Using Standalone or Separate Trusts Solely to Receive Retirement Benefits*

By Edwin P. Morrow III

Ed Morrow explains critical distinctions in naming living trusts, testamentary trusts and various substrusts as beneficiaries of IRA and other retirement plan assets.

There is a current debate among estate planning attorneys as to whether a separate trust should always be created to receive and administer significant retirement plan assets. Though most attorneys think good estate planning can be done with only one master trust, there are various drafting, compliance and post-mortem administration problems that are minimized by segregating these assets and using a separate trust solely for retirement benefits. A separate trust can be created in three ways: 1) as an *inter-vivos* standalone trust (often called a "standalone IRA trust"); 2) as a subtrust of an *inter-vivos* revocable living trust that holds other assets as well, or 3) as a subtrust of a testamentary trust created by Will.[1] This article will use "separate IRA trust" to refer to any trust (standalone, *inter-vivos* or testamentary) that is segregated to initially hold *only* retirement benefits. Separate IRA trusts will have different taxpayer ID numbers than the master living trust or probate estate.

Another issue in the trust drafting debate is how to create beneficiary designations to work in conjunction with the drafting of the trust to hold retirement assets. The most wonderful cutting-edge trust document can be undermined by an improper or incomplete beneficiary designation form. This is a more complicated debate than many would like to admit. There can be substantial differences among documents and designations that will have a critical impact on the distribution and taxation of these funds. Additionally, standalone trusts do have some negative characteristics that must be considered.

This article will contrast the following general and common beneficiary designations:

- Ex. #1: Primary Beneficiary: I name the John Doe Revocable Trust dated August 8, 2007
- Ex. #2: Primary Beneficiary: I name the John Doe Testamentary Trust
- Ex. #3: Primary Beneficiary: I name my wife Jane Doe

With the following more specific designations:

- Contra Ex. #1: Primary Beneficiary: I name the John Doe IRA Standalone Trust dated August 8, 2007 [or, even more specifically, I name the John Doe IRA Standalone Trust dated August 8, 2007 for the benefit of daughter Deborah Doe]
- Contra Ex. #2: Primary Beneficiary: I name the John Doe Testamentary IRA Trust [or, even more specifically, a subtrust for a beneficiary thereunder]
- Contingent Beneficiary: In the event that my wife Jane Doe (or her guardian, agent or personal representative) disclaims, I name the Bypass IRA Subtrust created under John Doe Revocable Trust dated August 8, 2007. In the event that my wife predeceases, I name as beneficiaries 50 percent to the John Doe Revocable Trust dated August 8, 2007 IRA subtrust for the benefit of my son Jeb Doe and 50 percent to the John Doe Revocable Trust dated August 8, 2007 IRA subtrust for the benefit of my daughter Deb Doe.

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Practitioners will have slightly different naming conventions for their own trusts and designations, occasionally modified to accommodate the whims and vagaries of the IRA provider. This article will refer to the above beneficiary designation examples as shorthand throughout this article.

This article will divide these issues into five categories involving the planning stages and then conclude with two related issues in post-mortem planning:

- Contrasting a standalone IRA trust as beneficiary to a separate IRA trust created as a subtrust in a testamentary trust or a subtrust in a living trust
- Contrasting a master living trust as beneficiary versus naming a separate or standalone IRA trust (Ex. #1, Contra Ex. #1, #2)
- Disadvantages of separate or standalone IRA trusts
- Contrasting testamentary trusts as beneficiaries to naming IRA subtrusts within the testamentary trust
- Spousal designations–naming bypass trusts
- Spousal designations–disclaimer planning issues
- Post-mortem administrative difficulties and differences when trust holds *only* IRA assets
- Post-mortem "removals," divisions and consolidation solutions

Standalone IRA Trust vs. Separate IRA Subtrusts

A standalone trust has the following advantages:

1) A standalone IRA trust increases the likelihood that the estate plan for the IRAs will survive later planning by another attorney who does not understand or appreciate the complexities of estate planning with IRAs. Attorneys routinely revoke, restate or amend old trusts, but would take more care in doing so with a specially labeled, separately signed IRA trust. A standalone IRA trust might also make later amendments easier (especially explaining to clients) when tax law or retirement asset mix changes the dynamics of the planning. This is especially true where trusts are designed to potentially accumulate retirement plan distibutions (accumulation trusts), since the requirements of this planning are still evolving through private letter ruling interpreting the 2002 regulations.
2) A standalone IRA trust increases the likelihood that the trustee will understand the complexities of administering separate trusts with IRAs and retirement plan assets, and ensuring that the IRA funds flow into the right trust. Testamentary trusts and living trusts often have an easily overlooked clause in the document to create a separate trust for IRA and retirement plan assets, and beneficiary designations will often fail to pay directly to this subtrust. Experienced estate planning attorneys and trust administrators may properly administer the creation of the subtrust, its separate EIN and any in-kind IRA transfers, but not everyone has the knowledge and experience necessary and this exposes the trust to mistakes. Even experienced attorneys, CPAs and financial advisors have difficulty with IRA providers making in-kind transfers. If improperly administered, the IRA may be paid to the master trust for the spouse or children rather than to the IRA subtrust, which could be a disaster if discovered too late. Every time a trustee-to-trustee transfer or rollover is made, chances for major titling errors increase.
3) A standalone IRA trust might allow the main Will or Living Trust to be simpler and less confusing to the client. This is especially true for the clients who insist on understanding every word and paragraph of the trust.
4) A standalone IRA trust, due to its specifically stated purpose and special treatment, would probably be easier to amend through a court proceeding after a grantor's incapacity or death, should that be required. Under the Uniform Trust Code (UTC), beneficiaries may amend a trust post-mortem, provided there is no "material purpose" thwarted by the proposed amendment.[2] The clear labeling and special treatment of a standalone IRA trust makes the grantor's purpose, qualifying as a designated beneficiary, see-through trust, unambiguous. This flexibility is especially important for accumulation trusts, which may be subject in future years to revised interpretations.
5) The tax basis of nondeductible IRAs is likely to be tracked better, because any good standalone IRA trust will ask for that information to be attached. The tax basis could easily get lost in a master trust with dozens of different assets and accounts.

Standalone or Separate IRA Subtrusts vs. One Master Living Trust As Beneficiary

In contrast to the above discussion of standalone IRA trusts versus separate IRA subtrusts, the differences between these two solutions (standalone IRA trust or separate IRA subtrust) and naming one master living trust as beneficiary are very significant. Note that appreciating and triggering many of these differences often requires the beneficiary designation form naming the separate IRA trust directly. Some differences include:

1) A typical living trust allows for debts and liabilities of the decedent to be paid from the living trust. This can jeopardize asset protection when insurance and retirement plans are payable to the trust. These retirement assets typically have strong asset protection features and are protected by most state laws and certain provisions of ERISA and the federal bankruptcy law. In most states, revocable living trusts can be accessed by creditors of a decedent or grantor, and even in states like Ohio that do not currently permit this, a clause that allows payment of debts, taxes and expenses of a decedent probably turns these protected assets into non-protected assets.[3]

   Example. John Dorian, a successful estate planning attorney with a $4M estate, including $1.5M in IRAs and $1M in life insurance, falls asleep on the road one night after a long late night meeting hashing out a family succession plan for a local engineering firm. The ensuing accident kills three people and John and injures three others. His liability insurance covers $1M, but the ensuing judgments ultimately total over $6M. The insurance and IRAs are payable to the John Dorian Living Trust. Will John's family see any of this money? The answer is state-specific and requires an extensive discussion beyond the scope of this article, but a reasonable attorney representing John's family would probably prefer that the IRA beneficiary designations had been payable to a separate IRA trust or subtrust that did not contain provisions for paying debts, expenses or taxes of the decedent.[4]

> The most wonderful cutting-edge trust document can be undermined by an improper or incomplete beneficiary designation form.

2) Paying IRA benefits to a separate trust increases the likelihood that debts, taxes and expenses will not and cannot be paid from the retirement plan subtrust, which helps to prevent the loss of designated beneficiary status.[5] One solution for a master living trust is to include a provision that prohibits the use of retirement assets for such administrative expenses and taxes after September 30 of the year following the year of death (the cut-off date for determining the designated beneficiary). This will help in qualifying the trust as a designated beneficiary, but may create trustee liability where the beneficiaries of the IRA funds are not the same as the residuary beneficiaries of the master trust. Will negatively affected beneficiaries sue the trustee for not getting expenses paid from IRAs before that date? If there is enough at stake, probably. It is always well advised to act with care regarding tax apportionment and other issues when residuary beneficiaries are different from other specific or outside beneficiaries, including IRA trust beneficiaries.[6]
3) A separate IRA trust allows the master testamentary trust or living trust to name older contingent beneficiaries, charitable beneficiaries and other commonly named beneficiaries without the risk of adversely affecting the ability of the IRA funds to be preserved and stretched out. It allows the master trust to contain broad general and limited powers of appointment, and other clauses such as lifetime powers of appointment, decanting powers, and trust protector provisions that permit great flexibility. These clauses can be problematic in a trust designed to hold retirement plan assets (especially conduit trusts).
4) A separate IRA trust allows the living trust to have the broadest possible spendthrift, *in terroram*, incentive, or other clauses that act to restrict or eliminate income payouts to a beneficiary, which might be problematic in a trust designed to hold retirement benefits (especially conduit trusts).
5) A separate IRA trust might simplify the fiduciary accounting issues after death involving division between income and principal and separate share rules. For instance, it might be wise to opt out of the UPIA (Uniform Principal and Income Act) for a separate trust receiving IRA benefits. This is due to the unintuitive 10 percent income and 90 percent principal division of receipts from IRAs. The IRS has deemed this inadequate to qualify for the QTIP marital deduction.[7]
6) A separate IRA trust simplifies tracing of the immediate payout of required minimum distributions (RMDs) to the beneficiary that may be

required in a conduit trust.[8] It is unclear whether such tracing is required (perhaps it is not since such practice is generally disfavored under Subchapter J), but it is still a concern if one wants to follow the safe harbor example.

Example. Trustee of conduit trust gets $50,000 in income from other sources, then pays out $30,000 to beneficiary, then gets a $40,000 RMD from the IRA. Does the trustee have to strictly follow the safe harbor by immediately distributing the $40,000 MRD, or can he satisfy the requirement with only $10,000? Does it matter whether the $30,000 is ordinary income or whether, for instance, it is dividends eligible for reduced taxation?

7) A separate IRA trust can simplify income tax filing and planning for the trust and beneficiaries because it becomes much easier to plan exactly how much IRD (Income in Respect of a Decedent) is left trapped in the trust at potentially higher brackets and where the Code Sec. 691(c) deduction will be used (*i.e.*, by beneficiary or by trust itself).
8) A separate IRA trust allows the trustee of a conduit trust to make a Code Sec. 645 election to combine the probate estate with a master living trust and use a fiscal year without affecting the separate IRA trust. Combining an estate with a conduit trust and using a fiscal year may jeopardize a conduit trust from qualifying as a designated beneficiary. There is no case law to this effect, but the IRS may find the tax deferral to the beneficiary often generated by using a fiscal rather than calendar year to be offensive to its concept of immediate flow through concept of a conduit trust.[9]
9) A separate IRA trust might simplify or make more efficient use of the GST exclusion (currently $2,000,000), because it is usually well advised to apply the GST exemption for the non-IRA assets left in the standard living trust. Generally, the GST allocation would be less valuable to a separate retirement plan trust due to heavier taxation and/or leakage as the MRD percentage increases. It is therefore more valuable to a trust holding other assets. GST allocation will be more valuable if applied to Roth IRA accounts and younger beneficiaries than to a trust with older beneficiaries.
10) Coinciding with the last points about GST, the related issues surrounding the granting of limited and general powers of appointment are also clearer with separate IRA trusts. It may be desirable to grant a general power of appointment to avoid a generation skip as to some subtrusts and not others. In the event that an accumulation trust is used, one should be careful to avoid either a general or broad limited power of appointment.[10]
11) A separate trust can more easily segregate Roth IRA and 401(k) assets that have completely different tax planning involved. For instance, the GST allocation issue noted above involves quite different considerations for Roth assets. Accumulation trust provisions may be less desirable when the ordinary income is trapped in a trust at higher tax rates but less odious when receiving Roth IRA distributions. Conduit trust provisions might be more common for ordinary IRA distributions, where the trustee would probably distribute the income anyway for tax reasons, but this rationale would obviously not be there for Roth distributions.
12) A separate IRA trust avoids the tremendous danger of having a pecuniary bequest in a master trust triggering the immediate recognition of income (IRD).[11] This applies not only to marital deduction/bypass (A/B) trust splits, but may apply to other such trust divisions as well. Obviously this can be a disaster of tremendous proportions for any large plan. A separate IRA subtrust that is not a standalone trust would have to be named as beneficiary directly in order to avoid this. See the discussion in the later section of this article.
13) A separate IRA trust avoids the confusion of working with both an administrative trust and the subtrusts created under a master living trust. Generally, while settling an estate and paying bills, taxes, etc, a trust has one EIN, and then when marital/bypass (A/B) or children's trusts are funded there is generally one or more new trusts (and taxpayer ID numbers) for tax purposes. Re-

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ceiving retirement benefits in the administrative trust poses complications for many reasons (*e.g.*, the Code Sec. 645 election mentioned above, payment of debts/taxes/expenses, complications of in-kind transfers of IRAs). Avoiding these pitfalls and tracking the IRD, principal/income and DNI flow from one trust to another is difficult for many tax preparers.

14) A separate IRA trust can more easily avoid prohibited transactions. For instance, a related party may be acceptable as a trustee or co-trustee of a trust holding assets other than IRAs. However, there is some risk that a related party taking a trustee fee that is wholly or partially attributable to IRA assets could be a prohibited transaction. Since it is quite common now for beneficiaries or their family members to serve as trustee, this would not be a rare occurrence. Separate IRA trusts allow one to choose a different trustee for the IRA assets or make clear that the related party trustee shall serve without fee as to the IRA trust. Alternatively, the trust might prohibit such fees without a U.S. Department of Labor (DOL) exemption letter or other documented authority and permit trust expenses to be used to hire an attorney or other agent to obtain the authority.[12]

15) Separate IRA trusts, if coordinated with a division at the level of the IRA beneficiary designation form, enable the beneficiaries to qualify to use the life expectancy of each beneficiary, as opposed to using the life expectancy of the oldest beneficiary of the master living trust.[13] There are multiple, inconsistent and unclear private letter rulings that address which beneficiaries of a master trust must be counted, and whether or when allocation of the IRA benefits to only certain subtrusts makes any difference.[14] If the maximum stretch-out is desired, naming the master revocable living trust as beneficiary of the retirement account creates substantial uncertainty as to whose life expectancies must be considered.

Example. John Cannon names the John Cannon Revocable Trust (or the John Cannon Testamentary Trust) as beneficiary of his $1.5M IRA. If the trust splits into three shares for 40-, 45- and 50-year-old beneficiaries, the life expectancy of the 50-year-old will probably have to be used. If there is a 10 percent share for a 75-year-old sibling, that 75-year-old beneficiary's life expectancy may have to be used for all four subtrusts as well.

Using the oldest beneficiary's life expectancy often has only a small impact, unless there are substantial differences in the ages of the trust beneficiaries. For example, the divisor for the ages above are 43.6, 38.8, 34.2 and 13.4 respectively, creating a first-year percentage withdrawal of approximately 2.3 percent, 2.6 percent, 2.9 percent and 7.5 percent.[15] But even small percentages may lead to larger savings if extrapolated over a lifetime.[16]

Disadvantages of Using a Separate or Standalone IRA Trust to Receive IRA Distributions

1) There is more complexity when there are several IRAs with a value over the applicable exemption amount (estate or GST). While the advantages discussed above probably call for using a separate or standalone IRA trust, practitioners must be careful of this contingency, especially with the explosive growth in IRAs and IRA rollovers. Unlike master living or testamentary trusts, many standalone IRA trusts or separate IRA subtrusts do not have further language of division built into the document.

Example. Jason Bourne has a $1M IRA and $1.5M in a qualified plan. He establishes a standalone IRA or separate IRA trust as a primary beneficiary of his IRA. A few years later he retires, rolling his qualified plan into the IRA so it now totals $2.7M. He also uses $1M of his lifetime exclusion with a $1M gift. He dies with his IRAs payable to the trust. The trust, however, does not qualify for the marital deduction (or, goes to a trust ill-designed for GST planning or worse, goes to grandchildren triggering an immediate GST issue).

Thus, the trust may have been appropriate when less than $2M flowed into it, but not when the IRA increased in size and the grantor's lifetime exemption decreased. The above scenario could cause $1.7M to be subject to GST or estate tax unnecessarily. Retirement plans of this size are becoming more common and practitioners must be careful to plan for such situations. One could put a formula clause right into the IRA beneficiary designation form if the IRA provider permits a customized beneficiary form. Or, the trust itself could contain a formula clause, with care to avoid a pecuniary funding clause.

2) Another disadvantage of separate trusts is potentially extra trustee fees due to minimum fees on each trust account. However, many professional trustees will consider related trusts together for billing purposes so that the billing would be the same, or only slightly greater, for two separate trusts.
3) Extra tax preparation and accounting fees will also be a consideration. Although the accounting may be simpler in segregating the IRA, the net fees for multiple trusts will probably be higher.
4) Advisors must also consider the increased chance that separate trusts can be collapsed through an "uneconomical administration" clause or statute. Ohio, for instance, has a statute to allow termination of trusts under $100,000. The Uniform Trust Code provision has a $50,000 target and notes that states may wish to reconsider this number. This might be avoided by stating that for purposes of application of that clause or statute, you wish the trust to be considered *in pari materia* with the other similar trusts.
5) Another concern with separate standalone IRA trusts is potential for overlooking or drafting conflicting tax apportionment clauses. Standalone IRA trusts cannot be viewed in a vacuum, even though separate from other wills and trusts.

Example. Trust receives $200,000 IRA/retirement plan distribution, $200,000 in dividend income, has $40,000 in expenses and pays out $360,000 to a beneficiary. Two separate trusts (assuming equal trustee fees and expenses) would issue K-1s for $180,000 ordinary income and $180,000 dividend income. If one master trust were used, the trustee could allocate the expenses solely to the ordinary income, and issue a K-1 for $200,000 dividend income and $160,000 ordinary income. This means that $20,000 receives the lower tax rate associated with dividends. If this difference is 20 percent, this means approximate savings of $4,000.

Naming the Master Testamentary Trust vs. Naming the IRA Subtrust (Ex. #2, Contra Ex. #2)

If a master testamentary trust is the beneficiary (as opposed to the IRA subtrust created therein), there are the negatives as pointed out above such as the forced use of the oldest beneficiary's life expectancy or the danger of a pecuniary formula division in the testamentary trust. In addition, there is the administrative danger that the trustee will improperly make the in-kind transfer and fail to properly retitle the IRA so as to be payable to the separate IRA subtrust. Naming the IRA subtrust of the testamentary trust as beneficiary instead of the master testamentary trust avoids the in-kind transfer and retitling danger, allows for each beneficiary's life expectancy to be used and avoids pecuniary formula funding dangers.

Spousal Designations: Naming Bypass Trusts

Some practitioners advocate naming a bypass trust directly as the retirement plan beneficiary, or as a contingent beneficiary to be funded by disclaimer as discussed below. As discussed above, the beneficiary designation might also be to an IRA subtrust within the bypass trust. If the bypass trust is named without naming a separate IRA subtrust, some of the same drafting problems listed in the first section apply. If the bypass trust does contain a separate IRA subtrust but the main bypass trust is named as the beneficiary, there is the in-kind transfer and retitling danger discussed previously. In general, however, this is a good solution for mid-size estates that want to fund A/B trusts *via* disclaimer funding to better control which assets will fund the bypass trust. As a general rule, IRA assets are disfavored for this purpose if other assets are available.

Spousal Designations–Disclaimer Planning

As discussed above, naming a bypass trust as a contingent beneficiary of an IRA is often a good planning option. Although one should be somewhat skeptical whether disclaimer funded plans will be activated by a surviving spouse, this author has found many clients (especially those of long-term marriage) to be very receptive to disclaimer planning. It offers tremendous flexibility due to the surviving spouse's unique privilege under the tax law to disclaim assets for which he or she can still receive benefits.[17]

The practitioner should strongly consider customizing the beneficiary designation form when using disclaimer planning. Consider Ex. #3 and Contra #3 at the beginning of this article. If both the spouses die in a common accident or the spouse predeceases the participant in that example, the children are left with the following burdens and disadvantages: they must use the life expectancy of the oldest beneficiary, there are the issues noted above when naming a master living trust as beneficiary, there are the titling issues and problems making in-kind transfers of IRAs, and there are the delays associated therewith.

If the trust pays outright to beneficiaries, the contingent beneficiary of the IRA should not be the trust, but the children outright (if minors, perhaps an UTMA custodian). If the trust is a longer-term asset protection trust, the subtrusts for the children can be named directly as in the Contra Example #3. If the trust pays outright to the beneficiaries at a certain age, then the beneficiary designation may provide that the contingent beneficiaries are the child's subtrust before X date and the child outright after X date.

Post-Mortem Administrative Considerations When the Trust Holds Only IRA Assets

In a conduit trust, there appears to be a Catch-22 when only IRA benefits are held by the trust. The safe harbor in the regulations requires that any distributions from the IRA be paid immediately to the beneficiary.[18] If taken literally, that means that funds cannot be taken out for trustee fees, investment management fees, attorney fees and other expenses. However, the IRS has allowed in several private letter rulings now that such expenses can be deducted.[19] Although these private rulings cannot be relied upon as precedent, they do give some insight regarding the IRS thinking on this practice.

A more important concern regarding separate IRA trusts is the need for clear coordination and direction to multiple trustees that portfolio management and diversification shall be made in accordance with the Uniform Prudent Investor Act (UPIA) and modern portfolio theory.

Example. John Doe dies with $1M payable to John Doe IRA Standalone Trust. He has $1M in another brokerage account titled in the John Doe Living Trust. His IRA account has small, mid-cap and international mutual funds. His trust brokerage account has large cap and value stocks. Together they may be prudently diversified, but separately each is not. Once can imagine much worse cases where most of the QP/IRA is employer stock. Just because the trustees and beneficiaries are the same does not necessarily mean they can be treated as one trust for diversification purposes. This diversification problem might also be solved by a post-mortem agreement between the trustee(s) and beneficiaries of multiple trusts.

Post-Mortem "Removals," "Rollovers," Trust Division and Consolidation Solutions

Post-Mortem "Removals"

As mentioned above, there is substantial uncertainty created as to who must be counted as a beneficiary in determining designated beneficiary status when a master living trust is named. Despite the uncertainty, there may be a solution. Reg. §1.401(a)(9)-4, A-4(a) provides that:

> In order to be a designated beneficiary, an individual must be a beneficiary as of the date of death. *** The employee's designated beneficiary will be determined based on the beneficiaries designated as of the date of death who remain beneficiaries as of September 30 of the calendar year following the calendar year of the employee's death. Consequently, ***any person who was a beneficiary as of the date of the employee's death, but is not a beneficiary as of that September 30 (*e.g.*, because the person receives the entire benefit to which the person is entitled before that September 30), is not taken into account in determining the employee's designated beneficiary for purposes of determining the distribution period for required minimum distributions after the employee's death.

This provision permits, for instance, a charity or older beneficiary to be paid in full prior to the beneficiary finalization date (September 30 of the year following death) and to then be disregarded.[20] It also allows a qualified disclaimer to remove a beneficiary from consideration.[21] These two techniques allow significant flexibility in "clean-up" mode. As opposed to many accumulation trust techniques that rely on private letter rulings, these are certain. For instance, in the John Cannon example above with the 75-year-old beneficiary taking 10 percent of the IRA trust, the trustee may be able to cash out that beneficiary's share with a complete distribution (decanting to another trust is unlikely to pass muster with the IRS, because that trust's beneficiaries would be considered).

Post-Mortem "Rollovers"

Generally non-spouses cannot rollover retirement benefits.[22] However, under the Pension Protection Act of 2006, a non-spousal beneficiary (including trusts that qualify as see-through trusts) can transfer such plans after death to an inherited IRA.[23] This is only permitted if the plan allows it.[24] Practitioners should strongly consider adding clauses in their trusts (and perhaps even on the beneficiary designation form if the plan administrator permits) to distribute in one manner if the employer plan allows transfer to an inherited IRA and in a different manner if the plan does not so allow. This should include the discussion of Net Unrealized Appreciation (NUA), since taking advantage of such provisions may alter beneficiaries' rights just as much, if not more, than nonspousal rollovers. It is not hard to imagine one beneficiary arguing for a full rollover and another arguing against it or for a partial rollover/NUA lump sum distribution, depending on the trust terms, since distributions are so often affected by definitions of "deferrable retirement benefits," "income," and the like. Many other clauses added to trusts are generally not desirable if there is to be no "stretch" gained from it. If the plan administrator does not currently allow such transfers, perhaps they can be convinced to do so, as it does not increase the plan administrator's burden yet provides an important benefit to plan participants.

Post-Mortem Trust Reformation/Division

If IRA benefits are payable to a trust that does not have a separate IRA subtrust, you may be able to fashion such a separate trust under state law remedies. Most states, including those that have adopted the UTC, have such provisions and they are commonly included in trust agreements as well.[25] In addition to trust "division", many states have provisions for post-mortem reformation for tax reasons or "change in circumstances."[26]

The Supreme Court has held that where federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law, the IRS is not bound by the state trial court determination regarding such property.[27] However, the IRS has signaled much greater acceptance of post-mortem changes to trusts as not affecting income-tax designated beneficiary status if accomplished by the beneficiary finalization date.[28]

Drafting Tip: It may be a good idea, especially in UTC states, to note that qualifying the trust as a designated beneficiary is a "material purpose" of the trust. Under the UTC, a court may allow an irrevocable trust to be amended with consent of the beneficiaries if it is not inconsistent with a "material purpose" of the trust.[29]

Post-Mortem Trust Consolidations

Converse to the above technique, after the beneficiary designation date and tax closing letters, the stand-alone trust and other substantially similar trusts could perhaps be consolidated into one trust, provided that certain provisions regarding the IRA stay in place. Many, though not all, of the reasons for separate trusts expire after those events.

Care should be taken when adding special provisions to trusts receiving IRA benefits regarding amendments, consolidations or mergers. The IRS generally ignores such powers when granted by state law, but may scrutinize them when they exceed powers granted under state law.[30] This is especially true of a trustee's (or trust protector's) power to alter beneficiaries or beneficiaries rights after the beneficiary finalization date.

Conclusions

Practitioners will find that some IRA providers are unresponsive, inflexible and difficult to deal with. This is especially true of "discount" providers, but less true of any firm providing wealth management. If the firm will not cooperate with value-added estate planning, the client should consider another IRA provider. If the client is unwilling to do this, the practitioner should inform the client, in writing, of the consequences of cookie-cutter IRA beneficiary designations.

Many of the problems noted herein are also solved through customizing a trusteed IRA, which can have even greater administrative simplicity and numerous advantages over separate or standalone IRA trusts.[31] A trusteed IRA can essentially create a conduit trust that avoids much, but not all, of the complexity of this planning. But there are some situations where the simpler trusteed IRA (or conduit trust) is neither feasible nor desirable.

Where the stakes are high, strongly consider naming a standalone or separate IRA trust as a beneficiary apart from the master living trust or testamentary trust. Do not delegate the funding and beneficiary designation to the client or financial advisor without supervision. Consider naming IRA subtrusts or standalone trusts directly on the beneficiary designation form to achieve longer stretch out tax deferral for younger beneficiaries, better asset protection, less titling/transfer risk and more assured see-through trust status. But beware of the risk associated with mega-QRP/IRAs over the client's estate tax exemption amounts and draft the separate IRA trusts and/or the beneficiary designation form with appropriate safety clauses to plan for such contingencies.

Endnotes

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1 Calls to estate planning organizations that have document preparation software, such as the American Academy of Estate Planning Attorneys, National Network of Estate Planning Attorneys and Wealth Counsel, LLC, all indicated substantial use of such standalone IRA trust planning by their members.

2 Uniform Trust Code (UTC), §411(b).

3 *See* UTC §505(a)(3), contrary to Ohio's *Schofield v. Cleveland Trust Co.*, 135 Ohio St. 328 (1939).

4 For one example of this danger, *see* LTR 200440031 (July 6, 2004), where this situation occurred but the IRS was kind enough to not consider the estate or creditors as beneficiary of the IRA for MRD purposes. Also see *Zahn vs. Nelson*, 170 Ohio App.3d 111, 2007-Ohio-667.

5 *See generally* ¶6.2.10 *Payments to estate for expenses, taxes,* at 301–03, Natalie Choate, Life and Death Planning for Retirement Benefits (6th ed. 2006). *See also* recent LTR 200610026 (Dec. 13, 2005), LTR 200610027 (Dec. 13, 2005), LTR 200608032 (Nov. 30, 2005).

6 Tax apportionment clauses should (but rarely do) include apportionment for income taxes. Consider the increased consideration of Roth conversions (including "deathbed" conversions), which can create outstanding benefits for beneficiaries, especially in states with a separate estate tax. For such cases the decedents' final income tax bill may be considerable. For a good discussion of conversion opportunities, *see* Robert S. Keebler and Stephen J. Bigge, *To Convert or Not to Convert, That is the Question*, J. Retirement Planning, May–June 2007, at 37.

7 For QTIP complexities, *see* Rev. Rul. 2006-26, IRB 2006-22.

8 *See* Reg. §1.401(a)(9)-5, A-7.

9 See Example 2 in Reg. §1.401(a)(9)-5, A-7.

10 *See generally* Natalie Choate, ¶6.3.09, *Powers of Appointment,* at 320–21, Life and Death Planning for Retirement Benefits (6th ed. 2006).

11 *See* Chief Counsel Memorandum (CCM) 200644020.

12 *See* attorney Sy Goldberg's *The Advisor's Guide to the Retirement Distribution Rules*, Oct 2006, quoted in *Ed Slott's IRA Advisor Newsletter,* Apr. 2007, at 7.

13 *See* Reg. §1.401(a)(9)-4, A-5(c), Reg. §1.401(a)(9)-8, A-2(a)(2), LTR 200317041 (Dec. 19, 2002).

14 *Supra* note 11, at ¶6.3.01, pages 304–308.

15 *See* the Single Life Table at Reg. §1.401(a)(9)-9, A-1.

16 An example of the long-term effect of using the above numbers is below, using a simple stretch illustration with a conservative seven-percent growth rate before tax, 5.5 percent in after tax accounts with minimum withdrawals moved to taxable accounts and no money spent:

If the children's individual life expectancies are used, the amount of assets in accounts after 43 years:

40-year-old: $5,466,140
45-year-old: $5,267,054
50-year-old: $5,085,157

Amount of assets in accounts if life expectancy of the oldest (50-year-old) must be used: $5,085,157 each.

Amount of assets in accounts if life expectancy of the 75-year-old must be used: $4,362,870 each (assuming children still start with $500,000 each).

17 *See* Code Sec. 2518 in general, Code Sec. 2518(b)(4) for spousal exception.

18 Example 2 in Reg. §1.401(a)(9)-5, A-7.

19 *See* LTR 200432027 (May 12, 2004), LTR 200432028 (May 12, 2004), LTR 200432029 (May 12, 2004), LTR 200620026 (Feb. 21, 2006).

20 LTR 200608032 (Nov. 30, 2005).

21 Reg. §1.401(a)(9)-4, A-4(c), LTR 200444033 (Aug. 3, 2004).

22 Code Sec. 408(d)(3)(C), Code Sec. 402(c)(9).

23 Code Sec. 402(c)(11).

24 IRS Notice 2007-7, IRB 2007-5, Jan. 14, 2007. This restrictive interpretation of IRC Sec. 402(c)(11) may change soon. The IRS has listed this as an "impending technical correction" due to take effect Jan. 1, 2008 to require plan administrators to permit rollover. See *www.irs.gov/retirement/article/0,,id=173372,00.html*

25 *See, e.g.,* UTC §417, or Ohio's version at Ohio R.C. §5804.17.

26 *See* UTC §416, Ohio R.C. §5804.16.

27 *H.J. Bosch*, SCt, 67-2 ustc ¶12,472, 387 US 456, 87 SCt 1776 (1967).

28 *See* LTR 200537044 (Mar. 29, 2005), LTR 200522012 (Feb. 14, 2005), LTR 200608032 (Nov. 30, 2005), LTR 200620026 (Feb. 21, 2006) for post-mortem trust modifications or LTR 200616039 (Jan. 25, 2006), LTR 200616040 (Jan. 25, 2006), LTR 200616041 (Jan. 25, 2006) for beneficiary designation modifications. See recent LTR 200742026, where the IRS did not honor state court post-mortem reformation of a beneficiary designation form.

29 *See* UTC §411, Ohio R.C. §5804.11.

30 *See, e.g.,* Reg. §20.2038-1(a)(2).

31 *See Ed Morrow, Contrasting Conduit Trusts, Accumulation Trusts and Trusteed IRAs,* J. Retirement Planning, May–June 2007, at 21.