Q&A 3.

[27] Reg. Sec. 1.401(a)(9)-4, Q&A 5 and 6.

[28] Reg. Sec. 1.401(a)(9)-4, Q&A 4.

[29] Sec. 401(a)(9)(B)(ii); Reg. Sec. 1.401(a)(9)-3, Q&A 1(a) and 2.

[30] Reg. Sec. 1.401(a)(9)-4, Q&A 5(a).

owner's IRA or QRP account can hold assets before it must finally be depleted is usually based on the life expectancy of either an eligible designated beneficiary (EDB) or of someone who is the same age as the deceased account owner.[31] Whereas the number of years is usually frozen based on a person's life expectancy as of the determination date, a surviving spouse who is the *sole* beneficiary of the account is permitted to extend the date as she or he ages.[32]

Look-Through Trust (a/k/a “See-through Trust”) -- If certain criteria are met, a trust can be named as a beneficiary of either an IRA or a QRP account and each of the individuals who are beneficiaries of the trust will be considered beneficiaries of the IRA or QRP.[33]

Qualified Retirement Plan ("QRP") - Profit sharing plan, 401(k) plan, pension plan, money purchase plan, defined benefit plan, or employee stock ownership plan ("ESOP").[34] For purposes of this paper, the term will also include Sec. 403(b) plans.

Remainder Beneficiary - A beneficiary that is entitled to payments upon the termination of someone else's rights (e.g., upon the termination of an income beneficiary's interest).[35]

Required Beginning Date ("RBD") - The first date that a distribution must be made from an IRA, QRP or 403(b) account to avoid the 50% penalty tax.[36]

IRAs**:** The RBD for an IRA is April 1 following the calendar year that the IRA account owner attains age 72.[37] ***QRP or 403(b)***: The RBD for a qualified retirement plan or a tax-sheltered annuity is the *later* of (a) April 1 following the calendar year that the account owner attains age 72 or (b) April 1 following the calendar year that the employee separates from service (e.g., somebody who works past age 72).[38] Individuals who own 5% or more of a business are not eligible for this later RBD: their RBD is April 1 following the calendar year that they attain age 72.[39]

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[31] After the account owner's death, life expectancies are based on the figures contained in Table A-1 of Reg. Sec. 1.401(a)(9)-9. See Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)-(c) and Q&A 6.

[32] Compare Reg. Sec. 1.401(a)(9)-5, Q&A (c)(1) (a non-spouse beneficiary) with Q&A (c)(2) (spouse is sole beneficiary).

[33] Reg. Sec. 1.401(a)(9)-4, Q&A 5 and 6.

[34] Sec. 401(a); Reg. Sec. 1.401-1(a).

[35] Private Letter Ruling 9820021 concluded that a charity that was a remainder beneficiary of a trust would be considered as one of the beneficiaries of the trust for purposes of computing the minimum required distributions.

[36] Sec. 4974; Reg. Sec. 54.4974-2, Q&A 1 and 2.

[37] Sec. 408(a)(6); Reg. Sec. 1.408-8 Q&A 3.

[38] Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-2, Q&A 2.

[39] Reg. Sec. 1.401(a)(9)-2, Q&A 2(b) and (c).

Rollover - A surviving spouse is the only person who can rollover a distribution from an inherited IRA or QRP account into a new IRA that treats the surviving spouse as the new account owner.[40] No other person can rollover an inherited retirement plan distribution; he or she must report each distribution as taxable income in the year that it is made from the deceased's account.[41]

See-through Trust -- Same as "Look-Through Trust"

Separate Accounts – If an IRA or QRP account is divided into separate accounts, then the minimum distributions after the account owner's death are generally computed separately based on the beneficiary of each of the separate accounts. In other words, the separate accounts are treated like separate IRAs. A separate account is a portion of the deceased's IRA or QRP account that is determined using an acceptable separate accounting and to which a pro rata allocation of investment gains and losses, etc. is made in a reasonable and consistent manner.[42] For an example of separate payout streams when an IRA was payable to a trust that provided 10% for charities and 90% for family, see PLR 200218039 (Feb. 4, 2002)(using the 1987 proposed regulations).

3. Additional benefits to a surviving spouse

a. Rollover to IRA for the surviving spouse

A surviving spouse is the only person who can rollover a distribution from an inherited IRA or QRP account into a new IRA that treats the surviving spouse as the new account owner.[43] No other person can rollover an inherited retirement plan distribution; he or she must report each distribution as taxable income in the year that it is made from the deceased's account.[44]

b. Tax trap for surviving spouse under age 59 ½ : 10 percent penalty

One situation where a complete rollover should be avoided is for s surviving spouse under age 59 1/2. Whereas a distribution from a deceased person's account is exempt from the 10 percent penalty on early distributions, once the assets are rolled over into one's own IRA, every distribution will be subject to the penalty if the surviving spouse is under age 59 ½. A planning strategy is to leave sufficient assets in the deceased spouses' account that the surviving spouse may need to draw upon until age 59 ½ (when he or she can then rollover that amount), but to rollover the excess amount that she or he is confident will not be needed before age 59 1/2. This will permit estate planning for the rolled over assets, and prevent accelerated distributions that could

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[40] Sec. 402(c)(9) for inherited QRP accounts and Sec. 408(d)(3)(C)(ii)(II) for inherited IRAs.

[41] The general prohibition against rolling over an inherited IRA is described in Sec. 408(d)(3)(C).

[42] Reg. Sec. 1.401(a)(9)-8, Q&A 2 and 3.

[43] Sec. 402(c)(9) for inherited QRP accounts and Sec. 408(d)(3)(C)(ii)(II) for inherited IRAs.

[44] The general prohibition against rolling over an inherited IRA is described in Sec. 408(d)(3)(C).

occur for the assets in the deceased spouse's IRA if the surviving spouse dies before rolling over those amounts.45

c. Leave in deceased's account? Three advantages if sole beneficiary

i. Annually recalculate remaining life expectancy.

If the surviving spouse is the sole beneficiary, she or he can annually recalculate the remaining life expectancy when calculating the annual RMD. For example, a 70 year old person has a life expectancy to age 88, but an 80 year old person has a life expectancy to age 91.46

ii. IRA only: elect to treat as own IRA

A surviving spouse may elect to treat the deceased spouse's IRA (but not QRP account) as his or her own account. This has the effect of a rollover. It might justify a failure to have received RMDs from the IRA: "I elected to treat the account as my own"

iii. No RMDs until deceased spouse would have been 72

If the plan participant or IRA owner died before age 72, the surviving spouse is not required to receive an RMD from the deceased spouse's account until the year the deceased spouse would have attained age 72 .47

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45 Sears v. Commissioner, T.C. Memo. 2010-146 (2010). A widow who was under age 59 ½ rolled over roughly $800,000 from her deceased husband's IRAs into her own IRAs, and then withdrew approximately $60,000 from those IRAs that same year. The Tax Court concluded that the 10% early distribution penalty applied. The penalty would not have applied if she had withdrawn the $60,000 directly from her deceased husband's IRAs. A similar outcome occurred in Gee v. Commissioner, 127 T.C. 1, 4-5 (2006).

46 Reg. Secs. 1.401(a)(9)-5, Q&A 4(b) and 1.401(a)(9)-5, Q&A 5(c)(2) (outright to spouse who is sole beneficiary) and 1.401(a)(9)-5, Q&A 7(c)(3), Example 2 (to a conduit trust with spouse as beneficiary). The life expectancies are from Reg. Sec. 1.401(a)(9)-9, Table A.

47 Sec. 401(a)(9)(B)(iv)(I).

D. Retirement assets payable to a trust for a surviving spouse

1. Case study: an 80 year-old surviving spouse

SURVIVING SPOUSE DISTRIBUTION OPTIONS – AT AGE 80

Example: At age 80, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (both of whom had died in the preceding year). Although the life expectancy of a 80 year old is 10 years (i.e., to age 90), Ms. Widow in fact lived to age 92. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 90, amounts could still be in the other IRAs at that age. The minimum amounts required to be distributed from each of six IRAs are listed in the table.

A - ***Her own IRA,*** established with contributions she made during her working career.
B -** ***A rollover IRA, funded after her husband's death with a distribution from his 401(k) plan.
C - ***A stretch IRA -- Her sister's IRA***
D - ***Bypass Trust #1 - Her deceased husband's IRA is payable to a standard bypass trust***, treated as a stretch IRA payable to a ***look-through accumulation trust*** (where the required distributions are based on the age of the oldest beneficiary of the trust. The same distribution rules apply to a QTIP trust.)
E -** ***Bypass Trust #2 - Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow. This provision permits a look-though trust to be treated as a ***conduit trust***

Age	IRAs A & B	IRAs C & D	IRA E
80	4.95%	-0-%	8.93%
81	5.19%	-0-%	9.53%
82	5.44%	-0-%	10.10%
83	5.69%	-0-%	10.87%
84	5.96%	-0-%	11.63%
85	6.25%	-0-%	12.35%
86	6.58%	-0-%	13.33%
87	6.95%	-0-%	14.29%
88	7.36%	-0-%	15.15%
89	7.76%	-0-%	16.40%
90	8.27%	100.00%	17.54%
91	8.78%	*empty*	18.87%
92	9.26%		20.41%
93	9.90%		21.38%
94	10.53%		23.81%

****Payouts "B" and "E" are only available to a surviving spouse.*** Other payouts are available to anyone.

Legal Authority for Various Payout Rules: **IRA A**: Reg. Sec. 1.401(a)(9)-5, Q&A 4 and Reg. Sec. 1.401(a)(9)-9, Table A-2. **IRA B:** Same, and Secs. 402(c)(9) and 408(d)(3)(C)(ii)(II) permit a surviving spouse to do a rollover. **IRA C:** Secs. 401(a)(9)(H)(i) and (vi), and 408(d)(3)(C). **IRA D:** Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 1, as modified by Sec. 401(a)(9)(H)(i) and (vi). **IRA E:** Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 2, reinforced by Secs. 401(a)(9)(H)(E)(ii)(I) and (H)(ii).

Required Payments <u>after Ms. Widow's Death</u>:

IRAs A & B: IRAs A & B will generally be liquidated within ten years after Ms. Widow's death to the beneficiaries that she named. Sec. 409(a)(9)(H)(iii)(2020).

IRA E: Ms. Widow is an *eligible designated beneficiary*, and a conduit trust permits her to recompute her life expectancy and to ignore remainder beneficiaries for RMDs. After Ms. Widow's death, payments from IRA E must generally be completed over ten years. Sec. 409(a)(9)(H)(iii)(2020)**.** (Compare Reg. Sec. 1.401(a)(9)-5, Q&A 5(c)(2) – old law provided that the remaining term was over the life of someone who was her age in the year of her death).

2. IRS PLRs - surviving spouse can rollover retirement assets payable to an estate or trust, provided the surviving spouse is the sole beneficiary

<u>IRS Private Letter Rulings - 2014 - 2020</u>

A surviving spouse can rollover a deceased spouse's retirement account, even when the account is payable to:

A TRUST FOR THE SPOUSE

***** PLR 201944003 (Aug 8, 2019) - payable to revocable joint trust
* PLR 201923002 (March 4, 2019) - payable to trust where spouse is trustee and beneficiary
* PLRs 201934006 & 201935005 - spouse mistakenly listed as contingent beneficiary
* PLR 201844004 (Aug 4, 2018) - payable to spouse's revocable trust
* PLR 201707001 (Nov 8, 2016) - payable to revocable joint trust
* PLR 201632015 (May 10, 2016) - payable to trust - community property state
* PLR 201507040 (Dec 24, 2014)
* PLR 201430029 (Apr 30, 2014) - H's IRA payable to W's revocable trust
* PLR 201430026 (Apr 29, 2014)
* PLR 201423043 (Feb 29, 2014) - Rollover Roth IRAs payable to a marital trust

THE ESTATE, WITH ESTATE POUR-OVER INTO A TRUST FOR THE SPOUSE

* PLR 201736018 (June 9, 2017) - payable to estate; pourover into trust
* PLR 201511036 (Dec 18, 2014) and * PLR 201437029 (June 05, 2014)

THE ESTATE, WHERE THE SPOUSE IS THE SOLE OR RESIDUARY BENEFICIARY OF THE ESTATE

*PLR 201931006 (7 May 2019) - probate estate was default beneficiary when beneficiary form left blank
* PLR 201451066 (Sep 25, 2014)
* PLR 201445031 (Aug 11, 2014) - spouse is residuary beneficiary of estate
* PLR 201430027 (Apr 30, 2014) - spouse is residuary beneficiary of estate
* PLR 201430020 (May 1, 2014)

VI. Second Marriages

One of the potentially contentious issues in a second marriage can involve financial and tax planning for retirement accounts when each spouse has children from a prior marriage. Whereas a QTIP trust (income to surviving spouse for life, remainder to children from a prior marriage) might work well for other assets such as stock and real estate, a QTIP trust poses income tax challenges for retirement accounts. This is because the annual RMD that must be distributed from a deceased spouse's retirement account to a QTIP trust will always be greater than the RMD that would have been required if the surviving spouse had rolled over the assets to her or his own IRA. After age 80, the annual RMDs payable to such a trust are twice what the RMDs would be if the spouse had rolled over the deceased spouse's retirement assets into her or his own IRA. Consequently, there will be trade-offs of income tax savings over other planning objectives.

Some ways that people have dealt with this situation has been to leave all retirement assets to a surviving spouse and to use life insurance as an alternative benefit for the children. Another has been to divide the retirement assets between the spouse and children. Another alternative for people who have charitable intent is to use a two-generation charitable remainder trust. Of course, in all situations the procedural requirements must be met to get the optimal outcome.

A. Prenuptial agreements

If the retirement assets are in a QRP, such as a 401(k) plan, then a prenuptial agreement will not be sufficient to transfer the assets to the children from a first marriage, even if those children are named as beneficiaries of the QRP account. If the plan participant was married at the time of death, a QRP must pay 100% of the account balance to the surviving spouse. In order for the named beneficiaries to be entitled to the assets, the spouse must execute a valid waiver that was signed while they were married, rather than before they were married. See Part IV.B.2, above.

If the retirement assets are in an IRA, then generally the named beneficiaries will be entitled to the IRA assets rather than the surviving spouse. Thus, if children from a prior marriage are named as beneficiaries, they will generally inherit.[1] In a state with community property laws, however, a surviving spouse may have a legal claim to a portion of the assets. This situation is posing an income tax riddle that has yet to be resolved. See Part IV.C.3, above.

Even if the planning was done well, we are hearing stories of bad outcomes because of administrative mistakes. One common situation is where an individual moves the retirement

[1] When a 401(k) account is rolled over into an IRA, a surviving spouse loses the protection that he or she would have had if the assets had remained in the 401(k) plan. Charles Schwab & Co. v Debickero, 593 F.3d 916 (9th Cir. 2010).

assets into a new IRA through either a trustee-to-trustee transfer or through a 60-day rollover. Whereas the beneficiary designation at the original IRA may have named the children from the first marriage as beneficiaries, the individual left the information blank at the new IRA. The IRA administrator will then apply its own default policies, such as paying the assets to a surviving spouse or to the probate estate. Good luck waiving a prenuptial agreement at the IRA administrator when that agreement conflicts with its own policies for a blank beneficiary designation.

B. Rollovers versus QTIP trusts - the income tax challenge

Whereas a QTIP trust (income to surviving spouse for life, remainder to children from a prior marriage) might work well for other assets such as stock and real estate, a QTIP trust poses income tax challenges for retirement accounts. This is because the annual RMD that must be distributed from a deceased spouse's retirement account to a QTIP trust will always be greater than the RMD that would have been required if the surviving spouse had rolled over the assets to her or his own IRA. After age 80, the annual RMDs payable to such a trust are twice what the RMDs would be if the spouse had rolled over the deceased spouse's retirement assets into her or his own IRA. Consequently, there will be trade-offs of income tax savings over other planning objectives.

Another tax consideration are the marginal tax-rates. In most cases, both the spouse and the children will not be in the highest marginal income tax rate of 39.6%. That rate only applies to individuals with taxable income well in excess of $400,000. By comparison, a trust is subject to those tax rates with income in excess of just $12,500. Thus whatever is left to accumulate in the trust for the children will likely be subject to higher income tax rates than if the spouse and the children had been named as beneficiaries rather than the trust.

The table on the next page compares the annual RMDs depending on whether the IRA was rolled over by the surviving spouse, was payable to an accumulation trust, or a conduit trust. In all situations, it is assumed that the trust is a "look-through" or "see-through" trust, so that the distributions may be made over the remaining life expectancy of the oldest trust beneficiary rather than in just five years.[2]

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[2] If a trust is named as a beneficiary of an IRA or some other type of qualified retirement plan account, Reg. Sec. 1.409(a)(9)-4, Q&A 5 and 6 permit beneficiaries of the trust to be treated as beneficiaries of the retirement account for purposes of determining minimum mandatory distributions if the following conditions are met:

(1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
(2) The trust is irrevocable or will become irrevocable upon the death of the employee.
(3) The beneficiaries of the trust are identifiable from the trust instrument, and

(4) Either one of the following documents has been provided to the plan administrator:
(a) a document that contains:
(i) a list of all of the beneficiaries of the trust (including contingent and remaindermen

A *conduit trust* is a trust where the governing trust instrument requires all retirement plan payments to be made directly to the primary intended beneficiary so that no retirement assets accumulate in the trust. One income tax advantage of a conduit trust is that for purposes of determining the annual RMDs, contingent trust beneficiaries (particularly older contingent beneficiaries and charities that have no life expectancy) of conduit trusts are not considered. Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 2. Another income tax advantage is that a surviving spouse of a conduit trust may annually recalculate his or her remaining life expectancy, so that the deceased spouse's retirement account never has to be fully depleted during the surviving spouse's lifetime.

An *accumulation trust* is a trust that does not contain such provisions, so that it is possible that some of the retirement assets could be retained in the trust. The two advantages of conduit trusts do not apply to an accumulation trust. Furthermore, an income tax consideration is that all of the retirement plan distributions retained by the trust will likely be subject to a 39/6% marginal income tax rate (though they will be exempt from the 3.8% net investment surtax, as described above in Part III.B.2).

Great resources that explain the difference between conduit and accumulation trusts and that include drafting language include:

Natalie Choate, *Life and Death Planning for Retirement Benefits,* www.ataxplan.com

Keith Herman, *How to Draft Trusts to Own Retirement Benefits*,
ACTEC Law Journal, Vol 39, No. 3 (Winter 2013), pages 207-267.

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beneficiaries with a description of the conditions on their entitlement sufficient to establish whether or not the spouse is the sole beneficiary) entitled to receive retirement assets;
(ii) a certification that the list is correct and complete and that the preceding 3 requirements have been met to the best of the retirement account owner's knowledge),
(iii) a statement that if the trust instrument is amended at any time in the future, the retirement account owner will provide corrected certifications to the plan administrator, and
(iv) a statement that the retirement account owner agrees to provide a copy of the trust instrument to the plan administrator upon demand.

(b) A copy of the entire trust instrument, together with a statement that the account owner will provide copies of future amendments.

B. Some planning options

1. Retirement accounts for spouse; life insurance for children?

One arrangement is to leave all retirement assets to the surviving spouse, but to purchase life insurance so that there is something from the children from a prior marriage to inherit.

2. Divide retirement accounts - spouse & children

Another strategy is to split the retirement assets between the spouse and the children from a prior marriage. Although this can be done fairly easily with IRAs, ERISA will prevent such a splitting of 401(k) accounts unless the spouse executes a qualified consent.

3. All retirement accounts for children?

a. Section 401 - need spouse's waiver

It will not matter who a married plan participant named as the beneficiary of a QRP account. If the individual was married on the date of death, the surviving souse is entitled to the entire account balance. The one exception is if the surviving spouse executes a qualified waiver. In that case the retirement assets will be distributed to the individuals, trusts or estate that were named as the beneficiaries of the QRP account. See above in Part IV.B.2.

b. Community property laws - IRS PLR – *Boggs*

Although the U.S. Supreme Court concluded in *Boggs v. Boggs* that a state's community property law has no impact on a plan participant's account in a QRP, community property laws can govern retirement assets in IRAs. However, the IRS concluded that byzantine income tax consequences can occur when a state's community property law is applied to an IRA. See above in Part IV.C.3.

4. Two-generation CRT for spouse and children from prior marriage

a. Concept

A significant challenge exists when there is a sequence of beneficiaries of a retirement plan account (e.g., "to A for life, then to B for life"). The stretch IRA regulations require distributions to be made from an IRA or a QRP account over a time period that does not extend beyond the life expectancy of the *oldest* beneficiary. The IRA will likely be depleted when the oldest beneficiary dies.

Whereas an IRA cannot make distributions over the lifetimes of the younger beneficiaries, a charitable remainder trust ("CRT") can. A charitable remainder trust pays distributions to individuals over their lifetimes (or for a term of years), and then terminates with a distribution to one or more charities.[3] Like an IRA, a CRT pays no income tax.[4] Thus there will be no income tax liability when an IRA is completely liquidated after a person's death with a single distribution to a CRT.[5] Unlike an IRA, the term of a CRT can last until the last of the multiple beneficiaries dies, which will usually be the *youngest* beneficiary. As is further explained below, a CRT that will last for 30 or 40 years should be a charitable remainder unitrust ("CRUT")[6] rather than a charitable remainder annuity trust ("CRAT")[7].

> **EXAMPLE:** Mr. Husband has a terminal illness. He would like his IRA to provide income to his second wife (age 80) for the rest of her life and then provide income to his children from his first marriage (currently ages 52 and 55) for the rest of their lives.
>
> If his IRA is payable to a QTIP trust that benefits both his spouse and children. If the trust is an accumulation trust (rather than a conduit trust), the IRA must be completely distributed by the year his wife attains age 90 (the life expectancy of an 80 year old is 10 years).[8] The result? The IRA will likely be empty when the surviving spouse dies, leaving nothing in the IRA for the children. What's worse, the IRA must be empty when the surviving spouse attains age 90, even if the spouse in fact lives to be 100!
>
> By comparison, if the IRA is distributed to a CRUT upon his death, the CRUT will provide income to his wife for the rest of her life (which could be beyond age 90) and then provide income to his children for the rest of their lives. In other words, the CRUT can extend payouts from the *life expectancy* of an 80 year old to the *actual years* lived by a 52 year old or a 55 year old. The CRUT also provides estate tax advantages: none of the assets in the CRUT will be included on the estate tax return of the surviving spouse. Furthermore, Mr. Husband has the personal satisfaction of benefitting his favorite charity.

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[3] Sec. 664.

[4] Sec. 664(c)(1). No matter how much income a CRT may earn in a year, no tax is paid until a distribution is made to a taxpaying beneficiary.

[5] PLR 199901023 (Oct. 8, 1998).

[6] Sec. 664(d)(2); Treas. Reg. § 1.664-3.

[7] Sec. 664(d)(1); Reg. § 1.664-2.

[8] Reg. Sec. 1.401(a)(9)-5, Q&A 7(a) and 7(c)(3), Ex. (1).

SURVIVING SPOUSE DISTRIBUTION OPTIONS – AT AGE 80

Example: At age 80, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (both of whom had died in the preceding year). Although the life expectancy of a 80 year old is 10 years (i.e., to age 90), Ms. Widow in fact lived to age 92. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 90, amounts could still be in the other IRAs at that age. The minimum amounts required to be distributed from each of six IRAs are listed in the table.

A - ***Her own IRA,*** established with contributions she made during her working career.
B -** ***A rollover IRA, funded after her husband's death with a distribution from his 401(k) plan.
C - ***A stretch IRA -- Her sister's IRA***
D - ***Bypass Trust #1 - Her deceased husband's IRA is payable to a standard bypass trust***, treated as a stretch IRA payable to a ***look-through accumulation trust*** (where the required distributions are based on the age of the oldest beneficiary of the trust. The same distribution rules apply to a QTIP trust.)
E -** ***Bypass Trust #2 - Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow. This provision permits a look-though trust to be treated as a ***conduit trust***
CRT - ***Charitable Remainder Unitrust*** - After his death, one of her husband's IRAs was distributed in a lump sum to a tax-exempt CRUT. The CRUT annually distributed 5% of its assets to Ms. Widow for her entire life, then made 5% payments to her husband's 50-year old child from his first marriage for the rest of the child's life, and then upon the child's death the CRUT will terminated and the assets were distributed to a charity.

AGE	IRAs A & B	IRAs C & D	IRA E	IRA CRT
80	4.95%	-0- %	8.93%	5.00%
81	5.19%	-0- %	9.53%	5.00%
82	5.44%	-0- %	10.10%	5.00%
83	5.69%	-0- %	10.87%	5.00%
84	5.96%	-0- %	11.63%	5.00%
85	6.25%	-0- %	12.35%	5.00%
86	6.58%	-0- %	13.33%	5.00%
87	6.95%	-0- %	14.29%	5.00%
88	7.36%	-0- %	15.15%	5.00%
89	7.76%	-0- %	16.40%	5.00%
90	8.27%	100.00%	17.54%	5.00%
91	8.78%	empty	18.87%	5.00%
92	9.26%		20.41%	5.00%
93	9.90%		21.38%	5.00%
94	10.53%		23.81%	5.00%

****Payouts "B" and "E" are only available to a surviving spouse.*** Other payouts are available to anyone.

b. Eligibility - some issues

i. Minimum 10% charitable deduction

The value of the charity's remainder interest of a CRT must be at least 10 percent of the initial net fair market value of all property placed in the trust, computed using the Section 7520 discount rates in effect at the time of contribution.[9] If a contribution is made to a trust that fails the 10 percent requirement, the trust will not qualify as a tax-exempt CRT.

ii. More likely CRUT than CRAT

There are two reasons that a CRUT is superior to a CRAT for a two-generation CRT. First, the value of the annual fixed amount distribution of a CRAT will decline with value in time because of inflation. A CRUT that earns over 5% per year can gradually increase in value, and consequently increase distributions.

More importantly, a CRAT is much less likely to satisfy the 10% deduction test than a CRUT. By way of background, there are two ways that the present value of a charity's remainder interest in a CRT can be less than 10 percent of the value of the property that was contributed to the trust. The first is if the stated payout rate is too high (e.g., "for the next 20 years, distribute to my child 30 percent of the trust's assets each year"). The solution is to lower the CRT's payout rate, but it cannot be lowered below 5 percent.

The second way is if the projected term of the trust is too long.[10] This makes it impossible in the low interest rate environment of 2019 to establish a CRUT that would last for the life of any individual under age 27. The problem is much more challenging for a CRAT. Until the IRS provided relief in 2016,[11] the 10% deduction requirement (combined with a 5%

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9 Secs. 664(d)(1)(D) (CRAT) and 664(d)(2)(D) (CRUT)

10 For example, if you invest $5 today and earn 3 percent interest every year for the next 100 years, then the $5 will grow to $100 in 100 years. Thus, the present value today of receiving $100 in 100 years is just 5 percent, which is less than 10 percent. The 10 percent requirement limits the projected term of a CRUT to a maximum of roughly 50 years.

11 With a CRAT, there can be a greater impact caused by the large spread between the fixed distribution amount (a minimum annual distribution of at least 5 percent of the value of the contributed property) and the assumed investment return of the assets in the trust (in the year 2015, the Sec. 7520 rate was never higher than 2.4 percent). The IRS offered relief for CRATs in Rev. Proc. 2016-42, 2016-34 I.R.B. 269. A CRAT will be able to qualify for a younger beneficiary, even if would otherwise fail the 5% probability of exhaustion test, as long as its governing instrument provides for an early termination (and transfer to charity) of the trust's assets if the assets ever fall to less than 10% of the original value contributed to the trust.

probability of exhaustion requirement) prevented a CRAT to be established for the life of anyone under age 70.

iii. Minimum annual 5% distribution

The minimum annual distributions from a CRT to its beneficiaries is 5 percent of the value of the assets.[12] A CRT cannot have a stated percentage of 3 percent or 4 percent, even though several states have adopted a 4 percent default rule under their state statutes for unitrusts and net-income trusts.

The minimum 5 percent distribution requirement has been an administrative challenge in the low interest rate environment of the past dozen years. Trustees often sell some assets in order to make the required distributions, which usually isn't a tax problem since the trust is tax-exempt. The only way to distribute less than 5 percent is if the trust instrument contains a net-income limitation (that is, the CRT is a NICRUT, a NIMCRUT or a FLIPCRUT).

iv. No marital estate tax deduction - avoid for a taxable estate

If the only beneficiaries of a CRT are a surviving spouse and a charity, an estate can claim a charitable estate tax deduction for the charitable remainder interest and a marital estate tax deduction for the martial interest.[13] However, once another beneficiary is added to the CRT, the marital estate tax deduction is lost.

Consequently, the two-generation CRT is best suited for estates that will not be subject to the federal estate tax.

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[12] Sec. 664(d)(1)(A) (CRAT) and Sec. 664(d)(2)(A) (CRUT).

[13] Sec. 2056(b)(8).