

How to Draft IRA Trusts

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I. OVERVIEW OF IRA TRUSTS

A. What are the Advantages of an IRA Trust?

1. Stretching

The “stretching” of an Individual Retirement Account (“IRA”) refers to allowing it to grow tax-deferred over the beneficiary’s life expectancy, usually taking out only the minimum necessary. IRAs were not originally intended to be wealth transfer vehicles. In 2002, however, the IRS issued final regulations with respect to Internal Revenue Code (“IRC”) §401(a)(9), which creates and governs IRAs. These regulations dramatically changed the rules regarding the calculation of Required Minimum Distributions (“RMD”) from IRAs.

These regulations opened up new planning opportunities for IRAs and their owners. Most importantly, the regulations permit a non-spouse beneficiary to “stretch” the taxable RMDs over his or her actuarial lifetime. The ability to compound the IRA investments, tax-deferred, over a much greater period of time makes IRAs now one of the most valuable assets in wealth succession planning for younger generations. A \$200,000 IRA, inherited by a 50-year-old, could exceed \$1.5 million in value over his and his children’s lifetimes. With these types of results, obtaining the maximum income tax stretch is obviously a key planning objective.

The “stretching” of an IRA account over the beneficiary’s life expectancy is available without the use of an IRA Trust. However, naming individuals as beneficiaries can jeopardize obtaining the stretch due to fault of the plan administrator or the beneficiary.

Why would some plan administrators “destroy” the stretch? Stretching an IRA causes more work and expense for plan administrators. Plan administrators must:

- Track account balance increases and decreases.
- Calculate the RMD based on the life expectancy of the account holder.

- Mail each distribution to the account holder.
- Report the account balance to the account holder and to the IRS.
- Report distributions to the account holder and IRS.
- Mail information reports to the account holder and to the IRS.

Assume a plan administrator has one million IRA account holders and each account holder has five potential beneficiaries. For the stretch to be available, each account would have to be divided into five separate accounts. Obviously it is easier for the plan administrator to handle the tasks one million times as opposed to five million. The plan administrator's cost structure is greatly increased when it separates accounts into separate shares.

Why might beneficiaries “destroy” the stretch? Realistically, how many beneficiaries take only the RMD? Accounts left outright are “found money” for the beneficiary, and found money is often spent quickly with no thought of the potential tax-deferred growth available.

2. Creditor/Divorce/Bloodline Protection

Creditors. While inherited IRAs are protected in bankruptcy, in a non-bankruptcy context, there is no guarantee of creditor protection. Unlike qualified plans such as 401(k) accounts, IRAs are not covered by the Employee Retirement Security Act of 1974 (ERISA). Thus, any exemption from creditor's claims falls under state law. Depending on state law, IRAs inherited outright may be subject to the claims of creditors of the beneficiary. See *Robertson v. Deeb*, 16 So. 3d 936 (Fla. Dist. Ctr. App. 2 2009). Another related issue is that the IRA is considered an available resource to a beneficiary receiving Medicaid or SSI, so that the account would have to be spent down to preserve such governmental benefits. An IRA Trust removes any doubt that the account, and thus the beneficiary, will be protected.

Divorce. Inherited assets are generally considered separate property in divorce proceedings, but there is no guarantee of this result, particularly as property division laws become more liberal. In addition, the beneficiary could be pressured into agreeing to

transfer or divide the IRA in a settlement and subsequent Qualified Domestic Relations Order. Such results can be avoided by use of an IRA Trust.

Bloodline Protection. Once a beneficiary inherits an IRA, he or she can then designate a beneficiary to receive the account at his or her death. Often, this will be the beneficiary's spouse. This means that a parent's IRA could end belonging to the spouse of a deceased child, who might then remarry. The IRA could end up completely outside the family, with no benefit to grandchildren or other descendants of the original account owner. In an IRA Trust, the grantor can ensure that the account will pass to his descendants at his child's death.

3. Proper Management

A beneficiary may have poor money management skills, be a spendthrift, or be too young or incapacitated to manage money. Also, an otherwise fully competent beneficiary may at any time decide to take out more than the RMDs because he is not aware of the tax rules and the choices he has, gets poor advice, or just wants to spend the money (or perhaps his spouse or someone else influences him to spend it). Any of these situations will cause taxation of the IRA to occur much sooner and the loss of years of tax-free compounding, and will ruin the opportunity to stretch. Use of an IRA Trust and a knowledgeable trustee will avoid these costly errors.

B. When Does it Make Sense to Use an IRA Trust?

Stretching of an IRA is theoretically available when an individual is named as beneficiary. However, as discussed above, in many instances the stretch is not accomplished. An IRA Trust should be used when the client wishes to ensure the stretch and do any one or more of the following:

- Control distributions after death (stop the beneficiary from destroying the plan).
- Force separation of accounts (stop the plan administrator from destroying the plan).
- Compel long-term tax deferral.
- Establish a post-death contingency plan allowing for disclaimer planning.
- Provide asset protection for IRA assets.

- Limit payout to special needs beneficiaries to ensure ongoing government benefits.
- Ensure that the benefits stay in the family.
- Ensure estate and or generation-skipping tax savings for children or grandchildren.

From a cost effectiveness standpoint, it may not make sense to use an IRA Trust when the account is less than \$200,000 or so, particularly if there are several beneficiaries such that each separate account would be relatively small.

II. IRA MINIMUM DISTRIBUTION RULES

A. Individuals as Beneficiaries

In order to counsel clients about planning with IRAs and other retirement accounts, particularly with regard to IRA Trusts, it is necessary to have a good working knowledge of the IRS's Required Minimum Distribution (RMD) rules. The RMD rules under Treas. Regs. §1.401(a)(9)-1 through §1.401(a)(9)-9 apply to distributions from:

1. Qualified plans;
2. IRAs (including Roth IRAs);
3. Deferred compensation plans under IRC §457;
4. IRC §403(b) annuity contracts; and
5. Retirement income accounts

Life Expectancy tables published by the IRS determine the divisor used to calculate the RMD. A Uniform Lifetime Table based on the life expectancy of the participant (account owner) and that of someone 10 years younger is used for a participant's lifetime distributions. There is an exception if the participant's spouse is actually more than 10 years younger than the participant. A separate Single Life Table is used by a "qualified beneficiary" after the participant's death. Treas. Reg. §1.401(a)(9)-9 Q-1, A-1.

Qualified plans automatically receive the same pay-out treatment as IRAs unless the plan document contains "optional provisions that override such default provisions."

Treas. Reg. §1.401(a)(9)-1 Q-3, A-3(c). Beware of optional plan provisions that might not allow for a stretch. Consider advising your client to roll assets out of qualified plans into an IRA to avoid possible adverse optional plan provisions.

Required Beginning Date. RMDs must commence by the participant's Required Beginning Date ("RBD"). The RBD is April 1 of the year following the calendar year in which the participant reaches age 70½ or the calendar year in which the employee retires from employment (if later, and the participant owns less than five percent of employer/business). Treas. Reg. §1.401(a)(9)-2.

Participant Dies After the Required Beginning Date. When a participant dies after his or her required beginning date, the beneficiary may continue using the hypothetical remaining (or "ghost") life expectancy of the participant, or a "Designated Beneficiary" may also use his or her life expectancy per the IRS tables. Surviving spouses younger than 59½ who are in need of funds should use the participant's hypothetical life expectancy. Treas. Reg. §1.401(a)(9)-2; IRC. 401(a)(9)(B)(i).

Participant Dies Before the Required Beginning Date. The dreaded "5-year rule" of IRC §401(a)(9)(B)(ii) applies when a participant dies before his RBD without having named a Designated Beneficiary. This means that the account must be fully distributed and taxes paid within five years. Some optional provisions in qualified plans mandate a five year or shorter payout even if there is a named beneficiary, in which case one should consider a rollover to an IRA. Treas. Reg. §1.401(a)(9)-3.

If the participant has named a Designated Beneficiary, then the Designated Beneficiary uses his or her life expectancy (Single Life Table) for taking RMDs.

Naming a Designated Beneficiary. A Designated Beneficiary must be named under the terms of the plan or by an affirmative election by the employee. A Designated Beneficiary does not have to be specified by name but must be identifiable on the date of the participant's death (e.g., naming "my spouse"). A class of beneficiaries capable of expansion or contraction (e.g., "my children") qualify as Designated Beneficiaries, as do individual beneficiaries of a qualifying trust. Only an individual (including a trust

beneficiary) may qualify as a Designated Beneficiary, and the individual must be alive at the date of death of the participant. Treas. Reg. §1.401(a)(9)-4.

Estates, charities, individuals born after the death of the participant, non-qualifying trusts and any non-individual (other than a qualifying trust) DO NOT count as Designated Beneficiaries.

September 30th Determination Date. A Designated Beneficiary must be determined by September 30 of the calendar year following the year of the participant's death. Until this date non-qualified beneficiaries may be "removed" by fully distributing their shares (e.g., to a charity), and beneficiaries may execute disclaimers to pass benefits on to the contingent beneficiaries, who are normally younger and will get more benefit from the stretch. A "downstream" recipient is then treated as the Designated Beneficiary. If the beneficiary dies before the September 30 date without disclaiming, the beneficiary continues to be treated as a beneficiary in determining the Designated Beneficiary. Treas. Reg. § 1.401(a)(9)-4, Q&A 4(a) and 4(c).

Example One:

1. Mary names a trust as beneficiary of her IRA. 90% of the trust is payable to her children over their lifetimes. 10% of the trust is payable to Mary's favorite charity.
2. If the charity's 10% is paid out of the trust by September 30 of the year after the year of Mary's death, the charity's interest will not destroy the stretch for the rest of the trust. See PLR 200218039.

Example Two:

1. Jack names his wife as primary beneficiary of his IRA and his grandchild as contingent beneficiary.
2. If Jack's wife executes a qualified disclaimer by September 30 of the year following the year of Jack's death, RMDs can be calculated based on the grandchild's life expectancy.

Example Three:

1. Jack names his sister Sue as primary beneficiary of his IRA and his nephew as contingent beneficiary.
2. If Sue dies before September 30 of the year following the year of Jack's death without performing a qualified disclaimer, RMDs are still calculated based on Sue's life expectancy.

It is important to remember, however, that for a disclaimer to be qualified, and thus ignored from a gift tax standpoint, it must be signed within nine months of the date of death of the original account holder. This date is almost always earlier than the September 30 deadline.

Commencement of Required Minimum Distribution for Beneficiaries. A non-spouse beneficiary must begin taking RMDs on or before December 31 of the year after the participant's death. Unless the spouse rolls over the IRA, RMDs for the spouse must begin on or before the later of: December 31 of the year after death, or December 31 in the year the participant would have attained age 70½. Treas. Reg. §1.401(a)(9)-3.

Only a surviving spouse is eligible to rollover an IRA (or qualified plan) to his or her own IRA. Treas. Reg. §1.401(a)(9)-7, 1.402(c)-2, A-1. Once rolled over, the spouse uses the Uniform Table to determine the RMDs, which must commence by spouse's RBD. In certain circumstances, a rollover may be available to a spouse even if an estate or trust is the beneficiary, but only by Private Letter Ruling from the IRS.

True rollovers to one's own IRA are not available to non-spouse beneficiaries. Starting with the passage of the *Pension Protection Act of 2006*, a non-spouse beneficiary is able to do a trustee-to-trustee rollover of a qualified plan to his or her own inherited IRA (separate from any contributory IRA). Once the account is rolled over, the beneficiary uses the Single Life Table to determine the RMDs. RMDs from a rolled over IRA or qualified plan must commence by December 31 of year following the year of participant's death. Plans were not required to permit these non-spousal rollovers until after January 1, 2010, but now all plans must allow non-spousal rollovers.

The new IRA account must be titled in the participant's name (e.g., the 401(k) owner) for the benefit of the beneficiary (e.g. "John Jones, Deceased IRA f/b/o Jane Jones"). Do NOT re-title the IRA in the name of the beneficiary (unless it is a spousal rollover) because this accelerates taxation. This is treated as a taxable distribution of the entire account, subject to tax at ordinary income tax rates. A true "rollover" to someone other than a spouse is a taxable distribution.

B. **Trusts as Beneficiary**

If a trust named as beneficiary of an IRA does not qualify as a "Designated Beneficiary," then the IRA must be paid out according to the five year rule (if the participant died before her RBD) or based on the participant's "ghost" life expectancy (if the participant died after her RBD). That means no stretch, so it is important to make sure that the trust qualifies as a Designated Beneficiary. There are four requirements under the § 409(a)(9) regulations:

1. The trust must be valid under state law.
2. The trust must be irrevocable upon death of owner.
3. The beneficiaries of the trust must be identifiable from the trust instrument.
4. A copy of the trust must be provided to plan administrator on or before October 31st of the year after the year of the participant's death. Treas. Reg. § 1.401(a)(9)-4, Q&A 5(b)(1)-(4).

While the first requirement should be a non-issue for any practitioner, the remaining requirements can cause difficulties. For example, requirement number two presents a problem when using a joint living trust, since the survivor's trust portion is revocable.

Standard Issues with Revocable Living Trusts. Even if the four requirements are met, there are still a number of potential problems with using a regular living trust as beneficiary of an IRA. Certain provisions normally contained in living trusts can cause acceleration of taxation of an IRA or prevent the stretch from being available. Issues with revocable living trusts include:

1. Use of Pecuniary Clauses. Pecuniary formula clauses, often used for credit-shelter or marital trusts, result in recognition of income for items of Income in Respect of a Decedent (“IRD”) used to fund the trust. IRC §661.
2. Payment of Debts and Expenses Clauses. IRA funds should not be used for this purpose.
3. Tax Apportionment Clauses. Estate taxes may be apportioned to all assets, including the IRA. PLRs 9820021 and 9809059.
4. Powers of Appointment. These cause issues with identifying beneficiaries. PLRs 200235038-41.
5. Joint Trusts. The survivor’s trust portion remains revocable. The IRS views the survivor’s trust and any sub-trusts as one trust, so no separate share treatment is available. PLRs 200317041, 200317043 and 200317044.
6. No Separate Share Provisions.

IRA Trusts. IRA Trusts are specially designed to avoid all of the problems inherent in using revocable living trusts yet provide all of the benefits of using a trust to preserve the IRA for the beneficiaries. With an IRA trust, the beneficiaries of the trust are treated as Designated Beneficiaries of the IRA. Thus, an IRA trust actually allows each beneficiary to stretch his share over his life expectancy.

This result was approved by the IRS in a 2005 Private Letter Ruling obtained by attorney Phil Kavesh and CPA Bob Keebler, which confirms that if one names a properly drafted sub-trust as the Designated Beneficiary, the beneficiary of that sub-trust can take RMDs over his or her life expectancy. PLR 200537044 (attached as Exhibit C).

IRA Trusts also include a host of savings provisions, exercisable by a Trust Protector, that can preserve the stretch for an accumulation trust. These are discussed in the section on Trust Protectors.

III. DRAFTING AN IRA TRUST

A. Revocable vs. Irrevocable

Early on, most IRA Trusts were drafted as revocable trusts that became irrevocable at the grantor's death. This allowed for easy modifications to account for changes in the grantor's goals or family situation. However, in a 2007 ruling, the Kansas Appellate Court, interpreting the Kansas Uniform Trust Code, held that an IRA payable to a decedent's revocable living trust (as opposed to an individual) opened up the IRA to claims of the decedent's creditors. *Commerce Bank v. Bolander*, 2007 WL 1041760 (Kan. App. 2007) (unpublished). Most practitioners feel the decision was erroneous, but there is certainly the possibility that courts in other UTC states could reach the same conclusion.

Best practice now calls for IRA Trusts to be irrevocable upon execution to prevent the application of such a ruling. Since IRA Trusts are generally unfunded, other than perhaps a nominal amount of cash, changes can be made by simply executing an entirely new trust. At the very least, clients should be informed of the advantages and disadvantages of both techniques so that they can make an educated decision about which type of trust to use.

B. Conduit vs. Accumulation

A trust share designed to receive IRA distributions can be drafted as either a "conduit" trust or an "accumulation" trust. A conduit trust requires that all distributions from the IRA are immediately distributed to the trust beneficiary. No distributions from the IRA are held inside the trust. Conduit trusts allow for easier identification of beneficiaries, since remainder beneficiaries or potential appointees under a power of appointment need not be considered, providing a safe harbor for the ability to stretch.

An accumulation trust does not mandate the further distribution of all IRA distributions to the beneficiary, so that amounts paid to the trust are allowed to accumulate within the trust. The key issue in analyzing an accumulation trust from a Designated Beneficiary standpoint is to determine which beneficiaries are "countable." All potential beneficiaries are countable unless such beneficiary is deemed to be a "mere

potential successor” beneficiary. Treas. Reg. § 1.401(a)(9)-5, A-7(c). Thus, contingent beneficiaries, limited and general powers of appointment, and the failure of beneficiaries clause must all be taken in account. PLR 200228025. The beneficiary with the shortest life expectancy, or none at all (such as a charity) is used for purposes of calculating the RMDs.

Beneficiaries who are mere potential successors do not have to be considered in determining the beneficiary with the shortest life expectancy.

Example: Jack leaves his IRA to his trust, which is for the benefit of his wife, Jane, during her lifetime. Upon Jane’s death, the trust provides for payment outright to Jack’s children. If all of the children are deceased, a charitable organization becomes the beneficiary. When Jack dies, all of his children are living. Because no amounts will be accumulated in the trust at Jane’s death, the charity is a mere potential successor to the children’s interest in the IRA.

The second ruling in PLR 200537044 allowed a one-time switch from conduit trust status to accumulation trust status:

- Each separate share in the IRA trust had language structuring the separate share as a conduit trust.
- The trust provided for an independent third party, as “trust protector”, to transform each sub-trust to an accumulation trust in the trust protector’s sole discretion by voiding the conduit provisions *ab initio*.
- The trust protector had the authority to limit the initial trust beneficiary *ab initio*.
- After the participant’s date of death, the trust protector exercised the power to switch and converted one share to an accumulation trust.

The IRS ruled that each share was able to use the life expectancy of its initial beneficiary to measure the RMD for that share.

The third ruling of PLR 200537044 was that payment of expenses from the IRA were not considered an accumulation. The trust provided that, “Trust expenses may be deducted prior to any such payment to or for the benefit of the beneficiary of the trust

share if the deduction does not disqualify the status of the trust as a conduit trust. This paragraph may be rendered void, *ab initio*, by the Trust Protector. . .” As under the second ruling, the IRS held that each share was able use the life expectancy of its initial beneficiary to measure the RMD for that share. This was because, even with the deduction for payment of trust expenses, no amounts distributed to the trust during the beneficiary’s lifetime would be accumulated in the trust, and thus would not be kept in the trust for the benefit of any future beneficiaries. Treas. Reg. § 1.401(a)(9)-5 Q&A 7(c)(3), Example 2.

Accumulation trusts may be appropriate for the following beneficiaries, for example:

- Disabled child
- Child in a profession subject to high risk of liability
- Child with substance abuse or gambling problems
- Child in a troubled marriage
- Successful child who has no current need for funds

The four requirements of Treas. Reg. §1.401(a)(9)-4, Q&A 5 apply to both conduit and accumulation trusts.

C. Sub-Trusts (Separate Accounts)

The use of sub-trusts or separate accounts for each beneficiary is imperative to be able to obtain the maximum stretch available. If there are multiple beneficiaries of one account, then the life expectancy of the oldest beneficiary is used to determine the RMDs. This can cause adverse results if there is a large age difference between beneficiaries (e.g. a 45-year-old child and one-year-old grandchild). With separate accounts, each Designated Beneficiary can use his or her own life expectancy, allowing for the maximum stretch. Treas. Regs §1.401(a)(9)-4, §1.401(a)(9)-8, A-2 (amended 6/14/04).

If the beneficiary designation form names multiple beneficiaries at death, separate accounts must be created by December 31 of the year following the year of death of the participant. The value of the account is split effective as of December 31 of the year of death.

The first and most important ruling of PLR 200537044 was that each beneficiary's trust share qualified for the maximum stretch available. The facts presented were:

- Upon the death of the grantor, the IRA trust created separate shares for each beneficiary (in this case, nine beneficiaries), each trust share was “treated effective *ab initio* to the date of the Decedent's death,” and each share functioned as a “separate and distinct trust” for the beneficiary.
- The beneficiary designation form named each separate share as a primary beneficiary of the IRA.
- Before the December 31 deadline, the IRA was divided into separate accounts for each share.

The IRS held that separate account treatment was permitted; the IRA RMD for each separate trust share was measured by the life of its sole beneficiary for whom the share was created.

Planning for a Surviving Spouse. Another issue relating to the use of separate trusts within an IRA trust is how to deal with the need to shelter some or all of the IRA for estate tax purposes.

With a federal estate tax exemption of \$5 million and spousal portability, this is currently an issue only for couples with taxable estates in excess of \$10 million. With an estate of that size, the surviving spouse may not have a need for support from the IRA, and it could be left in trust directly to children or grandchildren. For couples with lesser estates, the surviving spouse can simply roll the IRA over and then create his or her own IRA Trust.

However, the estate tax exemption is scheduled to drop to \$1 million on January 1, 2013, with an increased estate tax rate of 55%. Even if this does not come to pass, as is the majority view, we could still end up with an exemption of substantially less than \$5 million.

To preserve the ability to get the stretch for the younger generation beneficiaries and yet allow for estate tax savings if desirable, an IRA trust can be drafted to include a

credit-shelter trust. To the extent it is funded, the credit-shelter trust would allow for stretching over the surviving spouse's lifetime, but no additional stretch would be available after his or her death for the younger remainder beneficiaries. The mechanism for controlling how much, if any, of the IRA is paid to the IRA trust is the beneficiary designation form, discussed below.

D. Trust Protector Powers

The use of a trust protector in an IRA Trust adds much flexibility and protection against issues that may destroy the stretch. Besides the "standard" trust protector powers such as removal and replacement of a trustee and change of trust situs, trust protectors in IRA trusts can be given authority to ensure maximum benefit to beneficiaries of accumulation trust shares.

The first such power is the "toggle switch" described in the discussion of accumulation trusts above. After the grantor's death, the trust protector can use this power to convert a trust share from a conduit to an accumulation trust, as is appropriate given the circumstances of the beneficiary and his or her need for protection. The trust protector, armed with this toggle switch, can also determine, for any beneficiary who will have an accumulation trust, which contingent beneficiaries should be kept in or removed in a way that best balances the primary beneficiary's desire for stretch and fulfills the grantor's dispositive intent when that primary beneficiary passes away.

Trust protectors must be independent, so the grantor, beneficiaries and family members are ineligible. The best person to fill the role of trust protector is an attorney with extensive knowledge of trust and tax law. Some drafting attorneys will serve as trust protectors for their own trusts, but others are reluctant to do so due to liability concerns. Query whether the role of trust protector is inherently a fiduciary one, even if the trust states otherwise.

While banks and trust companies may be unwilling to serve as trust protector in most cases, there are some specialized entities that will serve as trust protector for an annual fee. One such company, established by the author, is TrustProtector, LLC (www.trustprotectorllc.com).

E. Beneficiary Designation Language

The most well-constructed IRA trust can fail if the beneficiary designation form is not drafted properly. If the “master” trust itself is named, RMDs must be paid out according to oldest beneficiary’s life expectancy, regardless of the separate share or sub-trust language in the trust. Each separate trust share must be named in the beneficiary designation form for separate share treatment to be effective. This is often difficult or impossible to do in an IRA custodian’s standard beneficiary designation forms, so custom drafting is recommended.

When the grantor of an IRA trust is married and has a taxable estate, he may wish to be able to provide for the possibility for some or all of the IRA to be held in a credit-shelter trust for the benefit of his spouse if doing so will save estate taxes at the spouse’s death. Since this is not ideal for accomplishing the goal of stretching over the younger beneficiaries’ lifetimes, flexibility can be preserved by careful drafting of the beneficiary designation form.

For a married grantor concerned about estate taxes, the beneficiary designation normally provides as follows:

Primary Beneficiary: Spouse, if he or she survives.

Secondary Beneficiary: (a) If spouse survives but disclaims all or any portion of the IRA, the IRA Trust (credit-shelter trust); and (b) if the spouse is deceased, to the separate shares of the IRA Trust for the grantor’s descendants, *per stirpes*.

The sample beneficiary form language provided follows this format. In addition to following the rules for qualified disclaimers, a disclaimer for less than the entire IRA must be expressed as a fraction (as opposed to pecuniary) to avoid triggering income tax upon funding.

Note: Certain firms, such as Vanguard, simply refuse to accept custom beneficiary designation language. One must then either move the IRA to another custodian or accept that there will be much less planning flexibility and the possible loss of separate share treatment.

IV. TAX ISSUES

A. Income tax

While the grantor of an IRA trust is alive, income tax compliance is generally not an issue as no income is generated in the trust. Once the grantor dies and distributions are made, the trust is taxed as any other non-grantor trust, and a fiduciary income tax return, Form 1041, must be filed each year.

Each distribution from an IRA, unless it is a Roth, must be reported as income to the trust. If the distribution is not paid out to the beneficiary during the same taxable year, it is subject to tax in the trust. If the distribution is paid out, such as is required with a conduit trust, it would be deducted by the trust and taxable to the beneficiary. Trust tax rates are much more steeply graduated than individual rates, reaching the top 35% rate at \$11,350 of income (2011). This necessitates careful planning by the trustee to avoid triggering more tax than necessary.

As each share is essentially a separate trust, a separate 1041 must be filed for each one. This is one of the costs that must be considered when planning for a relatively small IRA of which there will be many beneficiaries.

B. Estate Tax

An IRA trust can be drafted to include a credit-shelter trust to allow for estate tax planning at the grantor's level as discussed under the Sub-Trust heading. In addition, a child as primary beneficiary of a trust share who does not need the income can execute a qualified disclaimer so that her share passes to her children. This not only causes the IRA share to escape estate taxation at the child's death, but provides for a more powerful stretch over her children's lifetimes.

Estate tax savings at a beneficiary's death can also be purposefully drafted into the trust. In the fourth ruling of PLR 200537044, the IRS stated that the trust assets of the primary beneficiary's separate share would not be included in that beneficiary's taxable estate upon that beneficiary's death. The trust submitted for ruling provided that:

- Each trust share would accumulate the net income of the trust, and the trustee had discretion to distribute accumulated income and principal to the primary beneficiary only for his or her health, education, maintenance and support.
- No beneficiary had a general power of appointment over his or her share.

Thus, the IRA trust was essentially a generation-skipping trust, although no additional stretch was allowable for the remaining account balances at the children's deaths.

C. Generation-Skipping Transfer Tax

As we see from PLR 200537044, an IRA trust, just like a standard revocable living trust, can be drafted as a generation-skipping trust, avoiding estate and GST taxes for all beneficiaries. If there is a possibility that the value of the IRA could exceed the GST exemption, a fractional GST funding formula and exempt and non-exempt trust provisions should be included in the IRA trust. After the grantor's death, of course, care must also be taken to properly allocate the GST exemption on Form 706.

V. SAMPLE FORMS

A. IRA Trust (Selected Provisions) (Exhibit A)

B. Beneficiary Designation Form (Selected Provisions) (Exhibit B)

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