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IRAs and Qualified Plan Accounts: Should You Pass Them to Beneficiaries Outright or in Trust?

By Richard M. Morgan & Loraine M. DiSalvo

I. Introduction and Summary.

Most people today have a significant amount of their retirement savings in Individual Retirement Accounts ("IRAs") or one of many other types of tax deferred accounts generically known as "qualified plan" accounts ("QPs"), such as 401(k) accounts. Except for Roth IRAs or Roth 401(k) accounts which are funded with after-tax income, these accounts hold "tax deferred" assets. Tax deferred accounts are usually funded with compensation that was not subject to income tax when earned, income generated by the assets inside the accounts is also not subject to income tax, and the assets will not be subject to income tax until they are taken out of the accounts. This tax deferral generally allows the assets to grow faster than they would if held in a taxable account, which makes it desirable to keep assets in tax deferred accounts as long as possible. However, because the government wants to collect its income taxes eventually, there are rules which determine when and how assets must be taken out of these accounts. Various rules apply to tax deferred accounts: rules which determine when assets can be taken out of the accounts without a penalty, rules which determine the maximum amount which can be contributed to tax deferred accounts in any given year, and rules which determine when and how quickly assets have to be withdrawn from the accounts. We will reserve the discussion of the first two types of rules for a later time, and focus here on the rules that determine when you **must** take assets out of tax deferred accounts. Please note: these rules do not limit the amount which can be withdrawn in any given year, but rather only provide for the minimum amount that must be withdrawn.

The rules governing when and how quickly assets must be withdrawn from tax deferred accounts are generally referred to as the "minimum distribution" rules. The distributions required by these rules are often referred to as "minimum required distributions" or sometimes as "required minimum distributions." If you fail to take at least the minimum required distribution in any given year, you will be subject to a penalty equal to **50%** of the amount that was not timely withdrawn. Although there are some exceptions, tax deferred accounts generally become subject to minimum distribution requirements in one of two situations: either (1) the original account owner reaches age 70 1/2 years old or (2) the original account owner dies. One set of minimum required distribution rules applies to determine the minimum required distributions for the original account owner, and a somewhat different set applies to determine the minimum required distributions which must be taken after the original account owner's death.

In general, during the original account owner's life, the minimum required distribution rules are designed to help ensure that the assets in the tax deferred account will not be fully withdrawn during the owner's lifetime. This is because the minimum required distributions are based on the theoretical joint life expectancy of both the actual account owner and a hypothetical beneficiary who is ten years younger than

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the owner. However, the set of rules which applies once the original account owner dies are designed to force assets out of the tax deferred account more quickly. How much more quickly depends on several variables. If an individual is the "designated beneficiary" of the account (as defined by the IRS), that person usually gets to use his or her own life expectancy as the period which is used to determine the minimum required distributions from the account. If the account is deemed by the IRS to have no designated beneficiary, which is usually the result if an estate or charity receives assets from the account, then the assets may have to be withdrawn from the account within five years after the owner's death (if the owner was not yet 70 1/2 years old) or over the original owner's theoretical remaining life expectancy based on his or her age at the date of his or her death.

Deciding how to pass your IRA and QP assets after your death is a critical part of developing your estate plan. Your decisions can have a significant impact on your beneficiaries. A key decision is whether to have these assets pass to the intended beneficiaries outright or in trust. Outright distributions tend to be simpler and easier to implement both before and after your death. However, while having IRA and QP assets pass in trust may take more work to set up, it can provide a superior level of asset protection (for your beneficiaries) and control (for you). Recent court cases have held that inherited IRAs may not receive the same level of creditor protection as IRAs and QPs held by the original account owner normally receive in bankruptcy. A spendthrift trust can help provide an additional layer of protection for these assets, at least while they are still in the accounts. In addition, having a Trustee stand between a young or imprudent beneficiary can help ensure that the assets are not hastily and unwisely spent, while having a trust direct the distribution of assets which remain in the account at the beneficiary's death can help ensure that those assets end up with your desired beneficiaries, and not others.

If you decide to have IRA and QP assets pass to your loved ones in trust, you have another question to answer: whether to use a special trust structure to maximize the available income tax deferral, or whether to forego the possibility for maximum income tax deferral altogether. If a trust is named as the beneficiary of an IRA or QP, then the trust has to meet certain other IRS rules in order to avoid an IRS determination that the account has no designated beneficiary. If the trust meets these rules, then the beneficiary of the trust with the shortest life expectancy will be deemed by the IRS to be the designated beneficiary of the account. The designated beneficiary's life expectancy will then be the one used to determine minimum required distributions from the trust. The goal of structuring trusts is generally to have the intended primary beneficiary, such as the account owner's child, deemed by the IRS to be the designated beneficiary, rather than some contingent beneficiary such as a charity or a more remote potential heir of the account owner, so that the intended primary beneficiary's life expectancy can be the life expectancy used to calculate minimum required distributions instead of a shorter period.

Meeting the IRS rules which allow a trust's intended primary beneficiary to be deemed the designated beneficiary of an IRA or QP account requires the use of one of two types of special trust structures. One type of trust which can qualify is often referred to as a "conduit trust." Conduit trusts do not allow any amounts withdrawn from an IRA or QP to be held in the trust once they leave the tax deferred account. Instead,

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withdrawn amounts have to be immediately distributed out of the trust to the trust's primary beneficiary. In considering the beneficiaries of a conduit trust, the IRS will generally ignore beneficiaries other than the trust's primary beneficiary. This allows the trust's primary beneficiary to be considered to be the beneficiary with the shortest life expectancy. Conduit trusts allow a potentially broad range of secondary trust beneficiaries, including charities.

The other type of trust which can qualify under the IRS rules is often referred to as an "accumulation" trust, because amounts withdrawn from IRAs or QPs can be held in the trust and do not have to be distributed immediately. Accumulation trusts allow the Trustee to have more control over the withdrawn assets than conduit trusts do, and can help maximize the protective benefits of trusts. However, in order for an accumulation trust to ensure that the intended primary beneficiary's life expectancy can be used as the measuring life for minimum required distributions, rather than the life expectancy of some other potential beneficiary, the trust can never allow a beneficiary who has a life expectancy shorter than the life of the intended primary beneficiary to have any interest in the IRA or QP assets. This means, for example, that a child's power to change the way assets in the child's trust pass at the child's death would have to be limited so that the child could never benefit a spouse or sibling who was older than the child. It can also affect the client's ability to select contingent beneficiaries. For example, the client could not name a charity to receive assets if no descendant of the client is living at a given time. This limit on potential beneficiaries can create serious distortions in a client's desired estate planning.

Conduit trust planning is a common choice where the trust is primarily intended to protect the beneficiary from others, rather than from himself or herself. However, a conduit trust should not be used where you do not want the primary trust beneficiary to receive mandatory distributions, such as in a supplemental needs trust, or where the beneficiary has drug or alcohol problems, is a spendthrift, or may have significant creditor problems. In cases where the ability to hold and accumulate the IRA or QP assets along with other trust assets is desirable or critical, the client faces a choice between using an accumulation trust or simply not trying to have the trust qualify for long term income tax deferral under the designated beneficiary rules. Many clients will decide to forgo the potential tax deferral and instead maximize the flexibility of the trust.

The rest of this article discusses in more detail the many issues relating to estate planning with IRAs and QPs, and the decision of whether to have these assets pass to beneficiaries outright or in trust.

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II. Detailed Discussion - The Minimum Required Distribution Rules After An Account Owner's Death.

As discussed above, one key factor in determining which minimum distribution rules apply to an IRA or QP account after the original owner's death[1] is whether the IRS considers the account to have a "designated beneficiary." If the IRS determines that the account does not have any designated beneficiary, then the assets will either (A) have to be withdrawn from the account within five years after the original account owner's death, if the original account owner was younger than 70 1/2 at his or her death, or (B) have to be withdrawn over a period based on the original account owner's hypothetical remaining life expectancy at the date of his or her death, if the owner was 70 1/2 or older at death. While it seems odd to think of the life expectancy of a deceased person, you would look at the account owner's age at death, and the IRS table for a single person's life expectancy at that age will give you the appropriate number. The IRS generally considers an account which will be paid to the original account owner's estate to have no designated beneficiary. Similarly, an account which will be paid to a charity is also considered to have no designated beneficiary.

If the account has a designated beneficiary, then the IRS will generally allow the designated beneficiary's life expectancy to be used as the period on which minimum required distributions are based. The minimum required distributions for that account will be based on the beneficiary's life expectancy as of the "beneficiary determination date" for the account.[2] The individual's life expectancy is based on his or her age on the beneficiary determination date and a specific IRS table. Being able to use an individual's life expectancy as the period for calculating minimum required distributions allows for the assets to be withdrawn more slowly than other minimum required distribution rules would normally allow. An inherited IRA for which an individual beneficiary's life expectancy is being used to determine minimum required distributions is often referred to as a "stretch IRA."

If a trust is named as the beneficiary of an IRA or QP account, however, the trust must also meet certain rules for the IRS to consider the account to have a designated beneficiary. If the trust does not meet these rules, the account is deemed to have no designated beneficiary. For the trust to meet the rules, the trust beneficiaries must be "identifiable" as of the beneficiary designation date for the account. "Identifiable" means that the IRS must be able to determine the trust beneficiary who has the shortest life expectancy as of the beneficiary determination date, and that it must not be possible for a new beneficiary with a shorter life expectancy or with no life expectancy (such as a charity) to be added to the trust after the beneficiary

[1] The "original owner" of an IRA or QP, for purposes of this article, means either the person who originally opened and contributed to the account or the surviving spouse of that person, if the surviving spouse was designated as the beneficiary and then rolled the account over into an IRA established in the spouse's own name. A surviving spouse who rolls an IRA or QP into an account in the spouse's own name is effectively the original owner of the roll over account. Beneficiaries other than the surviving spouse of the original account owner are not able to roll over inherited IRA or QP accounts, although they can set up special "inherited IRAs" using those assets. However, the beneficiary of an inherited IRA is not treated the same as the original owner of an IRA account for income tax purposes.

[2] The "beneficiary determination date" is September 30 of the calendar year following the year in which the account owner's death occurred.

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determination date, at least with respect to the IRA or QP assets. The trust beneficiary with the shortest life expectancy is then the one whose life expectancy is used to determine the minimum required distributions for the trust.

If the trust does not allow the IRA or QP assets to be held and accumulated in the trust after the Trustee withdraws them from the account, and requires that all amounts withdrawn from an IRA or QP be immediately distributed outright to a particular beneficiary (usually the intended primary beneficiary of the trust), then the IRS will view that trust as having an identifiable beneficiary, and will consider the primary beneficiary to be the beneficiary with the shortest life expectancy without even considering the identity of the other potential beneficiaries of the trust. This is why the “conduit trust” structure was developed.

If the trust allows the Trustee to withdraw assets from an IRA or QP account and then continue to hold those assets in the trust, as an “accumulation trust,” then the IRS’s position is that other potential trust beneficiaries need to be considered along with the intended primary beneficiary in determining the beneficiary with the shortest possible life expectancy. This means that, if an IRA or QP account is made payable to an accumulation trust which benefits your child for your child’s lifetime, with a provision for the assets to pass to others at your child’s death, all possible beneficiaries must be considered. If the trust provides for assets to pass to a charity in the event that your child dies and there are no living descendants of yours left to take the trust property, the IRS will consider the account to have no designated beneficiary. If the trust instead provides for assets to pass to your heirs in that event, the IRS could look at the people who could potentially be your heirs at the beneficiary determination date. If any of those people have a life expectancy shorter than your child’s life expectancy at that time (which is possible, considering that your parents, siblings, grandparents, aunts, and uncles could all be potential heirs), the oldest then living person will be the beneficiary whose life expectancy is used for determining minimum required distributions for that trust. For this reason, accumulation trusts often contain provisions which limit the potential beneficiaries of IRA or QP assets so that no person who is older than the intended primary beneficiary can ever receive an interest in those assets. These provisions may help ensure the desired life expectancy is used for minimum required distribution purposes, but they can also cause severe distortions in the desired asset distribution plan.

In deciding whether to have IRA and QP assets pass to beneficiaries outright or in trust, you should always consider both the income tax effects and the non-tax benefits of each option. Having a trust serve as the beneficiary of IRA and QP accounts can help provide creditor and predator protection for the intended beneficiaries. For example, many state laws do not provide the same level of protection for an inherited IRA that is usually provided for an IRA or QP still held by its original owner. In addition, some recent court cases have indicated that inherited IRAs likely do not receive any significant federal protection in bankruptcy cases. Finally, if an individual is named directly as the beneficiary of an IRA or QP, that individual controls what is taken out of the account, and when. If the individual is very young, or has shown a tendency towards imprudent or even self-destructive behavior, having a third party Trustee stand between the individual and any inherited IRA or QP accounts can be very wise.

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Currently, we are aware of three (3) methods which allow a trust to meet the IRS rules and cause the intended primary beneficiary of the trust to be considered the designated beneficiary of an IRA or QP so that beneficiary's life expectancy can be used in determining minimum required distributions from the account:

A. The Conduit Trust Method.

The "conduit trust" method currently appears to be the safest method of ensuring that the beneficiaries of a trust are considered to be "identifiable" at the beneficiary designation date. The "conduit trust" name comes from the way in which the trust is structured: all distributions or withdrawals received by the trustee from an IRA or QP must immediately be distributed outright to the intended primary beneficiary of the trust. No amount withdrawn from any IRA or QP can be held by the Trustee for an extended period and accumulated in the trust. The beneficiary to whom distributions must be made is then the only beneficiary who the IRS will consider in determining which beneficiary of that trust has the shortest life expectancy.[3]

B. The Accumulation Trust Method.

If the trust is allowed to retain any amount withdrawn from an IRA or QP, the IRS will look at all of the potential beneficiaries of the trust, not just the primary intended beneficiary, to determine the beneficiary with the shortest life expectancy.[4] In order to prevent unintended results,[5] an accumulation trust usually

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[3] It gets more complicated if the trust has multiple beneficiaries who are intended to receive shares of the IRA or QP assets, such as a trust which is intended to be divided into shares for each of several children of the original account owner. The IRS normally considers all of the multiple beneficiaries of the trust, even if the trust is intended to create separate shares for each of those beneficiaries, and the IRS will then use the oldest beneficiary's life expectancy as the period for determining minimum required distributions for each separate trust. In order for each individual beneficiary of a separate share of that trust to be able to use his or her own life expectancy, rather than having all minimum required distributions controlled by the oldest beneficiary's life expectancy, the beneficiary designation itself must actually provide that the separate trust created for each beneficiary is the designated beneficiary of a particular portion of the trust. However, it can be difficult to get IRA custodians or QP administrators to allow a beneficiary designation which will adequately accomplish this, and often requires extra effort on the part of a client and his or her advisors.

[4] This is part of the "separate share" rule. The separate share rule essentially describes the way in which the IRS determines whether an account has a designated beneficiary, and, where there are multiple beneficiaries named, which beneficiary's life expectancy should be used to determine the minimum required distribution. The separate share rule tends to provide that, if there are multiple individual beneficiaries named directly (without trusts) as beneficiaries of a single account, the oldest beneficiary's life expectancy is used unless the account has been divided into separate shares, one for each individual beneficiary, before the beneficiary determination date. If a trust is the beneficiary, the separate share rule is applied somewhat differently, and the beneficiary designation itself must create the separate shares in order for each separate trust beneficiary to have any chance of using his or her own life expectancy, rather than the oldest trust beneficiary's life expectancy, for calculating minimum required distributions on his or her trust's share of an IRA or QP.

[5] One example of an unintended result came in an IRS private letter ruling, under which the trust provided that two young children were the primary beneficiaries of the trust. However, the trust also provided that, if the children both died before the trust assets had been fully distributed, an elderly uncle was to receive the assets. The IRS ruled that the uncle was the beneficiary with the shortest life expectancy at the beneficiary determination date, and that his life expectancy must be used to determine the minimum required distributions from the trust.

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must contain provisions which will prevent any person who has a shorter life expectancy than the intended primary beneficiary from ever benefitting in any way from any assets the trust receives from an IRA or QP. This means that many people who might otherwise be desirable contingent beneficiaries cannot be used for this purpose. It also prevents the use of charities as contingent beneficiaries. We normally do not like to use this method since it is a great example of the tax tail wagging the dog, and it tends to interfere significantly with our clients' estate planning desires. The accumulation trust method also requires the Trustee to segregate assets received from IRAs and QPs and income generated by those assets from all other trust assets, which creates significant ongoing hassles for the Trustee and can increase trust administration costs.

C. The Ostrich Method - Stick Your Head In the Sand and Ignore the Possibility That Contingent Beneficiaries Will Ever Be Necessary.

This method would mean that the trust should deliberately fail to name any future possible trust beneficiary who could have a shorter life expectancy than the intended primary beneficiary, even though that may mean leaving an open issue with regard to what happens if the intended primary beneficiaries are all deceased at some point. The IRS has for many years shown a tendency to ignore the possibility that a trust might someday have to be distributed to people who may not be specifically named or described as beneficiaries. A recent example of this is found in Private Letter Ruling 201320021, where the IRS looked at a Will which provided for a trust to be created for the account owner's child. The trust, which apparently did not qualify as a conduit trust, provided that only the decedent's children and their issue would receive benefits, and did not make any provision at all for the possibility that there would be no living child or descendant of a child at some point before the trust was completely distributed. That trust was designated as the beneficiary of the account owner's IRA. Based on the fact that the decedent had only one living child, and that the trust made no specific provision for other relatives to potentially benefit under the trust, the IRS stated that the decedent's only child was the only beneficiary of the trust, that the trust's beneficiaries were identifiable, and that the designated beneficiary of the IRA was the account owner's child. "[T] he Will does not provide for additional contingent beneficiaries for Trust A. Child B is the only child of Decedent P and therefore Child B is the only beneficiary of Trust A's interest in IRA X."

This IRS position, while consistently applied and probably intended to be taxpayer-friendly, makes absolutely no sense at all. We would not recommend under any circumstances that a client rely on this as a way to ensure that a trust will qualify as a beneficiary of an IRA or QP, because some day the IRS may wake up and realize the error of its ways, and change its approach. Here is why it makes no sense: If a trust fails to provide for the possibility that its primary intended beneficiaries may all be deceased at some point before the trust has been fully distributed, and those beneficiaries actually do all die while the trust still holds any assets, then state law will normally cause the trust assets to be distributed as if the trust's creator died at that moment in time, without a Will. In other words, there are always potential contingent beneficiaries of a trust, whether the trust creator spells them out or whether state law will apply. It makes no sense for the IRS to pretend otherwise. However, this position could provide a saving grace for a case like that in the private letter ruling, where an apparently poorly drafted trust has been named as the beneficiary of an IRA. Please

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note, however: if the decedent in the private letter ruling had specifically stated that her mother or her brother, who both survived her, would receive assets if her child died without descendants, as would be commonly done in a trust, the IRS would likely have held in this case that the mother was the designated beneficiary of the IRA. And if the trust had named a charity as a contingent beneficiary, the IRS would likely have held that the IRA did not have a designated beneficiary at all. Since the decedent was not yet 70 1/2 years old at her death, all of the IRA assets would therefore had to come out of the account within five years.

III. How Do You Decide Whether to Name Individuals or a Trust as the Beneficiary of an IRA or QP?

A. For Married Couples - At the First Spouse's Death.

1. **In Many Cases, the Spouse Should Be the Direct Beneficiary.** For married couples who intend for the surviving spouse to receive most or all of the benefit of the couple's combined assets after the first spouse's death, these couples should name each other directly as the primary beneficiaries on their IRAs and QPs, instead of a trust. This is true even if other assets will be passing to a trust for the surviving spouse's benefit. One reason for this is that naming the spouse directly gives the spouse the broadest possible array of options to maximize the income tax benefits associated with the account. For example, the spouse can maximize the income tax deferral and gain some potentially improved creditor protection by rolling the account over to his or her own IRA account, which causes the spouse to be treated as if he or she was the original account owner. If the spouse is under 59 1/2 years old and may want access to some or all of the IRA or QP assets before reaching that age, the spouse can keep some portion or all of the assets in the decedent's account, where the spouse can withdraw them without penalty before turning 59 1/2. The spouse can still do a roll over into his or her own IRA at a later date. Another reason for this is that many QPs are subject to ERISA, a federal law which applies to many types of employee benefits, and which requires the spouse to consent before anyone else (including a trust for the spouse's benefit) can be designated as the beneficiary on a married person's QP accounts.

2. **Where Control Over the IRA or QP Assets at the Surviving Spouse's Death is Important.** There are some situations where an IRA or QP owner wants his or her spouse to be able to benefit from the account, but wants to ensure that any assets which may remain in that account at the spouse's death pass to the account owner's preferred beneficiaries, rather than to beneficiaries the spouse might choose (since the spouse can name his or her own beneficiaries on any roll over or inherited IRA). There are also some situations in which the account owner wants the spouse to be able to benefit from an IRA or QP account, but also wants to provide an enhanced level of protection from the spouse's potential creditors.[6] The account owner may also want to protect the spouse from potential predators or from the spouse's own imprudent behavior by having a third party Trustee control the spouse's access to the IRA or QP assets. In these cases, it can be very beneficial to have a trust for the spouse's benefit named as the primary beneficiary of any IRA or QP, rather than naming the spouse

[6] While a QP has the highest level of asset protection under the federal ERISA rules, IRA accounts have more limited protection under federal bankruptcy rules. In addition, state law protections for IRA accounts outside of the bankruptcy context vary in strength. Georgia is one of the states which provides significant protection for IRAs held by their original owner or by a surviving spouse who has rolled the assets into his or her own IRA.

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directly. A significant downside of using a trust as the beneficiary in these cases is that the available income tax deferral may be much more limited than it could be if the spouse is named directly and rolls over some or all of the assets into the spouse's own IRA. Another downside is that, depending on the trust structure used to comply with the minimum distribution rules and whether the trust is intended to qualify for the marital deduction, the potential benefits provided to other desired beneficiaries of the trust may be limited.

3. **A Word of Caution for Those Who Do Not Want Their Spouse to Benefit From IRA or QP Assets.** In some cases, the account owner does not want to name his or her spouse as the beneficiary of one or more of his or her IRA or QP accounts. For example, the intent could be to have these assets pass to charity at the account owner's death, or to have those assets pass to very young beneficiaries to maximize the available income tax deferral beyond what even the spouse could receive. These people should review the discussion below, which addresses those who are single as well as the contingent beneficiary designation choices for married couples. But beware: as mentioned above, many QPs require the spouse to consent, in writing, to the designation of any beneficiary other than the spouse. Some IRAs may also be subject to this requirement, if the IRA assets came from the rollover of a QP account and the QP assets have not been commingled with either newly-contributed assets or existing assets which did not come from a QP roll over. You must be sure to find out what consents are needed, and that they can be obtained, in order to successfully name a beneficiary other than your spouse if these rules apply to your accounts.

B. **Beneficiary Selection Where There Won't Be a Surviving Spouse: Primary Beneficiary Designations for Single People and the Contingent Beneficiary Designation for Married Couples.** For situations where a surviving spouse will not be part of the picture, either because the account owner is not legally married or because we are planning for what will happen to the account at the death of the survivor of a married couple, selecting either a primary or contingent beneficiary for IRA and QP accounts is still important, but may be more complicated. Those whose intended beneficiaries are responsible, mature, and not in a high-risk profession or otherwise at heightened risk of creditor problems may want to use the simplest option and name those beneficiaries directly. This option also helps ensure that the beneficiaries will be able to receive the maximum available income tax deferral. This option is also preferable when you want to use IRA and QP assets to benefit charities, rather than individuals. However, in many cases where the estate plan includes trust planning to provide creditor and predator protection for individual beneficiaries, it makes sense to extend that protection to IRA and QP assets. Where the individual beneficiaries will not include a surviving spouse, the choice between using outright designations or a trust is somewhat less stark, since non-spouse beneficiaries do not get nearly as wide a possible array of options or as much potential income tax benefit from being named directly. For example, non-spouse beneficiaries do not have the option to roll an account over into their own account, and must begin taking minimum required distributions fairly soon after the original account owner's death in all cases. Therefore, the choice is generally made on the basis of whether simplicity or protection is most desired.

C. **Choosing the Trust Structure.** Those who prefer providing additional protection for their beneficiaries and choose to use a trust to receive IRA and QP benefits next need to determine how that trust will be structured. In many cases where beneficiaries are expected to be mature, responsible, and not highly likely to face creditor or predator problems, a conduit trust structure is often the best choice. The conduit trust

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requires that any assets withdrawn from an IRA or QP by the Trustee have to be immediately distributed out of the trust to the beneficiary. This structure weakens the protection and control benefits which having a trust serve as beneficiary can provide, since only the assets still held in the IRA or QP account will be subject to the trust. However, it is the clearest and least awkward way to ensure that the trust beneficiary will be able to maximize the available income tax deferral.

If maximizing protection or control is critical, which may be the case in many different situations (for example, beneficiaries with drug or alcohol problems, beneficiaries in very high-risk professions, or beneficiaries who may need to qualify for needs-tested government benefits); however, a conduit trust may not be the optimal structure. The forced distributions required by the conduit trust can be seized by a creditor, are more likely to be considered available to an ex-spouse by a court in a divorce situation, are placed directly in the hands of the beneficiary, and may cause a beneficiary to become ineligible for needs-tested benefits. If a conduit trust is not a desirable option, then it may be desirable either to use an accumulation trust and try to maximize the income tax deferral, in spite of the planning distortions accumulation trusts can require, or it may be best to simply forego the long term income tax deferral benefits of the IRA or QP.

IV. Other Notes.

A. **Charitable Beneficiaries.** If you have a desire to benefit one or more charities at your death, designating the charities as beneficiaries of your IRA or QP assets can be an excellent way to do so. Having charities serve as the beneficiaries of tax deferred assets can eliminate the income tax which would otherwise be payable when the assets are withdrawn from the IRA or QP accounts, since the charities are income tax exempt. However, if you want to designate one or more charities as beneficiaries along with other, non-charitable beneficiaries on the same IRA or QP account, it can be critically important to ensure that the charitable beneficiaries' shares are either paid out to them or segregated into separate accounts before the beneficiary determination date (as discussed earlier, this date is September 30 of the calendar year after the year in which the original account owner dies). If one or more charitable beneficiaries still have not received full distribution of their shares or had their shares segregated from other beneficiaries' shares at the beneficiary determination date, then the IRS may take the position that the account has no designated beneficiary, even where one or more individual beneficiaries or qualifying trust beneficiaries exist, since a charity is deemed to have no life expectancy and is not a qualifying designated beneficiary. This can mean a possible maximum income tax deferral period of as little as five years, if the account owner is less than 70 1/2 years old at his or her death. A wide variety of charities can be named as the beneficiary of an IRA or QP, including individual charities, charitable family foundations (including donor advised funds, supporting organizations, and private foundations) and charitable split interest trusts (including charitable remainder trusts and charitable lead trusts).

B. **Simply Ensuring That Maximum Income Tax Deferral may be Available Does Not Necessarily Mean That it will be Realized.** The economic benefits of long term income tax deferral can be very valuable. However, you should remember that the price paid for maximum income tax deferral is often maximum control by the beneficiary. The simplest way to maximize income tax deferral is to designate an individual as the beneficiary

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of an IRA or QP account. That designated beneficiary will then be in full control of the account after the account owner's death. Even if the individual beneficiary is named as the Trustee of a trust which receives the IRA or QP assets, rather than directly as the beneficiary, that person still has the ability to directly access the account as Trustee. In either case, that person can decide to withdraw all of the IRA or QP assets in a very short period of time, even all at once, instead of taking only the minimum required distributions. If the account owner has a strong desire to prevent this from happening, then a trust should be designated as the beneficiary of the account, and there should likely be a third party who serves as Trustee, instead of the beneficiary serving as his or her own Trustee. If, for any reason, it is desirable to keep the beneficiary from having maximum control over the IRA or QP account, then there could be a good reason to compromise or even forgo the potential income tax deferral.

C. **Beneficiary Designations Are Critical, and They MUST Be Carefully Coordinated With Your Overall Estate Plan.** IRA and QP beneficiary designations **must** be coordinated with your overall estate plan, and it is critical to keep them up to date as time passes. This means that periodic reviews are extremely important. If the intent is for IRA and QP assets to pass to a trust for a beneficiary, the trust must be properly designated as the beneficiary or it will not happen. It can be tricky to properly designate a trust as the beneficiary, and very, very careful attention should be paid in this regard. Do **not** simply designate your estate as the beneficiary. In addition, do **not** simply use language such as "trust under Will." For maximum income tax deferral, it is critical that trusts be very specifically designated. If the trusts being created by your estate planning documents are based on formulas, those formulas should ideally be mirrored in the beneficiary designations. If the IRA custodian or plan administrator will not accept the ideal designation, work with your estate planning advisors to craft acceptable alternative designations based on your current situation. The importance of this issue cannot be overstated.

If the intent is for assets to pass to specific individual beneficiaries outright, and one of those beneficiaries dies before the account owner, or if there are other significant changes such as someone's marriage or divorce, or the birth or adoption of a child, the account owner should check his beneficiary designations as soon as possible, and make any changes which may be needed in order to ensure that the desired distribution is carried out in light of the new circumstances.

D. **Qualified Plan Accounts Are Generally Less Flexible Than IRAs.** While IRA account custodians normally allow beneficiaries the maximum array of distribution options permitted by the IRS at the account owner's death, this is not normally the case with QPs, which tend to severely limit these options. The difference results from the different positions of IRA custodians and plan sponsors. IRA custodians typically would like the beneficiaries to continue to hold their assets with the custodian as long as possible. However, employer sponsors of qualified plans usually want beneficiaries to take their assets and leave as soon as possible, so that the employer's fiduciary responsibilities for that account cease. This means that, with regard to most QPs, a non-spouse beneficiary cannot normally achieve a "stretch" payout directly from the QP account, and will be forced to take a lump sum distribution. Congress came to the rescue to some extent a few years back when they began requiring QPs to allow a non-spouse beneficiary to roll over their QP account balance to a inherited IRA account set up for the beneficiary. This requirement was phased in, however, and some QPs may still not allow this roll over option. If the terms of the QP permit such a rollover, it is usually the best option to take.

E. **Planning With Conduit Trust Beneficiaries.** If you are using a conduit trust as the beneficiary of IRA and QP

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assets, the trust needs to limit the application of the conduit provisions so that it only applies to IRA and QP accounts which will actually allow a life expectancy or other long term payout option. If, for example, a QP account only allows a lump sum distribution and does not allow a beneficiary to roll over the account balance to an inherited IRA, you would not usually want conduit trust provisions to apply to that lump sum, since that would mean the entire lump sum would be immediately distributed to the beneficiary outright. If that happens, you have not only lost the ability to defer income tax on those assets because of the plan's unforgiving rule, but you have also lost the benefits of having a trust serve as beneficiary. In our practice, we normally provide that the conduit trust provisions of the documents will only apply to an IRA or QP if the custodian or QP permits either (1) a roll over to an inherited IRA, (2) a payout period based on a beneficiary's life expectancy, or (3) a payout option of at least 10 years.

We at Morgan & DiSalvo have spent many years considering the issues created by IRAs and QPs and helping our clients address these issues as part of their estate planning. If you would like to find out how we can help you address these issues in your own planning, please contact Scarlett Ollila at sollila@morgandisalvo.com or (678) 720-0750 to schedule a consultation.