CHAPTER 68

Using Standalone Retirement Distribution Trusts

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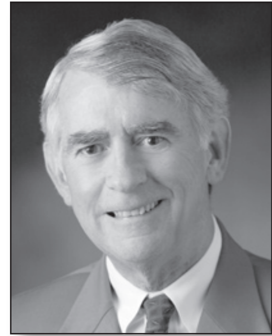

In the preceding chapter, you learned about the income tax-deferred "stretchout" available under Treasury Regulations for your IRAs and qualified plans. You also learned that this stretchout is available not just to you and your spouse, but also to your children or other beneficiaries whom you designate to receive these retirement assets after your death.

You also learned that a trust designated to receive retirement assets after your death may qualify for the same stretchout as an individual beneficiary, the length of the stretchout being based upon the life expectancy of the oldest trust beneficiary. In this chapter, you'll find out whether it makes more sense to have retirement assets payable to a living trust or to a "standalone retirement distribution trust."

Regarding your estate in general, the types of beneficiaries for whom a trust is advisable include a beneficiary who is financially irresponsible, a beneficiary with special medical needs, or a beneficiary with a developmental disability. Perhaps less clear-cut is a beneficiary who has a troubled marriage, a beneficiary who is in a high-risk profession, or a beneficiary whose own estate taxes can be reduced by placing all or part of his or her inheritance in a trust.

As to retirement assets in particular, a trust may be advisable to prevent a beneficiary from unwisely deciding to cash in your IRA or qualified plan right after your death so that it becomes immediately and fully income-taxable. But let's assume you're certain your beneficiaries will wisely opt to stretch out distributions over their life expectancies. Even so, unless your retirement assets are made payable to a trust, the benefits may wind up with someone whom you wouldn't have chosen as a beneficiary, because your beneficiary may not live a full life expectancy, and he or she gets to designate his or her own death beneficiary for any undistributed amounts.

Whatever the reason, if you're naming a trust as beneficiary of retirement assets, additional rules and strategies apply:

- If your trust has charitable beneficiaries who aren't "cashed out" by

September 30 of the year following the year of your death, your trust and its beneficiaries won't be entitled to any stretchout.

- If your trust has a contingent beneficiary who is older than the trust's primary beneficiary, unless your trust has appropriate provisions stating that it is a mere "conduit" for IRS required minimum post-death distributions, or unless each such contingent beneficiary disclaims his or her interest in the trust by September 30 of the year following the year of your death, the oldest contingent beneficiary's life expectancy will determine the stretchout period for your retirement assets.
- If your trust gives your primary beneficiary the power to "appoint" the trust at death among a group which might include older persons or charities, again, unless the trust has appropriate provisions stating that it is a mere "conduit" for IRS required minimum post-death distributions, the retirement assets may have a shortened stretchout or possibly no stretchout at all.
- If upon your death your trust splits into subtrusts for several beneficiaries, unless your IRA or qualified plan beneficiary designation form directly designates the subtrusts as beneficiaries of specified shares of the IRA or qualified plan, it is likely that the life expectancy of the oldest of all your trust's beneficiaries will be the stretchout period for that particular IRA or qualified plan.

By the way, qualified plan assets, unlike IRA assets, don't automatically qualify for stretchout by a non-spouse beneficiary. Each plan document must be checked in this regard.

As indicated above, if your trust is a mere "conduit" for IRS required minimum post-death distributions, it will qualify retirement asset distributions for stretchout over the life expectancy of the trust's (or its subtrusts') primary beneficiary, regardless of the identity of any contingent beneficiaries or of any potential appointees under powers of appointment.

But maybe you don't want your trust to be a mere conduit. Maybe you'd like to give your trustee the power to decide whether to distribute or accumulate the required minimum distribution amounts, for example, when you have an incapacitated beneficiary. If your trust confers such a power, it will only qualify for the desired stretchout if there is no possibility under the trust of there ever being a contingent beneficiary or a beneficiary of a power of appointment; 1) with no life expectancy (a charity); or 2) who may be older than the primary beneficiary. But eliminating all these persons as possible beneficiaries might thwart your intentions, so it is not always a simple decision.

Significantly, the IRS ruled in PLR 200537044 that where powers are given under a trust to a fiduciary to "toggle" a trust between being a "mere conduit trust" or a "distribute or accumulate trust," and to delete or modify contingent beneficiaries

and/or powers of appointment as needed to assure such "toggling" won't prevent the intended stretchout, full stretchout of an IRA over the separate life expectancy of the primary trust beneficiary is available. The ruling (and the trust) also stated that these powers had to be exercised by September 30th of the year following the year of the IRA owner's death. This ruling provides additional planning flexibility, but its use in your estate plan requires careful drafting.

Due to the complex rules and strategies in this area, many advisors believe a standalone retirement distribution trust is far preferable to a living trust as beneficiary of retirement assets. The reasons for this include:

- It is easier for your trustee and advisors to comply with the stretchout rules.
- Your living trust is simpler and easier to understand.
- Your living trust can name older and/or charitable beneficiaries, use normal marriage and adoption provisions, contain broad limited and/or general powers of appointment, and have broad spendthrift, in terrorem, incentive/disincentive, and similar payout-curtailing clauses. Such provisions, prone to being a stretchout-defeating minefield, are more easily avoided in a trust dedicated to receiving retirement distributions.

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