

**IRA DISTRIBUTIONS AND ROLLOVERS –
Integrating Estate Planning and Income Tax Planning**
*Focusing on: Retirement Assets To A Surviving Spouse
(Rollovers & Portability Are Your First Choice)*

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IRA DISTRIBUTIONS AND ROLLOVERS

- **Integrating Estate Planning and Income Tax Planning**
- **Focusing on: *Retirement Assets To A Surviving Spouse***

I. Introduction

In 2010, Congress introduced the law of portability for estates of married decedents to the federal estate tax paradigm. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296. Under this temporary law (which exists only in 2011 and 2012, unless extended), the estate of a surviving spouse can use part or all of the first deceased spouse's unused exemption amount ("deceased spousal unused exclusion amount" or DSUEA) to reduce the estate tax liability of the surviving spouse's estate.

Many estate planners, however, discourage married couples from planning to rely on the new portability law. First, the law is scheduled to expire at the end of 2012 and must be extended or renewed in order to be viable in future years. But of greater importance for this article, most estate planners feel that the tried and true credit shelter trust (a/k/a "bypass trust") continues to offer more benefits than portability offers, including greater potential estate tax savings and greater asset protection

Whereas a credit shelter trust may indeed be superior for traditional assets such as stock and real estate, there is one type of asset where portability will usually be the first choice that estate planners will turn to. That asset is a retirement plan account. Portability solves the serious income tax problem that exists when a trust for the surviving spouse is named as the beneficiary of a retirement account. Usually the required annual distributions from a decedent's retirement account to a trust will be larger than the distributions that are required to be made to the surviving spouse from a retirement account that was rolled over by the a surviving spouse.

By way of background, usually the best *income tax* outcome will occur if the surviving spouse is named as the beneficiary of a retirement account. In most cases the best results will occur if the surviving spouse rolls over the decedent's retirement assets into a new retirement account (typically an IRA) in the widow's or widower's own name. In the past, the positive income tax outcome of a rollover was offset by a negative *estate tax* outcome: the rolled over account could inflate the surviving spouse's estate, so that it may have been wiser to have kept these assets out of the surviving spouse's estate by using a credit shelter trust or an outright transfer of the assets to the children rather than to the surviving spouse. Portability solves this problem for many married couples. It offers the income tax advantage of a rollover by the surviving spouse with the estate tax advantage that upon the death of the surviving spouse, the estate can use the first deceased spouse's unused exemption amount to reduce or eliminate an estate tax liability.

For older surviving spouses, even a rollover may still require large annual distributions. The minimum annual required distribution from a rolled-over IRA ranges between 7% and 12% of assets for a surviving spouse between ages 86 and 96, which is well above what one could expect to earn each year on investments.

There is a solution that can preserve a larger portion of taxable retirement assets in a tax-sheltered environment for both an older widow/widower and younger beneficiaries, such as children. It is a two-generation charitable remainder trust (CRT). The retirement account owner can provide that such a CRT will be the beneficiary of some or all of the retirement assets. Upon the death of the retirement account owner there is a tax free distribution from the retirement account to the CRT. The distribution is tax-free because the income of a CRT is exempt from the income tax. Sec. 664(c). Typically such a trust annually distributes 5% of its assets to a surviving spouse, then 5% of assets to children, and then upon the death of the last child the trust terminates and distributes its assets to a charity. The arrangement works best when a surviving spouse has a short remaining life expectancy (e.g., is over age 75) and when all of the individuals in the next generation (typically children) are over age 40. It is particularly well suited to deal with retirement assets when parties are in a second marriage and have children from a prior marriage. Usually they cannot fully trust each other to name the children from the deceased spouse's prior marriage as beneficiaries of a rolled over IRA.

Finally, there are many other situations where a rollover could be a problem. The estate tax advantage of portability could be lost if there are multiple remarriages. Same-sex couples who live in states that recognize their marriages will find that they may not qualify for federal tax benefits available to a surviving spouse, such as portability or an IRA rollover. In these situations and others, estate planners will look to alternative tax-favored arrangements in lieu of a rollover to a surviving spouse for some or all of the retirement assets.

II. Rollovers Usually Produce Best Income Tax Outcome

A. Income Tax Objective: Defer Income Taxes As Long As Possible

The usual income tax objective with respect to retirement accounts is to defer and to reduce the amount of distributions as much as possible in order to generate investment income on the deferred income taxes. For example, if there is \$100,000 in a *traditional IRA*, then if the entire account is liquidated in a single year there could be a combined federal and state income tax liability of \$40,000 from the taxable distribution, leaving the individual with just \$60,000 to invest after taxes. Had the distribution not been made, the \$40,000 would remain in the IRA and would generate investment income for the IRA owner.

If, instead, the IRA Owner had a \$100,000 *Roth IRA*, then a complete distribution would not trigger any income tax liability because distributions from Roth accounts are generally tax-exempt. Still, there is a significant cost to liquidating a Roth account. Once the \$100,000 leaves the Roth account, the investment income earned on the \$100,000 is generally taxable whereas it

would have been tax-exempt had it been earned in the Roth account. Thus, with either a traditional IRA or a Roth IRA, the income tax objective is to keep the balance at \$100,000 inside the IRA and to avoid an early distribution.

Congress, however, enacted legislation that requires distributions to be made from qualified retirement plans under two circumstances. The first is intended to force distributions to be made when the employee is retired. Rather than determine whether an employee has retired or not, the laws provide that an IRA or other qualified retirement account must generally commence making distributions after an individual has attained age 70 ½. Sec. 401(a)(9) .

Such distributions must be made from an IRA even if the IRA Owner is a full time employee who is still working after age 71. Sec. 408(a)(6); Reg. Sec. 1.408-8 Q&A 3. However, employees who continue to work after age 70 ½ are usually able to delay the first such distribution from an employer plan (e.g., a 401(k) plan) but not from an IRA. Sec. 401(a)(9)(E); Reg. Sec. 1.401(a)(9)-2, Q&A 2. Individuals who own more than 5% of a business are not eligible for this later RBD: their RBD is April 1 following the calendar year that they attain age 70 ½ even if they work full time. *Id.*

Roth IRAs are exempt from mandatory lifetime distributions. Sec. 408A(c)(5). Individuals who have a Roth 401(k) or Roth 403(b) account do not have this advantage, but they can easily obtain it by making a tax-free rollover of the account to a Roth IRA. Reg. Secs. 1.402A-1, Q&A-1 and 1.408A-10.

The required annual lifetime minimum distributions are listed on the next page in Exhibit “A”.

EXHIBIT A
REQUIRED LIFETIME DISTRIBUTIONS AFTER AGE 70 ½

GENERAL RULES – Unless you are married to someone who is more than ten years younger than you, there is one -- and only one -- table of numbers that tells you the portion of your IRA, 403(b) plan or qualified retirement plan that must be distributed to you each year after you attain the age of 70 ½. The only exception to this table is if (1) you are married to a person who is more than ten years younger than you and (2) she or he is the only beneficiary on the account. In that case the required amounts are even less than the amounts shown in the table. To be exact, the required amounts are based on the actual joint life expectancy of you and your younger spouse.

TWO SIMPLE STEPS: **Step 1:** Find out the value of your investments in your retirement plan account on the last day of the preceding year. For example, on New Years Day -- look at the closing stock prices for December 31. **Step 2:** Multiply the value of your investments by the percentage in the table that is next to the age that you will be at the end of this year. This is the minimum amount that you must receive this year to avoid a 50% penalty.

Example: Ann T. Emm had \$100,000 in her only IRA at the beginning of the year. She will be age 80 at the end of this year. She must receive at least \$5,350 during the year to avoid a 50% penalty (5.35% times \$100,000).

--UNIFORM LIFETIME DISTRIBUTION TABLE --

<i>Age</i>	<i>Payout</i>						
70	3.65%	80	5.35%	90	8.78%	100	15.88%
71	3.78%	81	5.59%	91	9.26%	101	16.95%
72	3.91%	82	5.85%	92	9.81%	102	18.19%
73	4.05%	83	6.14%	93	10.42%	103	19.24%
74	4.21%	84	6.46%	94	10.99%	104	20.41%
75	4.37%	85	6.76%	95	11.63%	105	22.23%
76	4.55%	86	7.10%	96	12.35%	106	23.81%
77	4.72%	87	7.47%	97	13.16%	107	25.65%
78	4.93%	88	7.88%	98	14.09%	108	27.03%
79	5.13%	89	8.33%	99	14.93%	109	29.42%

[Computed from Table A-2 of Reg. Sec. 1.401(a)(9)-9 (2002) -- (rounded up)]

EXHIBIT B
MAXIMUM YEARS FOR DISTRIBUTIONS AFTER ACCOUNT OWNER’S DEATH

This table contains the maximum number of years that distributions may be made from an IRA or some other type of qualified retirement plan after the account owner’s death. The maximum term of years is the remaining life expectancy of either:

- (#1) the account owner, measured by his or her birthday in the year of death (or just 5 years if the account owner dies before the required beginning date (RBD)), or
- (#2) the life expectancy of a designated beneficiary, based on that beneficiary’s age at the end of the year that follows the account owner’s death.

Whether the term will be #1 or #2 is determined by the identity of the beneficiaries who have not been paid in full by the “determination date” (September 30 following the year of death). The term will be based on the account owner’s age (i.e., #1) if on the determination date there is any beneficiary who fails to qualify as a “designated beneficiary” (e.g., a charity or the account owner’s estate). If, instead, all of the beneficiaries are designated beneficiaries, then the payout is usually determined by the age of the oldest designated beneficiary (i.e., #2).

Table A-1 of Reg. Sec. 1.401(a)(9)-9 (“single life ”), required by Reg. Sec. 1.401(a)(9)-5, Q&A 5(a) & 5(c) and Q&A 6.

Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy	Age	Life Expectancy
0	82.4	20	63.0	40	43.6	60	25.2	80	10.2
1	81.6	21	62.1	41	42.7	61	24.4	81	9.7
2	80.6	22	61.1	42	41.7	62	23.5	82	9.1
3	79.7	23	60.1	43	40.7	63	22.7	83	8.6
4	78.7	24	59.1	44	39.8	64	21.8	84	8.1
5	77.7	25	58.2	45	38.8	65	21.0	85	7.6
6	76.7	26	57.2	46	37.9	66	20.2	86	7.1
7	75.8	27	56.2	47	37.0	67	19.4	87	6.7
8	74.8	28	55.3	48	36.0	68	18.6	88	6.3
9	73.8	29	54.3	49	35.1	69	17.8	89	5.9
10	72.8	30	53.3	50	34.2	70	17.0	90	5.5
11	71.8	31	52.4	51	33.3	71	16.3	91	5.2
12	70.8	32	51.4	52	32.3	72	15.5	92	4.9
13	69.9	33	50.4	53	31.4	73	14.8	93	4.6
14	68.9	34	49.4	54	30.5	74	14.1	94	4.3
15	67.9	35	48.5	55	29.6	75	13.4	95	4.1
16	66.9	36	47.5	56	28.7	76	12.7	96	3.8
17	66.0	37	46.5	57	27.9	77	12.1	97	3.6
18	65.0	38	45.6	58	27.0	78	11.4	98	3.4
19	64.0	39	44.6	59	26.1	79	10.8	99	3.1

B. Inherited Accounts

1. General rules

The second time that distributions are required is after death. A qualified retirement account must be liquidated. There are situations when an account may have to be liquidated in as little as five years. If the individual died before the required beginning date, and if any beneficiary of the account on the determination date was not a “designated beneficiary”, then the entire account must be distributed by the end of the calendar year which contains the fifth anniversary of the date of the employee's death. Section 401(a)(9)(B)(ii); Reg. Sec. 1.401(a)(9)-3, Q&A 1(a) and 2.

However, most tax planners arrange for the account to be liquidated over the remaining life expectancy of a beneficiary of the account. Often called a “stretch IRA.” The unisex life expectancy table is contained in Exhibit “B”. A beneficiary who is under age 65 will usually be able to withdraw amounts from the inherited account (and thereby keep the tax deferral opportunities of the retirement account available) until he or she attains age 83, 84 or 85.

Such a “stretch” liquidation period over the individual’s remaining life expectancy is possible if, as of September 30 in the year after death (the “determination date”), the only remaining beneficiaries of a retirement account are “designated beneficiaries” (a technical term for human beings). Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)-(c) and Q&A 6

2. Payments to a trust – accumulation – conduit - CRT

A trust is not a human being and generally does not qualify for stretch distributions measured by someone’s lifetime. Reg. Sec. 1.401(a)(9)-4, Q&A 5(a). However the tax regulations provide that a trust that is named as the beneficiary of a retirement plan account can be ignored if certain conditions are met (a “*look-through trust*”). Reg. Sec. 1.409(a)(9)-4, Q&A 5 and 6. The required distributions are then computed based on the ages of the beneficiaries of the trust. If a retirement plan’s distributions to a look-through trust can be retained by the trust (an “*accumulation trust*”), then generally the required distributions are determined by using the life expectancy of the oldest designated beneficiary of the trust (i.e., they must be made over the shortest remaining life expectancy).

If, however, the look-through trust must distribute all retirement plan distributions to a beneficiary so that there is no accumulation in the trust (a “*conduit trust*”), then generally distributions are computed by looking solely to the life expectancy of the individual who will receive the distributions. With a conduit trust for a surviving spouse, the required distributions can be annually recomputed to take into account the surviving spouse’s gradually extending life expectancy as she or he gets older. Thus the retirement assets will not have to be fully depleted at age 85, 90, or whenever. No other beneficiary has this advantage. The downside of this arrangement is that there will be very large mandatory distributions from the retirement account in

the surviving spouse's late 80's and 90's (e.g., between 14% and 25% of the retirement account's assets each year between ages 85 and 95), so that the retirement account will likely be almost depleted in a long-lived surviving spouse's final years.

Another option that should be considered, especially for an elderly spouse, is a lump-sum distribution of all or a portion of a taxable retirement account to a *charitable remainder trust* (CRT) that first benefits the surviving spouse, then other beneficiaries (such as children), and then a charity. The principal income tax advantage is that a CRT is a tax-exempt trust, so there will be no income tax liability when it receives the income from the retirement plan account. Private Letter Rulings 199901023 (Oct. 8, 1998), 9634019 (May 24, 1996), 9253038 (Oct. 5, 1992) and 9237020 (June 12, 1992).

As is demonstrated in Exhibits C and G, the economic effect of such a transfer to a CRT is like a rollover of taxable retirement assets from the retirement account to a two-generation tax exempt trust. This can be particularly helpful when the surviving spouse is elderly (over age 75) and has a short remaining life expectancy. It can also be helpful when there is a *second marriage* and the parties would like assurance that at least some of the taxable retirement assets will support both the second spouse and children from a first marriage for the rest of their lives.

In order for this arrangement to work, the youngest beneficiaries of the trust (e.g., the children) should generally be over age 40. This is necessary to get the required minimum 10% charitable deduction for a contribution to a CRT. Sec. 664. When a beneficiary is too young, the present value of the remainder interest that the charity will receive will be below 10%. Furthermore, the CRT is most useful for a traditional retirement account where it can defer income taxation of taxable assets. It offers little benefit for receiving tax-exempt assets from a Roth IRA.

3. Special Advantages for a Surviving Spouse

a. Rollover to surviving spouse's new IRA possible. A surviving spouse is accorded certain tax advantages that are not available to any other beneficiary. The most important advantage is the ability to rollover the assets in the deceased spouse's account to a new qualified retirement plan account (typically an IRA) where the surviving spouse is deemed the new account owner. Sec. 402(c)(9) for inherited QRP accounts and Sec. 408(d)(3)(C)(ii)(II) for inherited IRAs, which is an exemption from the general prohibition contained in Sec. 408(d)(3)(c).

b. Three tax advantages if leave in decedent's account. If a rollover is not done and the assets are left in the deceased spouse's account, and if the surviving spouse is the *sole* beneficiary of the account, then there are three special tax advantages available to the surviving spouse:

1. When determining the minimum required distribution from the decedent's account each year, the surviving spouse can recalculate her/his life expectancy each year, thereby insuring that there will indeed be assets in the retirement account for the rest of her/his life. Compare Reg. Sec. 1.401(a)(9)-5, Q&A (c)(1) (a nonspouse beneficiary) with Q&A (c)(2) (spouse is sole beneficiary). Such recalculation is also permitted when amounts are distributed to a *conduit trust* for the benefit of the surviving spouse.

Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 2. Such recalculation is not permitted when payments are made to an accumulation trust. The other beneficiaries of an accumulation trust prevent the surviving spouse from being considered the sole beneficiary.

2. If a married decedent died before age 70 ½, there are no required distributions from the inherited account to the surviving spouse until the year the deceased spouse would have attained age 70 ½. Sec. 401(a)(9)(B)(iv).

3. For IRAs only, the surviving spouse can elect to treat the deceased spouse's IRA as her/his own. This has the effect of a rollover to a new IRA for the surviving spouse without having to physically transfer the assets to a new IRA. Reg. Sec. 1.408-8 Q&A 5.

C. Greater income tax deferral when surviving spouse does a rollover

If a married individual would like his or her retirement assets to benefit both the surviving spouse as well as others (e.g., typically children), then maximum income tax advantages will usually be achieved if the surviving spouse does a rollover. Such a rollover will usually allow beneficiaries to retain the tax advantages that are offered by a traditional retirement account or a Roth account for many more years compared to leaving the assets in the deceased spouse's account and making distributions to the surviving spouse or to a trust for a surviving spouse. This principle holds true regardless of the age of the surviving spouse.

The reason is that the assets in a deceased spouse's retirement account that are payable to a trust for the spouse will generally have to be depleted by the end of the surviving spouse's life expectancy (i.e., at age 83, 85, or whatever). By comparison, when there is a rollover to a new IRA, the surviving spouse is only required to receive relatively modest annual distributions over her or his remaining lifetime. This permits larger amounts of cash to remain in the retirement account to pay for living expenses at any age. There might also be a large remaining balance upon the death of a surviving spouse, which could then permit the surviving spouse's IRA to provide income over the life expectancies of much younger children or grandchildren.

The income tax challenge is greatest for elderly couples, since the surviving spouse's remaining life expectancy will be relatively short. Estate planners frequently run into this challenge. Over half of all federal estate tax returns were filed for individuals who died after age 80: 53% for men and 66% for women. Over 19% of all returns were filed for individuals who died after age 90. Although many decedents will have a surviving spouse who is considerably younger, the majority of married couples – particularly those who are in their first and only marriage – are usually very close in age.

These principles are illustrated in Exhibits C, D, E, F and G on the following pages.

EXHIBIT C
SUMMARY OF DISTRIBUTION OPTIONS FOR A SURVIVING SPOUSE

How many years can a deceased spouse's retirement account have the income tax advantages of a tax-sheltered account, whether in a tax-exempt retirement account or in a tax-exempt charitable remainder trust ("CRT")? The greatest income tax benefits are usually achieved with the greatest number of years. There are basically four distribution options when planning distributions to a surviving spouse. The choice of each option will affect the number of years that assets can remain in a tax-sheltered environment.

	<u>Number of Years in Income Tax-Sheltered Environment</u>
Rollover	= Actual life of surviving spouse, plus life expectancy of beneficiary
Accumulation CST	= Remaining life expectancy of surviving spouse
Conduit CST	= Actual life of surviving spouse, plus a few more years
CRT	= Actual life of surviving spouse, plus actual lives of all other beneficiaries

ROLLOVER: If the surviving spouse is the beneficiary, he or she can do a rollover to her or his own IRA. Only a surviving spouse can do such a rollover. The best that other beneficiaries can do is a transfer the assets to a new IRA administrator, where distributions will still be required to be made over that beneficiary's remaining life expectancy.

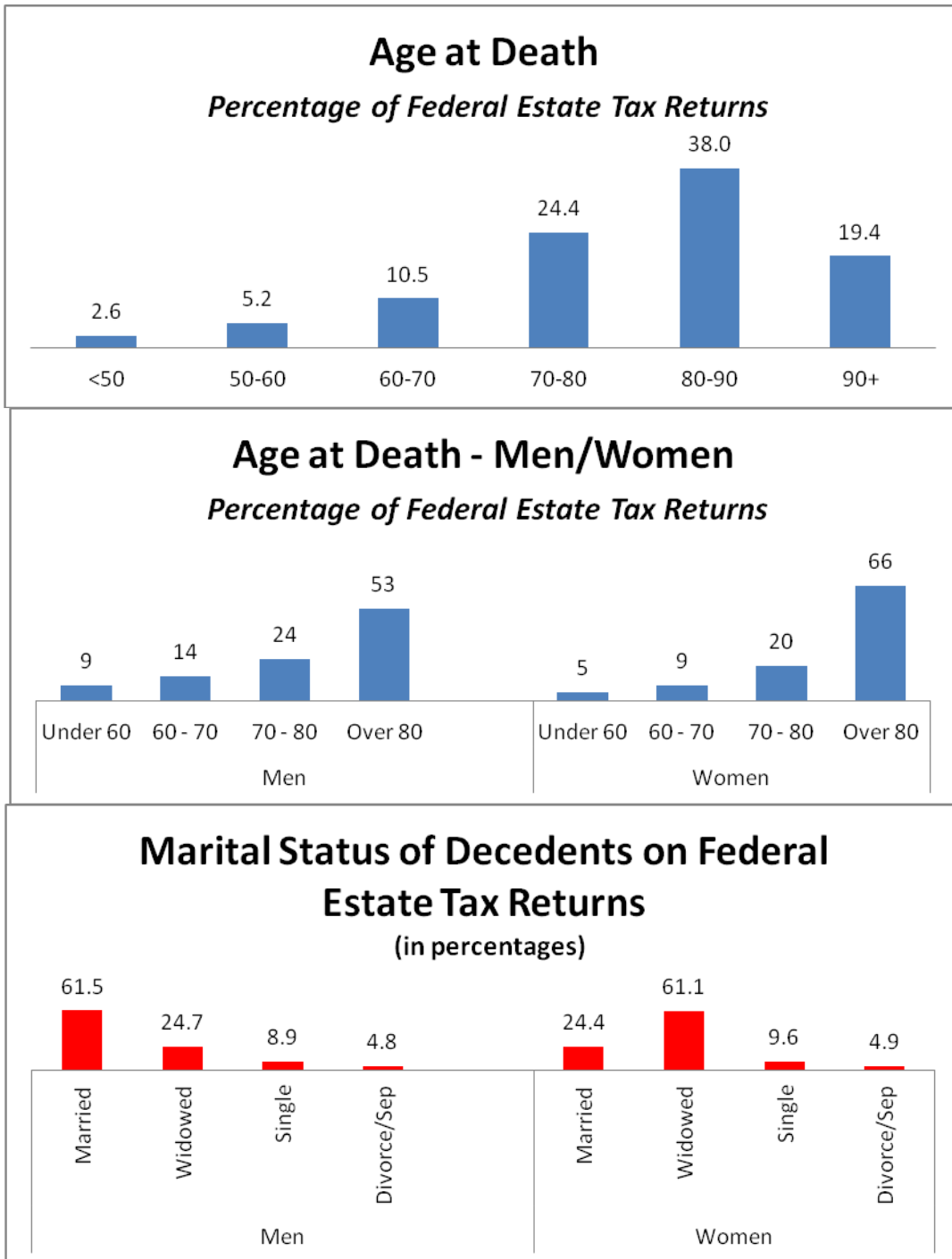
TRUST AS BENEFICIARY: Other options include naming as the beneficiary of the retirement account either (1) an accumulation credit shelter trust (CST), (2) a conduit CST, or (3) a charitable remainder trust for the joint lives of the surviving spouse and other named beneficiaries (typically children), with the remainder to a charity.

If a QTIP trust is named as the beneficiary, then the required distributions will be the same as those that are required to be made to a CST. That is, the required payments will depend on whether the QTIP trust is an accumulation trust or a conduit trust. If the surviving spouse is the *sole* beneficiary of the account and that spouse does not do a rollover, then required distributions from the deceased spouse's account to the surviving spouse are the same as the "conduit trust CST" rules, above.

AGE OF SURVIVING SPOUSE: Exhibit D illustrates that the majority of estate tax returns (for both male and female decedents) are filed for decedents who died after age 80. If the surviving spouse is reasonably close in age to the decedent, then most will become widowed after age 70.

Exhibits E, F and G : Exhibits E, F and G contain the minimum required distributions under various scenarios to a 70-year old surviving spouse (Exhibit E), a 60-year old surviving spouse (Exhibit F) and an 80-year old surviving spouse (Exhibit G). In the case of a CRT named as a beneficiary of a retirement account (see Exhibit G), the deceased spouse's retirement account would be liquidated shortly after death in a tax-free transfer to the tax-exempt CRT. The CRT would then pay 5% of its assets annually to the surviving spouse for life, then 5% to a child for life, and then would liquidate to a charity upon the child's death.

EXHIBIT D



Sources: 1st and 3rd graph: Martha Britton Eller, *Which Estates Are Affected by the Federal Estate Tax? An Examination of the Filing Population*, IRS STATISTICS OF INCOME BULLETIN (Summer 2005) 1, at Figure D on p. 4. Middle Graph Computed from data from IRS Statistics of Income for 2007 decedents, available at: <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=210768,00.html>.

EXHIBIT E

SURVIVING SPOUSE DISTRIBUTION OPTIONS – AT AGE 70

Example: At age 70, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (both of whom had died in the preceding year). Although the life expectancy of a 70 year old is 17 years (i.e., to age 87), Ms. Widow in fact lived to age 92. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 87, amounts could still be in the other IRAs at that age. The minimum amounts required to be distributed from each of five IRAs are listed in the table.

- A - *Her own IRA***, established with contributions she made during her working career.
- *B - *A rollover IRA***, funded after her husband's death with a distribution from his 401(k) plan.
- C - *A stretch IRA -- Her sister's IRA***, where Ms. Widow was named as the beneficiary. Payments from this IRA must be made over a term of years that cannot exceed Ms. Widow's remaining life expectancy in the year that follows her sister's death (i.e., 17 years). A rollover is not possible. Only a surviving spouse can rollover distributions from a deceased person's retirement account.
- D - *Bypass Trust #1 - Her deceased husband's IRA is payable to a standard credit shelter trust***, where the trust distributes net income to her for life and then to a child. This is treated as a stretch IRA payable to a ***look-through accumulation trust*** where the required distributions are based on the age of the oldest beneficiary of the trust. The same distribution rules apply to a QTIP trust.
- *E - *Bypass Trust #2 - Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow***. This provision permits a look-through trust to be treated as a ***conduit trust***. When a surviving spouse is the beneficiary of a conduit trust, she is treated as the "sole" beneficiary of the IRA which permits her life expectancy to be "recalculated" each year rather than be frozen for a fixed term of years. The same rules would apply to a QTIP trust.

<u>AGE</u>	<u>IRAs A & B</u>	<u>IRAs C & D</u>	<u>IRA E</u>	<u>AGE</u>	<u>IRAs A & B</u>	<u>IRAs C & D</u>	<u>IRA E</u>
70	3.65%	5.88%	5.88%	81	5.59%	16.67%	10.31%
71	3.78%	6.25%	6.13%	82	5.85%	20.00%	10.99%
72	3.91%	6.67%	6.45%	83	6.14%	25.00%	11.63%
73	4.05%	7.14%	6.76%	84	6.46%	33.33%	12.35%
74	4.21%	7.69%	7.09%	85	6.76%	50.00%	13.16%
75	4.37%	8.33%	7.46%	86	7.10%	100.00%	14.08%
76	4.55%	9.09%	7.87%	87	7.47%	empty	14.93%
77	4.72%	10.00%	8.26%	88	7.88%		15.87%
78	4.93%	11.11%	8.77%	89	8.33%		16.95%
79	5.13%	12.50%	9.26%	90	8.78%		18.18%
80	5.35%	14.29%	9.80%	91	9.26%		19.23%
				92	9.81%		20.41%

**Payouts "B" and "E" are only available to a surviving spouse. Other payouts are available to anyone. [citations to legal authority for these distributions appear after Exhibit G]*

EXHIBIT F
SURVIVING SPOUSE DISTRIBUTION OPTIONS – AT AGE 60

Example: At age 60, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (both of whom had died in the preceding year). Although the life expectancy of a 60 year old is 25 years (i.e., to age 85), Ms. Widow in fact lived to age 92. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 85, amounts could still be in the other IRAs at that age. The minimum amounts required to be distributed from each of five IRAs are listed in the table.

- A -** *Her own IRA*, established with contributions she made during her working career.
- *B -** *A rollover IRA*, funded after her husband's death with a distribution from his 401(k) plan.
- C -** *A stretch IRA -- Her sister's IRA*
- D -** *Bypass Trust #1 - Her deceased husband's IRA is payable to a standard credit shelter trust, a look-through accumulation trust (required distributions are based the age of the oldest beneficiary of the trust. The same distribution rules apply to a QTIP trust.)*
- *E -** *Bypass Trust #2 - Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow. (a conduit trust; the surviving spouse can annually recompute remaining life expectancy to reduce distributions).*

<u>AGE</u>	<u>IRAs A & B</u>	<u>IRAs C & D</u>	<u>IRA E**</u>	<u>AGE</u>	<u>IRAs A & B</u>	<u>IRAs C & D</u>	<u>IRA E</u>	<u>AGE</u>	<u>IRAs A & B</u>	<u>IRAs C & D</u>	<u>IRA E</u>
60	none	3.97%	3.97%	70	3.65%	6.58%	5.88%				
61	none	4.13%	4.10%	71	3.78%	7.04%	6.13%	80	5.35%	19.23%	9.80%
62	none	4.31%	4.26%	72	3.91%	7.58%	6.45%	81	5.59%	23.81%	10.31%
63	none	4.50%	4.41%	73	4.05%	8.20%	6.76%	82	5.85%	31.25%	10.99%
64	none	4.72%	4.59%	74	4.21%	8.93%	7.09%	83	6.14%	45.45%	11.63%
								84	6.46%	83.88%	12.35%
65	none	4.95%	4.76%	75	4.37%	9.80%	7.46%				
66	none	5.21%	4.95%	76	4.55%	10.87%	7.87%	85	6.76%	100.00%	13.16%
67	none	5.49%	5.15%	77	4.72%	12.20%	8.26%	86	7.10%	empty	14.08%
68	none	5.81%	5.38%	78	4.93%	13.89%	8.77%	87	7.47%		14.93%
69	none	6.17%	5.62%	79	5.13%	16.13%	9.26%	88	7.88%		15.87%
								89	8.33%		16.95%
								90	8.78%		18.18%
								91	9.26%		19.23%
								92	9.81%		20.31%

**Payouts "B" and "E" are only available to a surviving spouse. Other payouts are available to anyone.*

*** If a surviving spouse is the sole beneficiary of a deceased spouse's retirement account, there are no required distributions to the surviving spouse from an inherited account until the year that the deceased spouse would have attained age 70 ½. Thus in this example, if the 60 year old surviving spouse had been the same age as the deceased spouse, there would be no required distributions from IRA E until the year that he would have attained age 70 ½. If, however, the deceased spouse died after age 70 ½, then there would be required distributions from IRA E as shown in italics.*

EXHIBIT G

SURVIVING SPOUSE DISTRIBUTION OPTIONS – AT AGE 80

Example: At age 80, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (both of whom had died in the preceding year). Although the life expectancy of a 80 year old is 10 years (i.e., to age 90), Ms. Widow in fact lived to age 92. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 90, amounts could still be in the other IRAs at that age. The minimum amounts required to be distributed from each of six IRAs are listed in the table.

- A -** *Her own IRA*, established with contributions she made during her working career.
- *B -** *A rollover IRA*, funded after her husband's death with a distribution from his 401(k) plan.
- C -** *A stretch IRA -- Her sister's IRA*
- D -** *Bypass Trust #1 - Her deceased husband's IRA is payable to a standard bypass trust, treated as a stretch IRA payable to a look-through accumulation trust (where the required distributions are based on the age of the oldest beneficiary of the trust. The same distribution rules apply to a QTIP trust.)*
- *E -** *Bypass Trust #2 - Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow.* This provision permits a look-through trust to be treated as a *conduit trust*
- CRT - Charitable Remainder Trust** - After his death, her husband's fourth IRA was distributed in a lump sum to a tax-exempt CRT that will annually distribute 5% of its assets to Ms. Widow for the rest of her life, then to her husband's 50-year old child from his first marriage for the rest of the child's life, and then upon the child's death will be distributed to a charity.

<u>AGE</u>	<u>IRAs A & B</u>	<u>IRAs C & D</u>	<u>IRA E</u>	<u>IRA CRT</u>
80	5.35%	9.80%	9.80%	5.00%
81	5.59%	10.87%	10.31%	5.00%
82	5.85%	12.20%	10.99%	5.00%
83	6.14%	13.89%	11.63%	5.00%
84	6.46%	16.13%	12.35%	5.00%
85	6.76%	19.23%	13.16%	5.00%
86	7.10%	23.81%	14.08%	5.00%
87	7.47%	31.25%	14.93%	5.00%
88	7.88%	45.45%	15.87%	5.00%
89	8.33%	83.33%	16.95%	5.00%
90	8.78%	100.00%	18.18%	5.00%
91	9.26%	empty	19.23%	5.00%
92	9.81%		20.41%	5.00%

**Payouts "B" and "E" are only available to a surviving spouse.* Other payouts are available to anyone.

Legal Authority for the Various Payout Rules in Exhibits E, F and G

IRA A: Reg. Sec. 1.401(a)(9)-5, Q&A 4 and Reg. Sec. 1.401(a)(9)-9, Table A-2.

IRA B: Same, and also Secs. 402(c)(9) and 408(d)(3)(C)(ii)(II).

IRA C: Sec. 408(d)(3)(c) and Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)(1)(I).

IRA D: Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 1.

IRA E: Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 2. The life expectancies are from Reg. Sec. 1.401(a)(9)-9, Table A.

Required Payments after Ms. Widow's Death:

IRAs A & B: IRAs A & B can become "stretch IRAs," where payments are made over the life expectancy of one of the beneficiaries selected by Ms. Widow. Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)(1)(I).

IRA E: After Ms. Widow's death, payments from IRA E must be completed over a term of years based on the life expectancy of someone who was her age in the year of her death. Since she died at age 92, payments must be made over no less than 4.9 years. Reg. Sec. 1.401(a)(9)-5, Q&A 5(c)(2).

IRA CRT (Exhibit G): The charitable remainder unitrust (CRUT) will commence payments to the next beneficiaries (children) upon the death of the surviving spouse. A CRUT must annually distribute at least 5% of the value of its assets, recalculated annually. With a two generation trust (parent and then child), the parties will likely select the 5% amount to be able to get the minimum 10% charitable deduction necessary for the trust to qualify as a CRT.

END OF EXHIBITS

III. Payments to a Trust for Spouse Usually Has Bad Income Tax Outcome - Examples

The purpose of a traditional credit shelter trust (a/k/a bypass trust) is to preserve and transfer as much wealth as possible to other beneficiaries (typically children) upon the death of the surviving spouse. Such trusts miserably fail to accomplish this objective whenever they are named as beneficiaries of a retirement account.

This is because an inherited retirement account must be liquidated over a period of years that cannot exceed the beneficiary's remaining life expectancy. A life expectancy represents the age at which half of the people are projected to die before and half will die after (oversimplified). For the 50% of the population that live past the projected age, the required distribution rules mandate that the inherited retirement account must be fully liquidated while the beneficiary is still alive. Thus by naming an accumulation credit shelter trust or QTIP trust as a beneficiary of a retirement account – whether a traditional taxable account or a tax-free Roth account – the tax law will require the account to be fully liquidated for the 50% of surviving spouses who live past that age.

This is the outcome regardless of whether the surviving spouse is young or old at the time of the first spouse's death. The problem is more acute for an elderly surviving spouse since the remaining life expectancy is fairly short, thereby causing a more rapid liquidation of the inherited retirement account.

A surviving spouse can avoid this harsh outcome under two circumstances. Instead of an accumulation trust being named as the beneficiary of the retirement account, the beneficiary of the retirement account could be either (1) the spouse (rather than a trust), in which case she can do a rollover or (2) a conduit trust, in which case her remaining life expectancy can be annually extended. Only a surviving spouse qualifies for these two benefits. Other beneficiaries are stuck with a maximum fixed term payout that is determined in the year after death.

The negative income tax consequences from naming a trust for a surviving spouse as the beneficiary of a retirement account can be illustrated with these examples:

#1 - 80 year old surviving spouse; accumulation trust (Exhibit G): Mr. Husband had named a QTIP trust (which qualified for IRA distribution purposes as a look-through accumulation trust) as the beneficiary of his IRA. The two beneficiaries of the accumulation trust are his 80 year old widow (Ms. Widow) and his 50 year old daughter (Daughter). An 80 year old has a life expectancy of 10.2 years, to age 90, but Ms. Widow in fact lived to age 92. The IRA must be fully liquidated in the year Ms. Widow attained age 90.

#2 - 80 year old surviving spouse; conduit trust (Exhibit G): Same facts, except assume that the trust qualified as a conduit trust. Although Ms. Widow can recompute her remaining life expectancy each year to extend the payout period past age 90, with required annual payouts of 19%

and 20% in her final years of life, the assets in the retirement account will likely be virtually depleted by the time distributions could begin to the daughter.

#3 - 80 year old surviving spouse; rollover to a new IRA (Exhibit G): Same facts, except the surviving spouse is named outright as the beneficiary and she does a rollover to a new IRA. She will be required to take relatively modest annual distributions of between 6% and 9% of the assets. Upon her death at age 92, her (then) 62 year old daughter will have an inherited IRA and can receive distributions over an additional 23 years (the remaining life expectancy of a 62-63 year old), nearly a quarter century of additional tax deferral from Mr. Husband's original IRA.

#4 - 60 year old surviving spouse; accumulation trust (Exhibit F): Same facts as scenario #1, except assume that the surviving spouse is 60 years old and the daughter (from Mr. Husband's first marriage) is 28 years old. Whereas Ms. Widow in fact lives to age 92, the IRA must be liquidated in the year Ms. Widow attains age 85, since a 60 year old has a remaining life expectancy of 25 years. In addition to eliminating Daughter from receiving any benefits from the IRA, the other disadvantage of this scenario is that the IRA will have been liquidated while Ms. Widow is still alive. It would have been better to have had a sizeable IRA that she could have drawn upon in her later years when she might have large medical or long-term care costs. A conduit trust (Example #2) would allow assets to exist in the IRA over Ms. Widow's entire lifetime, but the large required distributions that Ms. Widow would be required to receive in her late 80's and early 90's would mean that little would likely be left in the IRA in Ms. Widow's final years.

#5 - 60 year old surviving spouse; rollover (Exhibit F). Same facts as scenario #4, except the surviving spouse is named outright as the beneficiary and she does a rollover to a new IRA. There are great income tax advantages of a rollover compared to having the IRA payable to a trust. She will not be required to take any distributions from her own IRA until she turns age 70 ½. Then between ages 70 and 92 she will be only required to take relatively modest annual distributions of between 4% and 9% of the assets. The principal disadvantage is that upon her death at age 92, there is a very high probability that she will not have named Mr. Husband's daughter from his prior marriage as the beneficiary of her IRA.

#6 - 50 year old surviving spouse; first marriage; rollover danger. When a surviving spouse is under age 59 ½, the danger from rolling over all of the deceased spouse's retirement assets is that it exposes the surviving spouse to the 10% penalty for early withdrawals if amounts are distributed from the rollover account before she attains age 59 ½. *Peggy Ann Sears v. Commissioner*, T.C. Memo. 2010-146. Rather than roll over all of the deceased spouse's retirement assets, it would be best to leave in the deceased spouse's account sufficient assets to cover anticipated financial needs until the surviving spouse attains age 59 ½. There is no 10% penalty for receiving distributions from a decedent's account. Sec. 72(t)(2)(A)(ii). Furthermore, if the spouse died young, there are no required distributions from the deceased spouse's account to the surviving spouse until the deceased spouse would have attained age 70 ½. Sec. 401(a)(9)(B)(iv). Once the surviving spouse attains age 59 ½, it would be safe to do a rollover of whatever assets remain in the deceased spouse's retirement account into a new IRA for the surviving spouse.

#7 - - *80 year old surviving spouse; CRT (Exhibit G):* Same facts as scenario #1, except that the entire retirement account is liquidated in a lump sum distribution to a tax-exempt CRT. There will be no income tax liability upon receipt of the taxable distribution since the CRT is a tax-exempt trust. The CRT will then distribute 5% of the value of the assets to the surviving spouse for the rest of her life (to age 92), then will distribute 5% of the value of the assets to the daughter for the rest of her life, and then upon daughter's death will distribute the remaining assets to a charity. As long as the CRT can earn more than 5% each year, the balance in the CRT will never shrink. One problem with this arrangement, however, is that neither Widow or Daughter can dip into the assets of the CRT for a financial emergency. Thus, in most cases a CRT should only be used to provide a steady annuity stream of income when there are other assets available to Widow and Daughter to cover anticipated financial needs.

#8 - *60 year old surviving spouse; a two-generation CRT is usually not possible.* Same facts as scenario #4 (surviving spouse is 60 years old and the daughter from Mr. Husband's first marriage is 28 years old). A CRT will not work because there must be at least a 10% charitable deduction for a contribution to a CRT (based on the present value of when the charity is likely to receive the assets in the trust), and the 28 year old's long remaining life expectancy causes the deduction to be less than 10%. Had the child been 30 years old, the transaction would barely qualify for the minimum 10% charitable deduction.

#9 - *With an "accumulation" trust, the entire retirement account might have to be liquidated before the surviving spouse dies. A "conduit" credit-shelter trust permits a surviving spouse to annually recalculate her remaining life expectancy. This assures that retirement assets will be available for the surviving spouse's entire lifetime. Does that solve the problem so that estate planners should recommend a conduit trust to act as a credit shelter trust?*

No, it does not solve the problem. The recalculation rules have the benefit of assuring that the retirement account will not have to be fully liquidated before the death of the surviving spouse. But the required distributions will still be so large that as a practical matter the retirement account will be severely depleted by the time that a surviving spouse lives into her or his 90's (not an infrequent occurrence).

IRA "E" in Exhibits E, F and G illustrates how the recalculation formula works. IRA "E" was the IRA of the first spouse to die and was payable to a "conduit" credit shelter trust or a "conduit" QTIP trust. A conduit trust is accomplished by providing in the trust instrument that all retirement plan distributions must be conveyed to the surviving spouse and that no part of any distribution can be accumulated in the trust.

There are two advantages to utilizing such a clause. First, the spouse will likely be in a lower income tax bracket than the trust, so usually less income tax will be paid on the IRA distributions. Second, a surviving spouse who is a beneficiary of a conduit trust can re-compute her/his life expectancy so that the IRA does not have to be empty at age 85, 90 or whenever. This increases the likelihood that some assets will be in an IRA for the entire lifetime of the surviving spouse.

Despite these advantages, there are two significant problems with IRA “E”, especially if the surviving spouse lives a long life. First, the annual mandatory payments from an IRA to a conduit bypass or QTIP trust are always greater than the minimum mandatory payments from a rollover IRA. After age 80, the mandatory bypass/QTIP trust payments are roughly double the mandatory rollover IRA payments. Following repeated annual payouts as large as 14%, 16% and 20%, the assets in such an IRA will likely be virtually depleted upon the death of a long-lived spouse.

Second, since all payments were made to the surviving spouse, there is the potentially undesirable result that all of the accumulated after-tax distributions could be included on the surviving spouse’s estate tax return, which is an outcome that the credit-shelter bypass trust was supposed to prevent. Thus, there is little point in funding a conduit bypass trust with retirement assets if the spouse will live a long life. A rollover will usually be much better.

IV. Rollovers And The Estate Tax

Even before portability, estate planners have often recommended leaving retirement assets to the surviving spouse for several reasons. One estate-tax strategy has been that the income tax that the spouse paid on withdrawals helped to reduce the size of the surviving spouse’s taxable estate.

The estate tax challenge was greatest for estates that were top-heavy with retirement assets. Take, for example, a married physician whose sole assets were \$9 million in a retirement account and a \$1 million house in joint tenancy. The income tax law encouraged a rollover, but the estate tax law was nudging the physician to put some of the retirement assets into a credit shelter trust so that it would not be in the surviving spouse’s estate. The problem, as described in the preceding few paragraphs, was that the mandatory distribution rules effectively forced the entire retirement account to be liquidated for a long-lived spouse so that the after-tax proceeds were indeed included in the estate of a surviving spouse who lived a long life. This is the outcome that a credit shelter trust was supposed to prevent.

This is the beauty of portability. The retirement asset will likely be in a long-lived surviving spouse’s taxable estate either way: whether she gets the retirement assets through a rollover or whether she gets them indirectly as taxable distributions from a conduit credit shelter trust. The advantage of a rollover over a credit-shelter trust is that the surviving spouse retains the income tax advantages offered by a retirement account for her entire life and she will have smaller required distributions over her lifetime. A rollover allows larger amounts to remain in her IRA for financial needs late in life. If she needs the cash, she can take large distributions. But she won’t be required to take large distributions against her will because they were mandated by the tax laws. As Exhibits E, F and G demonstrate, after age 80 the annual required distributions from a retirement account to a conduit trust are nearly double the annual required distributions that would have to be made from a rollover IRA.

V. Portability and Rollovers

A. Portability Mechanics

In 2010, Congress introduced the law of portability for estates of married decedents to the federal estate tax paradigm. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296. Under this temporary law (which exists only in 2011 and 2012, unless extended), the estate of a surviving spouse can use part or all of the first deceased spouse's unused exemption amount ("deceased spousal unused exclusion amount" or DSUEA) to reduce the estate tax liability of the surviving spouse's estate. Sec. 2010(c)(2)

This law essentially gives a married couple a potential combined \$10 million exemption – double the \$5 million exemption available to others. Section 2010(c). It provides that the estate tax applicable exclusion amount is (1) the "basic exclusion amount" (\$5.0 million, indexed for inflation to \$5.12 million in 2012), plus (2) a surviving spouse can add the DSUEA from the estate of the first spouse to die.

Portability offers estate tax savings when the poorer spouse dies first. For example, if husband owns \$10 million of assets and wife owns nothing, the prior estate tax law exacted punishment if the wife died first and then the husband died in a later year with a \$10 million estate. It also permits spouses to transfer wealth in the manner that seems natural – to leave all wealth to the surviving spouse, rather than transfer some or all of it to other beneficiaries when the first spouse dies. Thus, if the husband with \$10 million of assets dies in the year 2011, he can leave his entire estate to his wife. If she dies in 2012, then her estate can claim a \$10 million exemption (her own \$5 million and her husband's DSUEA of \$5 million) and completely avoid the estate tax. Furthermore, for assets other than retirement accounts, there is the income tax benefit that assets included in both spouse's estates will have their income tax basis increased two times instead of once.

To be eligible to use the DSUEA, there must have been a timely-filed estate tax return when the first spouse died. Sec. 2010(c)(5)(A). This is the case even if the first spouse had less than \$5 million of assets at the time of death. The Service described the procedural requirements in IRS Notice 2011-82, 2011-42 I.R.B. 516. Extensive additional details on the portability provisions can be found in these Heckerling materials, particularly the presentation of Thomas W. Abendroth (Tab 6 of the Heckerling materials).

B. Why Estate Planners Often Prefer Credit Shelter Trusts Over Portability

Portability provides simplicity, the natural order of things ("everything to my spouse") and the income tax advantage of two step-ups in tax basis – one time when each spouse dies. Yet many estate planners discourage married couples from planning to rely on the new portability law. First, the law is scheduled to expire at the end of 2012 and must be extended or renewed in order to be viable in future years. But of greater importance for this article, most estate planners feel that the

tried and true credit shelter trust (a/k/a “bypass trust”) continues to offer more benefits than portability offers, including greater potential estate tax savings and greater asset protection. See, for example, Marc Bekerman, *Credit Shelter Trusts and Portability: Does One Exclude the Other?*, *Probate & Property*, May/June 2011 at 11-15; Steven R. Akers, *Estate Planning Effects and Strategies Under the “Tax Relief. . . Act of 2010”* ABA Real Property, Trust & Estate Law eReport, February 2011, at 10-17, available at http://www.americanbar.org/content/dam/aba/publications/rpte_ereport/2011_aba_rpte_ereport_01_complete.authcheckdam.pdf.

Steve Akers eReport listed several reasons why a credit shelter trust may be superior to portability:

1. Portability requires the administrative cost and hassle of filing a federal estate tax return, even when the estate is under \$5 million. IRS Notice 2011-82, 2011-42 I.R.B. 516. There is hope that someday there might be a short form established for this purpose (“706-EZ”), but nothing exists yet. By comparison, a credit shelter trust can be established upon the death of the first spouse even when the estate is under \$5 million and no estate tax return is needed (e.g., the poorer spouse dies first).
2. The portability law expires at the end of 2012 and there is no assurance that the law will be in place in 2013 or later years.
3. The growth in value of the assets transferred to the surviving spouse are not excluded from the gross estate of the surviving spouse unlike the growth in a credit shelter trust which is excluded. For example, a growth stock worth \$2 million when the first spouse died might be worth \$20 million when the second spouse dies. With portability, that amount would be included in the surviving spouse’s estate, but a credit shelter trust would have prevented inclusion in that estate.
4. The deceased spousal unused exclusion amount is not indexed for inflation.
5. The unused exclusion from a particular predeceased spouse might be lost with remarriages in the future.
6. There are other standard benefits of trusts, including asset protection, providing management, and restricting transfers of assets by the surviving spouse.

C. Portability Provides Solution for Retirement Assets

When it comes to retirement plan assets, there is a problem with point #3 above: “The growth in value of the assets transferred to the surviving spouse are not excluded from the gross estate of the surviving spouse unlike the growth in a credit shelter trust which is excluded.”

Although this may be true of conventional assets such as stock and real estate, in most cases it will not be true of retirement assets.

There are two main reasons:

First, there will not likely be growth in the value of the retirement assets. Instead, the value of retirement assets that are payable to a credit shelter trust will have likely shrunk because of the income taxes levied on the distributions which, by law, must be larger than the distributions that would have been required if there had been a rollover to an IRA of the surviving spouse.

Second, the majority of retirement assets that are payable to a credit shelter trust will likely be *included* in the surviving spouse's estate. This is because in most cases people will choose a "conduit trust", which requires the credit shelter trust to redistribute to the surviving spouse the entire amount of all distributions that it received from the retirement account. For a surviving spouse who lives to her life expectancy (age 85, 90, or whatever), the majority of retirement assets will likely have been distributed to the surviving spouse and, after payment of income taxes, the remaining proceeds will be included in the surviving spouse's estate.

If an estate planner's objective is to use a credit shelter trust to transfer as much wealth as possible to the next generation by keeping those assets out of the estate of the surviving spouse, then paying retirement assets to a credit shelter trust miserably fails that objective.

BY COMPARISON: A two-generation charitable remainder trust can operate as a credit shelter trust for retirement assets and other income-in-respect-of-decedent ("IRD") assets. The CRT's assets will usually not be included in the estate of the surviving spouse. And the CRT offers income tax advantages because it is exempt from the income tax. As was illustrated above, this technique can be very useful for second marriages and when there is an elderly surviving spouse. Annual distributions are usually limited to 5% of the CRT's assets each year, leaving a sizeable amount of wealth to be invested to produce income to the next generation and to make a very large distribution to a charity upon termination of the trust.

COMBINED ESTATES UNDER \$10 MILLION: For married couples with a combined estate under \$10 million, portability significantly diminishes the concern that a rollover of retirement assets to a surviving spouse will generate a higher estate tax liability when the surviving spouse dies. Even if the surviving spouse's estate is over \$5 million, the surviving spouse's estate can use the DSUEA to avoid paying estate tax on the retirement assets, as long as the sum of the two taxable estates is under \$10 million. For married individuals who have a disproportionately large portion of their wealth in retirement accounts, portability permits the married couples to do what seems natural: leave 100% of the retirement assets to the surviving spouse who, following a rollover to an IRA, can then leave the remaining retirement assets to beneficiaries as an inherited IRA.

COMBINED ESTATES OVER \$10 MILLION: For married couples with a combined estate over \$10 million, the tax planning becomes much more challenging. Upon the death of the surviving spouse there will be an estate tax levied on the retirement assets. If the retirement assets are in a traditional taxable retirement account (as opposed to a tax-free Roth account), then the estate is effectively paying estate tax on deferred income taxes. Beneficiaries who receive taxable distributions from an inherited retirement account will be able to deduct the federal (but not any state) estate taxes as itemized deductions on their federal income tax returns under Sec. 691(c), but the outcome isn't pretty.

A married couple with an estate over \$10 million should consider a lifetime Roth IRA conversion of retirement assets to reduce the amount of deferred income taxes that inflates the size of their estate. Another alternative is to make a charitable bequest of income-in-respect-of-decedent assets (such as retirement accounts) since such bequests effectively qualify for a combined estate tax and income tax deductions, thereby devoting greater resources to the charitable causes that they support. The use of a two-generation CRT as a credit-shelter trust for IRD assets is another possibility.

VI. Wrap-Up

Estate planning for retirement assets has always been a quandary because of the conflicting incentives offered by the income tax laws and the estate tax laws. In the case of a surviving spouse, the best *income tax* outcome usually occurs when the surviving spouse is named as the beneficiary of a retirement account and she or he then rolls over the decedent spouse's retirement assets into a new IRA. In the past, the positive income tax outcome of a rollover was offset by a negative *estate tax* outcome: the rolled over account could inflate the surviving spouse's estate. Yet the traditional estate tax solution of using a credit shelter trust to mitigate the estate tax upon the death of the surviving spouse has negative income tax consequences under the income tax.

Portability solves this problem for many married couples, especially those with combined estates under \$10 million (or whatever the future estate tax exemption becomes). It offers the income tax advantage of a rollover by the surviving spouse with the estate tax advantage that upon the death of the surviving spouse, the estate can use the first deceased spouse's unused exemption amount to reduce or eliminate an estate tax liability. Let's hope that the law, or an even improved version of it, becomes permanent.

For estates over \$10 million, and for other situations such as second marriages where there are children from prior marriages, things get more complicated. The estate planner needs to be more resourceful to deal with the estate planning challenges posed by retirement assets.