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August 10, 2007

Via email: marjorie.hoffman@irscounsel.treas.gov

Ms. Marjorie Hoffman
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Internal Revenue Service
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Re: Request for Guidance Clarifying Reg. § 1.401(a)(9)-5, A-7(b) and (c)

Dear Ms. Hoffman:

I am writing to you on behalf of the American College of Trust and Estate Counsel ("ACTEC") to ask that you issue a published ruling further to clarify the manner in which the minimum distribution rules will be applied when a trust is the beneficiary of a decedent's retirement plan.

In a letter addressed to you and dated March 27, 2003, Virginia Coleman, on behalf of ACTEC explained the need for guidance on this matter. A copy of that letter is enclosed.

As explained in the enclosed letter, taxpayers need clarification of the distinction between a "contingent beneficiary" and a "successor beneficiary." Taxpayers who have family members who require the protections afforded by a trust, such as minors, may wish to designate a trust as a beneficiary of a retirement plan. However, unless the trust requires that all amounts withdrawn from the plan be distributed immediately to the beneficiaries of the trust (a "conduit trust"), there is a concern that required minimum distributions may not be calculated based on the beneficiary's life expectancy. Conduit trusts rarely provide the protection for beneficiaries that a trust is intended to provide. Thus, taxpayers are forced to forgo the option to allow amounts withdrawn from a retirement plan to be accumulated in the trust for later distribution to or for the benefit of a beneficiary or risk accelerating required distributions from retirement plans. This result obtains even where the trust terminates when a beneficiary reaches a specified age.

Moreover, much of the guidance has been provided on this subject through private letter rulings. IRC Section 6110(k)(3) of the Internal Revenue Code provides that a taxpayer may not rely on a private ruling issued to another taxpayer. In addition, the private letter rulings appear to be inconsistent in important respects, and the factual predicates for the rulings are not always completely described. Therefore, we ask that you issue a revenue ruling on this issue.

Representatives of ACTEC would be pleased to meet with you to discuss why we think that this matter should be given a high priority. ACTEC also will be pleased to offer any technical assistance that you may find useful in carrying out this project.

Respectfully submitted,

Daniel H. Markstein, III
President

Encl.

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ACTEC Request for Published Ruling Clarifying Reg. § 1.401(a)(9)-5, A-7(b) and (c)

March 27, 2003

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Re: Request for Published Ruling Clarifying Reg. § 1.401(a)(9)-5, A-7(b) and (c)

Dear Marjorie:

This letter is submitted by the American College of Trust and Estate Counsel on behalf of its Employee Benefits Committee.[1] It follows up on your suggestion to your fellow panel members prior to the ALI-ABA Video Law Review program this past May that with the issuance of "final" regulations under Section 401(a)(9) the Internal Revenue Service would be amenable to issuing further guidance in the form of published rulings. You also said you would welcome the input of practitioners as to where such guidance was needed.

At the time, some panel members suggested that one area that remained unclear after the final regulations, and as to which further guidance would be welcome, was the distinction between a "contingent beneficiary" and a "successor beneficiary" under Reg. § 1.401(a)(9)-5, A-7(b) and (c), respectively. This distinction is crucial to the determination of whether there is a "designated beneficiary" of a qualified plan or IRA where a trust is named as beneficiary: a potential recipient of funds under the trust that is treated as a "contingent beneficiary" will be taken into account in determining the designated beneficiary, whereas a potential recipient that is treated as a "successor beneficiary" will not be. One or more qualified plans or IRAs are the largest financial asset of many individuals, and as a result standard estate planning principles will call for the beneficiary of all or some portion of the plan or IRA to be a trust. Estate planning practitioners need to know what are the consequences under the distribution rules of naming one or another kind of trust as a beneficiary. In addition, if it is important that the plan or IRA have a designated beneficiary, practitioners need to know what are the rules that must be followed in order to achieve that result.

Recent private letter rulings have only heightened the confusion surrounding this subject and thus the need for published guidance. Private letter rulings, issued on an ad hoc basis in response to particular fact situations, are not intended to provide general guidance and are a poor vehicle for this purpose.

The purpose of this letter, therefore, is to illustrate for you by example the questions which need to be answered, and to offer our suggestions in each case as to what the result should be. It is hoped that the examples could form the basis for a published ruling.

In all the following examples, it is assumed that the trust described is named as beneficiary of a qualified plan or IRA, and that the trust is not a "conduit" trust, so that some portion of the distributions from the plan or IRA will or may be accumulated in the trust and not paid out currently.

1. Trust provides for all income to be paid to X for life, remainder at the death of X to Y, who is younger than X, if Y is then living. If Y does not survive X, the remainder will go to C, which is a charity.[2]

Suggested result:. C is a successor beneficiary and not a contingent beneficiary. Thus C will not be taken into account in determining the identity of the designated beneficiary, and X is the designated beneficiary.

There are two possible rules which could lead to this result, either of which would be equally workable. Since the rules may lead to different results in different situations, however (see, for instance, Example 2, below), it is important for practitioners to know which rule is operative.

One rule is that a contingent remainderman under a trust (C in the above example), who will take only if the primary remainderman (Y in the above example) does not survive to take, will be treated as a successor beneficiary except a primary remainderman who is older than the current beneficiary. The rationale behind this rule is that a primary remainderman who is younger than the current beneficiary will be presumed to survive the current beneficiary and thus to take. By contrast, if the primary remainderman is older than the current beneficiary, the primary remainderman will be presumed not to survive the current beneficiary, so that the contingent remainderman will take on the death of the current beneficiary. Applying this principle, which we will call the "life expectancy rule," to Example 1, since Y is younger than X and C will take only if Y does not survive X, C is treated as a successor beneficiary.

The other rule which could be applied in this circumstance is that a remainderman under a trust will be treated as a contingent beneficiary if and only if he or she would take upon the hypothetical death of the current beneficiary on the beneficiary determination date. All remaindermen who would not take in this circumstance will be treated as successor beneficiaries. Under this principle, which we will call the "snapshot rule," contingent remaindermen would always be treated as successor beneficiaries. Applying this rule to Example 1, since Y would take if X were to die on the beneficiary determination date, and C would take nothing, C is treated as a successor beneficiary.

We note that if instead the Service were to take the position in the above example that C was a contingent beneficiary, a position which we strongly feel is ill-advised, it would be incumbent upon the Service also to make it clear to practitioners under what circumstances, if at all, the naming of a charity, or intestate heirs, or some other beneficiary which was not an individual, as a contingent remainderman would not cause the trust to fail to have a designated beneficiary. For instance, assume the trust in the above example instead provided on the death of X for distribution to the descendants of the grantor by right of representation (per stirpes) with C charity to take only if no descendants survived X, and on the beneficiary determination date the grantor had five children, twelve grandchildren and three great-grandchildren. Would C be treated as a contingent beneficiary in that circumstance? If not, what rule would be applied to differentiate that case from the trust described in Example 1?

2. Trust is the same as in example 1 except that Y, the primary remainderman, is older than X.

Suggested result: The result depends on whether the operative rule is the life expectancy rule or the snapshot rule. We are indifferent as to which rule is to be applied, so long as the rule is clearly stated and consistently applied.

Under the life expectancy rule, C would be a contingent beneficiary and thus there would be no designated beneficiary, because Y is older than X and thus will be assumed not to survive to take on the death of X. Thus, one must look to the next remainderman, which is

C. Note, however, that if the trust provided that if Y did not survive X Y's children would succeed to Y's interest, and C would take only if none of Y's children survived, and if at the beneficiary determination date Y had one or more children who were younger than X, C would be treated as a successor beneficiary under the life expectancy rule, and the designated beneficiary would be X.

Under the snapshot rule, C would be a successor beneficiary, because if X died at the beneficiary determination date Y would take. The fact that Y was older than X would be irrelevant.[3]

3. Trust is the same as in example 1 except that X also has a testamentary special power of appointment exercisable in favor of the grantor's children and more remote descendants, all of whom are younger than X.

Suggested result: The result is the same as in Example 1 and is not affected by the special power of appointment, regardless of whether the life expectancy rule or the snapshot rule is applied. Under either rule, all the possible appointees are contingent beneficiaries: under the life expectancy rule because they are all younger than X, and under the snapshot rule because any of them could take on the hypothetical death of X on the beneficiary determination date depending on how the power of appointment was exercised. Because all possible appointees are younger than X, X remains the designated beneficiary. This result would be the same no matter how the class of appointees was defined, so long as members of the class were "identifiable" within the meaning of Reg. § 1.401(a)(9)-4, A-1 and were all younger than the holder of the power of appointment.[4]

4. Trust is a discretionary trust for the benefit of minor child A until A reaches age 30, whereupon the trust will terminate by distribution outright to A. If A does not survive until age 30, the trust will terminate in favor of A's children or, if none, in favor of charity C. A has no children at the beneficiary determination date.

Suggested result: All remaindermen other than A, who will take only if A does not survive until age 30, will be treated as successor beneficiaries, so that A is the designated beneficiary.

We feel that there are powerful policy reasons for this result. This kind of trust is a standard vehicle for the holding of property for young children; its sole purpose is to defer outright ownership until the child reaches sufficient maturity to be able to deal responsibly with the assets. The probability that the child will survive to the termination date of the trust is overwhelming. To require that someone else be treated as a designated beneficiary, or that there be no beneficiary at all, based on a hypothetical disposition of the trust which almost certainly will not happen, seems arbitrary and not in accordance with the reality as to who is the beneficiary of the trust. We note also that in this circumstance, a determination that the designated beneficiary is anyone other than the minor child is likely to have a severe adverse consequence in terms of the permissible payout period.

We understand that there might be concern about abuse if a rule were adopted that the designated beneficiary of all trusts which by their terms terminated in favor of the current beneficiary during the beneficiary's actuarially determined life expectancy was the current beneficiary. At some point, if the trust terminates at age 50, 60 or beyond, the likelihood that the current beneficiary will in fact take becomes less than overwhelming, and the likelihood that the trust will terminate in favor of remaindermen other than the current beneficiary becomes more than negligible. We suggest, therefore, that the Service adopt a cut-off age beyond which, if the trust does not by its terms terminate, the designated beneficiary will be determined on the same basis as if the trust by its terms lasted for the beneficiary's lifetime. Extrapolating from the generation-skipping transfer tax (IRC § 2632(c)), we would further suggest age 46 as the cut-off age.[5] In other words, if a trust will terminate in favor of the current beneficiary at age 45 or before, remaindermen other than the current beneficiary will be disregarded; if, however, the trust will terminate in favor of the current beneficiary at age 46 or older, remaindermen who take if the current beneficiary does not survive to take will be taken into account on the same basis as if the trust by its terms went for the life of the current beneficiary.

We are aware that our suggested result is contrary to the result reached in PLR 200228025, which was decided under the 1987 proposed regulations. PLR 200228025 involved a trust for the benefit of two grandchildren, which would terminate with respect to 50% when each grandchild reached age 30. If one grandchild died before that age, the other would take the entire trust. If both grandchildren died before age 30, a collateral relative, age 67, would take. The ruling does not state who would take if the 67 year old was not alive to take, which was surely highly probable in the extremely unlikely event that both grandchildren died before age 30; that evidently was not considered relevant. The ruling held that the designated beneficiary was the 67 year old. We respectfully submit that at least under the final regulations this result is wrong, and that the older of the two grandchildren should instead have been treated as the designated beneficiary.

5. Trust is a discretionary trust for A for life, terminating at A's death in favor of A's estate.

Suggested result: A is the designated beneficiary, because A's estate should be treated as "stepping into the shoes of" the beneficiary for 401(a)(9) purposes and thus as the equivalent of the beneficiary.

A position the Service has recently taken in the charitable remainder trust ("CRT") area strongly supports this result. Normally, a CRT set up for the benefit of a second trust for an individual, rather than for the benefit of the individual directly, may last only for a term of up to 20 years rather than for the individual's lifetime. In Rev. Rul. 2002-20, however, the Service held that in certain circumstances, a trust as beneficiary of a CRT will be treated as the equivalent of an individual beneficiary, thus permitting the CRT to run for the life of the individual beneficiary of the second trust.

Rev. Rul. 2002-20 involved three CRTs established for the benefit of three slightly different trusts for the benefit of C, a disabled individual. All three of the beneficiary trusts lasted for C's lifetime and provided for distributions to be made solely to C. On C's death, two of the three beneficiary trusts terminated in favor of C's estate; the other gave C a general power of appointment over all funds which were not required to reimburse Medicaid for assistance provided to C during life, in default of which the trust assets would be distributed to charity. The ruling holds that in all three situations, the CRT may last for C's lifetime, because "Upon C's death, the assets remaining in Trust B will be distributed either to C's estate or, after reimbursing the state for any Medicaid benefits provided to C, will be subject to C's general power of appointment. In these situations, the use of the assets in Trust B during C's life and at C's death is consistent with the manner in which C's own assets would be used. C, therefore, is considered to have received the unitrust amounts directly from Trust A [the CRT] . . .". Similarly in this context, payment of the trust assets to the beneficiary's estate on termination of a trust should be treated as the equivalent of payment to the beneficiary himself, because it is the same ultimate disposition of the property which would have occurred had the beneficiary received the trust assets during life.

We are aware, of course, that the estate *of the employee* cannot be a designated beneficiary because only an individual can be a designated beneficiary. Reg. § 1.401(a)(9)-4, A-3. There is no inconsistency between this rule, however, and a recognition that the estate *of an individual, named beneficiary* will be treated in the same way as the named beneficiary.

6. Same as in example 4, except that upon A's death A has a testamentary general power of appointment, exercisable in favor of any person or persons including A's estate. In default of appointment, distribution will be made to C charity.

Suggested answer: A is the designated beneficiary, because a testamentary general power of appointment, exercisable in favor of the estate, should be treated in the same way as if the estate were directly named as beneficiary. To draw a distinction between the two would elevate form over substance. Rev. Rul. 2002-20 treats the two as indistinguishable in the CRT context, and they should likewise be treated as indistinguishable in this context.

We would very much appreciate your consideration of these questions for a published ruling, and would be pleased to work with you toward this end in any way that you felt was helpful. Although in all cases, as described above, we have our own views as to what we feel the answer should be, at this point we feel any answers at all, so long as they are clear, would be preferable to the current state of confusion.

Yours sincerely

Virginia F. Coleman, Immediate Past Chair
Employee Benefits Committee

Ronald D. Aucutt, President

[1] The American College of Trust and Estate Counsel is a professional association of over 2,600 lawyers throughout the United States, elected to membership by their peers on the basis of their professional reputation, ability, and contributions in legal matters affecting estate planning.

[2] This example is identical in substance to Example 1 in Reg. § 1.401(a)(9)-5, A-7(c)(3) except for the addition of C as contingent remainderman. The example in the regulation postulates that no one has a beneficial interest in the trust other than the primary remaindermen, the children of the grantor. This is a somewhat puzzling statement, since the trust property must pass to some person or entity, either by the terms of the governing instrument or applicable state law, if the children do not survive the income beneficiary.

[3] PLR 200252097, although it did not by its terms apply the final regulations, suggests that the Service is applying the snapshot rule. There the trust named as beneficiary was for the benefit of Taxpayer C for life, terminating in favor of C's children at C's death or, if none, in favor of the heirs of the grantor living at C's death. At the beneficiary determination date, C was childless, and the grantor's heirs were C's siblings, all of whom were older than C. The Service held that D, the oldest of C's siblings, was the designated beneficiary.

[4] The result we suggest is consistent with what appears to be the view of the Service as stated in PLR 200235038. There the beneficiary of an IRA was a trust for the benefit of child C, under which C had a testamentary power of appointment exercisable in favor of anyone other than C's estate, his creditors, or a "Disqualified Appointee". A "Disqualified Appointee" was defined as any individual older than C, any person other than a trust or an individual, or any trust having as a beneficiary an individual older than C. The Service held that the designated beneficiary under the trust was C because "any potential beneficiary of taxpayer C's interest in IRA X must be no older than taxpayer C."

[5] IRC § 2632(c) defines a "GST trust" in part in terms of whether or not the trust will distribute to a "non-skip person" (i.e. a member of the generation immediately below the grantor) before age 46. If so, there is a statutory presumption that the non-skip person will take.

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