INCORPORATING RETIREMENT BENEFITS INTO THE ESTATE PLAN AND DRAFTING TIPS FOR RETIREMENT BENEFIT TRUSTS

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

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

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

As an illustration, consider the following: After this presentation, you should be able to answer the questions at the end of the fact pattern:

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

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

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

QUESTIONS:

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

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

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

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

A. <u>From an Estate Tax Standpoint, Who (or What) Should be Selected as Beneficiary?</u>

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

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

What this means is double (or triple) taxation [income tax at about 40 percent, estate tax at 35 percent = 75 percent plus Washington State estate tax (assume 10 percent) = 85 percent!]. Is this a problem? The issues are timing and growth, because all estate assets (except those received by gift or inheritances) are "double taxed" (income tax at acquisition, gift or estate tax at transfer). The goal is to build enough flexibility in the overall plans (estate and IRA/qualified plans) to permit deferral, and select the right beneficiary <u>to maximize and increase the estate-tax free exemption amount</u>.

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

1. <u>Exemption (Bypass) Trust as Beneficiary</u>.

"IRD" is a "wasting asset," because it is subject to income tax on distribution. However, it grows income tax free <u>until</u> distribution. This should be compared to capital growth assets, <u>which also grow income tax free until sale</u> (at the much lower 15 percent capital gains tax). Therefore, assets <u>other</u> than IRD assets should be picked first in funding the bypass trust.

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

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

In contrast, if the surviving spouse were named as 100 percent beneficiary of the $2,500,000 benefit, and other, appreciating assets, were used to fund the exemption trust, the $5,000,000 trust would be fully funded, and hopefully would grow to; e.g., $6,000,000, without estate taxation in either spouse's estate. In the meantime, the surviving spouse would be taking distributions from the ongoing rollover IRA account or plan account, and paying income tax, ultimately reducing and "diluting" the size of his or her estate taxable property. This is consistent with an overall goal of estate planning; e.g., to maximize the "leverage" of the $5,000,000, and minimize the otherwise taxable estate of the surviving spouse and/or the marital deduction includible in the estate of the surviving spouse.

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

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

2. Estate (or Other Entity) as Beneficiary.

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

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

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

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

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

3. Spouse as Beneficiary.

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

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

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

B. What About Portability of the Deceased Spouse Unused Exemption Amount (DSUEA) Under the 2010 Laws (at Least Until the End of 2012); and What About the Fact that the Estate Tax Rate is Now About the Same as the Income Tax Rate?

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

That was OK because much of TRUIRJCA was good news by way of lower gift and estate tax rates of 35 percent, an increase in the gift tax exemption from $1,000,000 to $5,000,000, and the ability for one spouse to "inherit" the unused estate tax exemption of a pre-deceasing spouse via "portability" of the Deceased Spouse Unused Exemption Amount or "DSUEA." But this good news is only certain until the end of 2012 when we face another "Sunset" of the new laws! Much of what follows in this outline has to be prefaced with the cautionary comment: it would be foolish to proceed with dramatic revisions or dismantling of what's already been done for clients based on TRUIRJCA, until its provisions are no longer subject to a "sunset," whether as currently in effect or in modified form.

It is rumored that under TRUIRJCA one of the more likely provisions to survive is "portability" of the DSUEA of a first spouse to die, into the hands of the surviving spouse. If true, this is a game-changer for the following, <u>fairly common</u>, situation:

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

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

Let's see how portability works for these clients.

Assume that husband client has an $8,000,000 rollover IRA in his name, and the couple have a $2,000,000 residence, all being community property. As described above they have children of only this marriage, they've been married for many years, and they aren't concerned about remarriage of the surviving spouse or otherwise wanting to "control" their half of the community property.

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

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

☞ ***Practice Tip***: *Wife's bequest of her community property interest in her husband's IRA to him, in her Will, is often missed by practitioners. It is the counterpart to what he is doing for her if he dies first, and it reduces the complexity of where her interest in this asset is supposed to go, if she says nothing about it in her Will–it might even go to a residuary heir who is different than the husband even though she never intended this result. See: RCW 6.15.020 which confirms the authority to dispose of a community property interest in the IRA by Will. <u>However</u>, it may be advisable to accompany the bequest with the authority of the surviving spouse to disclaim to the estate of the deceased spouse, which could increase the amount of "non-IRD" assets available to fund the bypass trust, particularly under state estate tax laws (such as Washington law), via non-pro-rata selection by the Personal Representative. [See Section III of this outline.]*

The reason for pre-TRUIRJCA distortion was that the estate tax exemption of the first spouse to die would be "wasted" in an "all to spouse" estate plan. The survivor would later die with a "back-loaded" estate of $10,000,000 of which only $5,000,000 would be covered by his or her own exemption. So if estate tax savings were a priority (even at 35 percent the taxes would be substantial), there would have to be income-taxable distributions to husband to create more non-IRA assets, or more likely the husband would name a bypass or exemption trust as the beneficiary of his half of the IRA and the residence, and the wife would do the same regarding her half of these assets. They would do this so as to "fund" a trust that "utilized" their exemption so it would not be "wasted" at their death.

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

Under TRUIRJCA these "funding of trust" problems (complexity and "faster" income-taxable RMDs) don't exist. The surviving spouse can be 100 percent owner of all assets but still have <u>both the $5,000,000 exemption of her husband and her own $5,000,000 exemption</u>, at her death. There is a procedural requirement in that the personal representative (surviving spouse in Washington) would need to prepare and file a federal estate tax return which would operate as an election to leave the "unused" (in this case $5,000,000) exemption amount to the surviving spouse. It doesn't get much simpler than that.

Finally, the new 35 percent estate tax rates are virtually the same as the income tax rates–so perhaps "stretch the IRA via spousal rollover and use portability for estate tax" will be the new "mantra" because income taxes in some form are a virtual certainty, and many believe that rates will go up in the future, not down, whereas the survivor's estate may not be subject to federal estate tax because covered by his or her exemption, the survivor's use of gifting or other estate-reduction techniques during his or her lifetime, or even, as originally proposed in 2001, repeal of the federal estate tax.

☞ ***Practice Tip****: There are at least three (3) "problems" with this new "mantra":*

- *It doesn't account for the Washington (or other state) estate tax, which has a lower ($2,000,000) exemption and no "portability"–so a bypass trust is still needed to avoid "wasting" the predeceasing spouse's exemptions.*

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

- *A funded bypass trust is <u>always</u> exempt from estate tax in the survivor's estate, and is not subject to changes in the law (such as a reduced exemption)–as is the exemption which is given to the surviving spouse via portability. In addition, re-marriage by the surviving spouse (and death of the second spouse) could reduce or eliminate the exemption given to her by the original spouse via portability.*

C. <u>"Gift Tax Trap" in Completing IRA Beneficiary Designations</u>.

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

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

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

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

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

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

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

II. INCOME TAX ASPECTS OF RETIREMENT PLANS AND IRAs

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

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

A. Importance of DB Status.

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

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

This might be "fixable" via segregation of shares into separate accounts or pay-out to the charitable organization, if done in time. But it is preferable to keep completely separate IRAs and plans either for individuals or qualifying trusts, and charities, but not for both. If a trust is named as beneficiary, with this mix-up of individuals and a charitable organization, the situation is even worse and possibly not fixable.

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

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

✏ ***Practice Tip**: The surviving spouse of the IRA owner or plan participant is (in terms of maximum "stretch" and flexibility) the best of all individual (not trust) DBs because the surviving spouse can "start over" and get a "fresh start" by way of a spousal rollover to the spouse's own IRA account, which will not need to commence RMDs until the spouse reaches his or her required beginning date, AND the beneficiaries named as designated beneficiaries of that IRA will determine the payout period when the surviving spouse dies. This avoidance of the one-year rule for commencement of benefits, and a "new" DB for a "new" IRA (not an "inherited IRA, which is not the same thing) is solely available to the surviving spouse of an individual.*

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

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

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

The answer is unfortunate–there is a five-year distribution requirement in this situation whether the decedent was an IRA owner or a plan participant. See, Reg. Sections 1.401(a)(9)(B)(ii), 1.401(a)(9)-3, A-4, and A-2. Obviously, this is going to create a "spike" in income taxation to the non-DB regarding. The five-year distribution period is not a required equal-payment, per year, RMD method–distributions could be delayed until the end of the period but this is little comfort.

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

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

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

Note: Roth IRAs don't have a required beginning date for the IRA owner so it's presumed under the RMD guidelines that the five-year rule applies in all cases (unless of course there is a DB).

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

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

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

This is typically better (longer) than the five-year rule: for example, the payout period for an age 70½ decedent would be a fraction with a 15.3 year divisor.

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

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

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

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

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

However, effective for distributions after December 31, 2006, IRC Section 402 was amended by the 2006 Pension Protection Act (PPA) to permit such beneficiary (or trust for such beneficiary) to do a "direct transfer" (not rollover–no benefits should be distributed to the beneficiary) from the Plan to an IRA, an "inherited IRA," which can make distributions over the life expectancy of the beneficiary.

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

When the PPA was enacted, many assumed that the non-spousal rollover would be required of qualified plans. After all, the plans would be able to "get rid" of the deceased participant's benefits, just by way of a distribution to an IRA, instead of a distribution to an individual. However, that was not the case until more recent legislation stated that plans must permit non-spousal rollovers. [The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA)]. This was not clearly required until 2010.

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

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

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

Clients and IRA custodians often look to the "contingent" or "alternate" beneficiary that may be named in the beneficiary form or the IRA document for the answer, but this is incorrect, the contingent, alternate, or "second" beneficiary would receive benefits only if the first-named beneficiary did not survive the participant or IRA owner and that is not the case. The correct term to use here is "successor" beneficiary to the original DB or non-DB, after this original beneficiary dies. It is the original beneficiary who needs to actually "name" his or her successor for remaining benefits on his or her death. IRA custodians should permit this, often using standard forms but filled out by the first beneficiary rather than the IRA owner.
What abut the time-frame for these "successor" beneficiary payments? The time-frame doesn't change–it's still whatever was in effect on the death of the first beneficiary. There is no "fresh start" with a new life expectancy. What if no successor beneficiary is named–the typical IRA document will state that remaining benefits be payable to the estate of the first beneficiary in this way incorporating the first beneficiary's selections of individuals. The estate as beneficiary in this situation does not mean that the benefits have to be accelerated in the pay-out schedule, or paid out of the IRA before the probate estate is closed. Rather, the "right to receive" the benefits, under the remaining time-frame, is distributed out of the estate to the appropriate heirs, and they can continue to receive benefits under the same schedule. Remember that this is still an inherited IRA which is in the name of "X, deceased, fbo _______." So the "fbo" portion is what is changed, from the first beneficiary, to the estate, to the heir(s). See: Exhibit A with sample provisions acknowledging this "transfer" of this continuing right to distributions, not a lump-sum distribution upon termination of the trust or estate.

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

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

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

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

What if the non-IRA-owning spouse dies first? Can their community property interest be given to a trust under their Will (bypass/exemption or QTIP). The answer is yes: <u>See</u> RCW 6.15.020.

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

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

Although there has been some speculation to the contrary, it is generally believed that the *Boggs* decision applies only to the qualified, ERISA-governed plan benefits which are subject to displacement, for estate planning purposes, by ERISA preemption.
Accordingly, if a participant has attained age 59½, is a participant in a profit sharing plan providing for "in service" withdrawals, at any age, or in some other manner (termination of employment, termination of the plan itself, etc.) can access the benefits in a qualified plan, much more control can be exercised over the post-distribution rollover IRA.

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

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

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

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

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

✏ ***Practice Tip****: See Section I.B. for a description of outright bequest/disclaimer provisions needed to implement this type of planning.*

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

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

See Exhibit A, for sample provisions in a Will or Revocable Trust which will assist in providing flexibility in the timing of distributions, and complying with the “designated beneficiary” requirements for a trust.

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

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

Note: Even with "portability" under TRUIRJCA of 2010, clients may prefer this "trust" format as "protection" to ensure that the residuary beneficiaries (children) will receive their estate.

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

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

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

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

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

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

It is important that a trust which is named as a beneficiary of a plan or IRA also qualify as a "Designated Beneficiary" under the age 70½ minimum distribution rules. Otherwise, all of the plan benefits would have to be paid to the trust either: (1) within five (5) years after death of the participant or IRA owner if death is before the required beginning date; or (2) over the remaining life expectancy of the decedent if death occurs after the required beginning date. This is not a good situation from an income tax standpoint, since income tax would have to be paid by the trust over a short period of time, which would reduce benefits otherwise available by "stretched out" distributions to the trust over the (younger, usually) trust's beneficiary's lifetime.

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

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

2. What are the Problems with Naming a Trust a Beneficiary; For Example, Can a Special Needs or Supplemental Care Trust Qualify as a "Designated Beneficiary" so that Plan or IRA Benefits Can be Stretched Out Over the Trust Beneficiary's Lifetime?

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

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

(a) Valid Under State Law. This requirement will most likely be satisfied.

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

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

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

Because of the problems with the number 2 requirement, the attorney preparing a Special Needs Trust which may (or will) be a beneficiary of a significant plan or IRA benefit is in the position of deciding between: (a) shorter IRA payout period and higher income tax to the trust, or (b) ensuring DB status by using either a (i) "conduit trust" which requires that all RMDs be paid each year to the beneficiary (which would result in disallowance of benefits intended to be protected by the trust because paying out all RMDs to the beneficiary would exceed the "special needs" limitations of the trust's main operative provisions), or (ii) maintain the discretionary trust provisions of the trust, but prohibit ultimate distribution to non-qualifying (older or entity) beneficiaries, or otherwise ensure DB status.

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

Similar concerns exist for a typical Bypass or QTIP trust. A "conduit" approach guarantees DB status, but may result in little or no residuary benefits if the spouse lives to full-life expectancy. A discretionary "see-through" trust (accumulations permissible so long as RMDs are distributed to the trust and taxed as income) will be preferred. Unfortunately, there is no absolute assurance that contingent beneficiaries (such as charities) won't stand in the way of DB status, unless, under Reg. Section 1.401(a)(9)-4, A-5(c), and PLR 2004-38044, at the death of the first spouse, if the surviving spouse were to die, the residuary beneficiaries (children) were all old enough to be outright (not trust) beneficiaries. This may be the case, or it may not. An ability for a Trustee to name residuary takers who must be the same age or younger than the Trust's oldest (measuring life) beneficiary would provide assurance of DB status. PLR 2002-35038.

There are other drafting methods of obtaining DB status for a discretionary (non-conduit) trust: (1) The trust could provide that living residuary individual beneficiaries (grandchildren) will receive trust benefits upon the death of lifetime beneficiaries (or to a UTMA account for such residuary beneficiaries); (2) The trust could provide that only individual (not entity) beneficiaries born after (not before) a certain date will receive residuary trust benefits; (3) The trust could provide that benefits will not be distributed to any non-individual beneficiary, or to any beneficiary who is older than the oldest lifetime beneficiary; or (4) use a "conduit trust" for lifetime beneficiaries. See Exhibit A.

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

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

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

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

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

B. An "Erroneous" Beneficiary Designation May Be "Corrected" if Timely Actions are Taken

Here's an example of an "erroneous" IRA beneficiary designation, which could be an income–tax disaster of a 5–year mandatory payout if the IRA owner dies before reaching age 70 ½:

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

This is not a "trust" beneficiary with the complexity described above in which a "contingent" future beneficiary such as the University of Washington could jeopardize qualifying "designated beneficiary" status permitting the use of life expectancies of individual beneficiaries. It is a "class" of beneficiaries, only one of which cannot be a qualifying designated beneficiary, but if not corrected the entire class will forfeit designated beneficiary status. Reg. 1.401(a)(9)-4, A-3.
Of course, if the University of Washington could be persuaded to execute a valid disclaimer of its benefits (within 9 months of the date of the IRA owner's death) the "taint" of the non-individual would be removed–but this is not likely to happen. So, what steps can be taken to "fix" this unintended "acceleration" of income tax consequences?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

EXHIBIT A

Will/Trust Provisions Dealing with Plan/IRA Assets

ARTICLE ___
RETIREMENT BENEFITS

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

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

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

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

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

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

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

Benefits for payment of any debts, taxes, expenses of administration or other claims against or relating to my estate.

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

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

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

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

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

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

__.9 **2006 Pension Protection Act; Direct Transfers**. Pursuant to the provisions of the Pension Protection Act of 2006, my Personal Representative and/or Trustee shall have full power and authority to instruct the Administrator or Custodian of any Retirement Benefit to make a direct transfer of such Benefits to an inherited IRA of any beneficiary or trust for a beneficiary under this will, or under the beneficiary designation applicable to such Retirement Benefit, if, in the opinion of my

Personal Representative and/or Trustee, such direct transfer will be beneficial for tax purposes, and/or will permit a longer period of payments under the minimum distribution rules of IRC Section 401(a)(9).

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

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

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

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

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

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

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

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

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

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