Postmortem Strategies to Shift Retirement Plan Assets to the Spouse

A spouse who is not named the beneficiary of the decedent's qualified plan or IRA may still be able to receive these assets. This article examines when such a spouse will be allowed to roll over the retirement assets into her own IRA.

BRUCE D. STEINER, ATTORNEY

There are several tax advantages to designating one's spouse as the beneficiary of qualified retirement plan or IRA benefits. During the participant's lifetime, distributions can be spread out over the joint and survivor life expectancies of the participant and spouse. Upon the participant's death, the benefits will qualify for the marital deduction, thus deferring estate tax. The spouse could elect to defer the 15% additional estate tax on excess retirement accumulations for decedents dying before 1/1/97. (The Taxpayer Relief Act of 1997 repeals the 15% excise tax on excess distributions from retirement plans and the 15% additional estate tax on excess retirement accumulations. The repeal of the excess distribution tax is effective for excess distributions received after 1996. The repeal of the excess accumulation tax is effective for decedents dying after 1996.)

The spouse can also elect to roll over the benefits into her own IRA (or elect to treat the participant's IRA as the spouse's own IRA under Prop. Reg. 1.408-8), thus deferring income taxes until the spouse reaches age 70½. Alternatively, the spouse can remain as the beneficiary (rather than rolling the benefits over into her own IRA), and thereby obtain the flexibility (1) to take distributions before age 59½ without imposition of the 10% penalty tax for premature distributions, or (2) to defer distributions until the decedent would have reached age 70½.

In each case, the decedent's estate is eligible for the marital deduction for the entire value of the qualified plan or IRA benefits. The benefits will not be taxable to the spouse until they are received, and the income taxes paid by the spouse will reduce the amount subject to estate tax in the spouse's estate.

Moreover, if the spouse rolls the benefits over into her own IRA, the spouse can designate new beneficiaries and payout methods, and thus obtain substantial additional income tax deferral in several ways. As noted above, the spouse can defer all distributions until she reaches age 70½. At that point, the spouse can take distributions over the joint and survivor life expectancy of the spouse and her oldest designated beneficiary (subject to the minimum distribution incidental benefit (MDIB) rules during the spouse's lifetime). After the spouse's death, the beneficiaries chosen by the spouse can spread the remaining benefits over the life expectancy of the oldest designated beneficiary. This can achieve considerable income tax deferral, especially if the spouse designates young beneficiaries.

For all these reasons, it is most common, and generally advisable, to designate the spouse as the beneficiary of qualified plan and IRA benefits.

Despite the advantages of designating the spouse as the beneficiary of these benefits, sometimes a taxpayer dies having named his estate, a trust, or another person(s) as the beneficiaries of the retirement benefits, or dies without having named a beneficiary.

BRUCE D. STEINER, a member of the New York, New Jersey, and Florida Bars, is tax counsel to the law firm of Kleinberg, Kaplan, Wolff and Cohen, P.C., with offices in New York City and Teaneck, New Jersey. He is a frequent author and lecturer on taxation and estate planning, and has previously written for ESTATE PLANNING.

When this occurs, the parties involved may wish instead to pay these benefits to the spouse if the spouse could roll them over into her own IRA.

A spouse who is not named as the beneficiary can receive retirement benefits in various ways, such as by exercising an elective share, as a result of a disclaimer, by intestacy, under the provisions of the qualified plan or IRA, as community property, or as a distribution from an estate or trust. Accordingly, if qualified plan or IRA benefits are payable to the participant's estate, or to a beneficiary other than the spouse, the parties should promptly consider whether these benefits can be distributed to the spouse in such a way that she will be able to roll them over into her own IRA.

Beginning with *Ltr. Rul.* 9416045 in early 1994, the IRS has consistently stated that generally, if a decedent's qualified plan or IRA benefits pass through a third party, such as an estate or a trust, and then are distributed to the decedent's surviving spouse, the spouse will be treated as acquiring them from the third party and not from the decedent. Consequently, the surviving spouse usually will not be eligible to roll over the retirement benefits into her own IRA.

Notwithstanding this general rule, the Service has ruled in various situations that a surviving spouse can roll over qualified plan and IRA benefits even though she was not designated as the beneficiary of such benefits. In these rulings, the Service disregarded the estate or trust through which these benefits passed, and treated the spouse as acquiring the benefits from the decedent, so that the spouse could treat them as her own and roll them over into the spouse's own IRA.

If there is a distribution to the spouse from an estate or a basket trust which could have consisted of qualified plan or IRA assets, or other assets, some of the rulings focus on whether the spouse had the power to select which assets the spouse received, while other rulings permit rollovers once retirement assets are allocated and distributed to the spouse. On the other hand, if qualified plan or IRA benefits pass to a marital trust, the rulings consistently allow rollovers where the spouse has the power to distribute to herself or withdraw the retirement benefits, but not where such a distribution is dependent on the discretion of a trustee other than the spouse.

Beginning with *Ltr. Rul.* 9623056, the Service has taken the position that if the trustees other than the spouse have no discretion with respect either (1) to the allocation of the retirement benefits to a trust or (2) to the distribution of the benefits from the trust to the spouse, the spouse will be treated as having acquired the benefits from the decedent and not from the trust, so that the spouse can roll them over into her own IRA. In view of the evolution and development of the Service's analysis, the rulings beginning with *Ltr. Rul.* 9416045, and especially those beginning with *Ltr. Rul.* 9623056, should be considered more indicative of the Service's views than should prior rulings.

Several words of caution are in order here. First, while postmortem planning may often achieve substantial tax savings, it is not a substitute for good estate planning. Second, estate planners should become familiar with the rules governing qualified plan and IRA distributions, and should consider these assets in planning their clients' estates. Third, because private letter rulings cannot be relied on except by the taxpayers to whom they are issued,[1] taxpayers may wish to obtain their own private rulings, particularly if the existing rulings have been inconsistent. Depending on the circumstances, such a ruling may be necessary to persuade the trustees of the qualified plan or the trustee or custodian of the decedent's IRA to release the assets without withholding 20% income tax,[2] and to persuade the trustee or custodian of the proposed spousal rollover IRA to establish the spousal rollover IRA.

A final observation: Some of the estate plans in the private rulings discussed below appear to be unduly complicated. Because the rulings permitting spousal rollovers generally turn on the spouse's ability to receive the qualified plan or IRA benefits without the discretion of anyone else, it would seem that these benefits could simply have been left directly to the spouse, without disrupting the decedent's estate plan.

Illustrative rulings

Elective share. In some cases, a spouse may acquire qualified plan or IRA benefits by claiming an elective share under state law. In *Ltr. Rul.* 9524020, the decedent left his qualified plan benefits to his estate. He then left his residuary estate one-half to a marital trust and one-half to a nonmarital trust.

The decedent's wife claimed her elective share. The ruling concluded that the spouse had the power to select the assets to satisfy her elective share, and that she selected that her elective share be satisfied out of the qualified plan benefits. The Service held that the

[1] Section 6110.

[2] Section 3405(c).

spouse acquired the qualified plan benefits from her husband, and not from his estate, so that she could roll them over into her own IRA.

Even if state law gives the executor, rather than the spouse, the power to select the assets to satisfy the elective share, the result should be the same if the spouse is the sole executor or to the extent the executor has no choice but to allocate the IRA to the spouse.

Intestacy. A spouse who receives qualified plan or IRA benefits by intestacy can roll them over into her own IRA. In *Ltr. Rul.* 9047065, the decedent did not name a beneficiary of his IRA. Under the default provisions of the IRA, his benefits were payable to his estate. The decedent did not leave a will. Under the applicable state intestacy law, his estate—including his IRA benefits—was payable one-half to his wife and one-half to his children from a previous marriage. The Service determined that the spouse could roll her portion of the IRA benefits over into her own IRA.

Disclaimers. With the creative use of disclaimers, it is often possible to enable qualified plan or IRA benefits to become payable to the surviving spouse, so that the spouse can roll them over into her own IRA.[3] These disclaimers can take various forms. Depending on the situation, the disclaimers can be made by the primary beneficiary of the benefits, or by the beneficiaries of an estate or trust to which the benefits are payable. As a result of the disclaimers, the benefits may pass to the spouse as a contingent beneficiary of the plan or IRA, as the residuary beneficiary of the estate, by intestacy, or under the default provisions of the plan.

In *Ltr. Rul.* 8838075, the decedent's revocable trust was the primary beneficiary of his qualified plan benefits, and his wife was the contingent beneficiary. The trustees of the revocable trust, with the consent (in the form of disclaimers) of the beneficiaries of the trust, disclaimed the qualified plan benefits so that they passed to the spouse as the contingent beneficiary. The Service permitted her to roll the benefits over into her own IRA.

[3] For examples of the uses of disclaimers, see Steiner, "Disclaimers: Post-Mortem Creativity," 4 Prob. & Prop. 43 (Nov/Dec 1990).

In *Ltr. Rul.* 9609052, a New York case, the decedent left his IRA to his estate. In his will, he provided for a pecuniary credit shelter trust and left his residuary estate to his wife. His wife and all his living issue disclaimed their interests in the credit shelter trust so that his entire estate passed to his wife. The Service, noting that the spouse was the sole executor, permitted her to roll over the IRA benefits into her own IRA. The Service ruled that the spouse will be treated as having acquired the IRA proceeds from the decedent if the spouse is the sole executor and the sole beneficiary of the IRA proceeds passing through the estate. Because the executor in this case lacked discretion to distribute the IRA proceeds to anyone but the spouse, the result should have been the same even if the spouse had not been the executor.

Ltr. Rul. 9615043, also a New York case, is similar to *Ltr. Rul.* 9609052, except that in *Ltr. Rul.* 9615043, the will provided for an outright pecuniary marital bequest and a residuary credit shelter trust. The decedent's wife disclaimed her interest in the credit shelter trust, and all the decedent's issue (the minors through a guardian ad litem) disclaimed both their interests in the credit shelter trust and their intestate interests, so that the residuary estate passed to the spouse by intestacy. Because the spouse was entitled to the entire estate, she could roll over the IRA benefits. The ruling does not indicate who the executor was.

The decedent in *Ltr. Rul.* 9450041 left his qualified plan benefits to his estate. He left the marital share of his estate 25% to a general power of appointment trust and 75% to a QTIP trust. His wife, as the executor of her husband's estate, allocated the qualified plan benefits to the general power trust. She then disclaimed her interest in the qualified plan benefits in the general power trust so that these benefits passed (pursuant to the terms of the will) to the nonmarital trust. The beneficiaries of the nonmarital trust then disclaimed, so that the benefits passed to the spouse by intestacy.

The Service permitted the spouse to roll the benefits over into her own IRA. Interestingly, it did not matter that the spouse's disclaimer was untimely; because the benefits she disclaimed ultimately came back to her, her disclaimer did not result in a taxable gift to anyone else.

The Service reached a similar result in *Ltr. Ruls.* 9623064 and 9626049, in which the decedent left his tangible property to his wife and the rest of his estate to a QTIP trust. His wife disclaimed an interest in the QTIP trust corresponding to the IRA benefits, and his issue (the minor and unborn issue through a guardian ad litem) disclaimed both their interests in the QTIP trust and their intestate interests. As the personal representative, the spouse (who was represented to have the authority under state law to decide which assets to use to fund the intestate share) proposed to fund her intestate share with the IRA benefits. The Service then permitted the spouse to roll the IRA benefits over into her own IRA.

In *Ltr. Ruls.* 9247026 and 9045050, the decedent left his qualified plan benefits to a trust. The trustees disclaimed the benefits so that they were payable to the spouse under the plan's default provisions. In each case, the Service allowed the spouse to roll the benefits over into her own IRA.

In *Ltr. Rul.* 9437042, however, the decedent named his estate as the beneficiary of his qualified plan benefits. The executors and the beneficiaries of the residuary trust wished to disclaim the benefits so that those assets would pass to the spouse under the plan's default provisions. The Service ruled that the decedent's executors could not make a qualified disclaimer because the decedent exercised control over his plan benefits, and the beneficiaries of the residuary trust could not make qualified disclaimers because the ruling request was filed more than nine months after the decedent's death. Consequently, the benefits would be treated as passing to the spouse through the estate and the trust, and thus, she could not roll them over into her own IRA. The Service suggested, though, that if all the beneficiaries of the residuary trust had made qualified disclaimers, the benefits would have been treated as having passed directly to the spouse.

Community property. The decedent in *Ltr. Rul.* 9427035 left his IRA to a basket trust, which was divided into five separate trusts. His wife's 50% community property interest in his IRA was payable to a trust called the Survivor's Trust, which she had the power to withdraw. The Service held that, because the spouse had the power to withdraw the Survivor's Trust, which she exercised, she was treated as the direct beneficiary of 50% of her husband's IRA, and could roll over her 50% of her husband's IRA into her own IRA. The Service also reached the same conclusion in *Ltr. Rul.* 8927042, involving similar facts.

Neither of these rulings discussed Section 408(g), which states that Section 408 (dealing with IRAs) is to be applied without regard to any community property laws. In view of the rulings that

allowed a spousal rollover in similar situations where the spouse had the right to withdraw the trust assets, the community property aspects of the IRA were probably not necessary to obtain the desired result.

Benefits payable to the estate

Spouse is sole executor and beneficiary. In a number of cases, qualified plan or IRA benefits were payable to the decedent's estate, either as the named beneficiary or under the default provisions of the plan or IRA. In each case, the surviving spouse was the sole executor and the sole beneficiary of the estate, and the Service allowed the spouse to roll the benefits over into her own IRA. For example, in *Ltr. Ruls.* 9515041, 9450042, and 9229022, the estate was the named beneficiary, and the wife was the sole executor and sole beneficiary of the estate. In *Ltr. Ruls.* 9402023, 8925048, 8746055, and 8649037, there was no named beneficiary, the benefits were payable to the estate under the default provisions of the plan, and the wife was the sole executor and sole beneficiary of the estate.

Spouse is sole beneficiary; no mention of who was the executor. As noted above, the Service permits the spouse to roll over qualified plan or IRA benefits payable to the decedent's estate if the spouse is the sole executor and sole beneficiary. When the spouse is the sole beneficiary of the estate, however, it should not make any difference who the executor is, because the executor has no discretion to distribute the IRA to anyone other than the spouse.

Thus, in *Ltr. Rul.* 8911006, the decedent left his IRA to his estate. His wife was the sole beneficiary of his estate, but no mention was made of the identity of the executor. Nevertheless, the Service allowed the spouse to roll the IRA benefits over into her own IRA.

Spouse is residuary beneficiary of estate. In several rulings, decedents left their qualified plan or IRA benefits to their estates. Although the spouse was not necessarily the executor or the sole beneficiary of her husband's estate, she was the residuary beneficiary. As long as other assets were used to fund the pre-residuary bequests, so that the spouse received qualified plan or IRA benefits, she was permitted to roll the benefits over into her own IRA.

In *Ltr. Rul.* 9545010, the spouse was the executor of her husband's estate. She was entitled to the residuary estate—part outright and part in trust. Because she used the IRA benefits to fund her outright share, the Service treated her as receiving the IRA benefits from her husband, so she could have them transferred to her own IRA.

In *Ltr. Rul.* 8842058, the decedent's IRA was payable to his estate in the absence of a beneficiary designation. The spouse was the residuary beneficiary. Other assets were used to satisfy the specific bequests so that the spouse received the IRA as residuary beneficiary. The Service permitted her to roll over the decedent's IRA into her own IRA. Although it is not clear from the ruling, presumably once the specific bequests were satisfied, the executor no longer had any discretion to distribute the IRA benefits to anyone other than the spouse.

In *Ltr. Rul.* 9034046, the primary beneficiary of the decedent's IRA did not survive, so the IRA was payable to his estate. His wife was the residuary beneficiary of his estate. The Service ruled that the spouse could roll over the IRA benefits to her own IRA. Similarly, the decedent in *Ltr. Rul.* 9138067 left his pension benefits to his estate. His wife was the residuary beneficiary of his estate. The Service permitted her to roll the pension benefits over into her own IRA.

In view of the more recent rulings that permit rollovers when no one other than the spouse had any discretion as to either the allocation or the distribution, it would appear that the results in these rulings could be obtained today only if the spouse were the sole executor or if the executor first distributed other assets to the spouse to the extent possible.

Other cases permitting spousal rollovers. In several cases, spousal rollovers were permitted where qualified plan and IRA benefits were payable to the decedent's estate and used to satisfy an outright marital bequest. In *Ltr. Rul.* 9537030, the decedent left his IRA to his estate. His will created a pecuniary formula marital bequest to his wife. His wife was the executor and had the power to select the assets to use to fund the marital bequest. The Service permitted her to use a portion of her husband's IRA to satisfy the marital bequest and then to roll that portion over into her own IRA.

The decedent in *Ltr. Ruls.* 9010084 and 9006050 left his IRA to his estate. Although the facts in these rulings are sketchy, it appears that in each case: (1) the marital share passed to the spouse outright, (2) the IRAs were allocated to the marital share, and (3) the Service permitted each surviving spouse to roll the benefits over into her own IRA. Similarly, in *Ltr. Rul.* 9620038, the will provided for a pecuniary credit shelter trust, and the residuary estate passed to the spouse outright. The decedent's

IRA beneficiary designation was "as per estate." The state court determined that "as per estate" meant that the IRA was to be paid directly to the spouse as the designated beneficiary. The Service allowed her to roll it over into her own IRA.

These rulings suggest that once the executor has allocated the IRA to the marital share, and the marital share passes to the spouse outright so that it is no longer subject to the discretion of anyone other than the spouse, a spousal rollover is permitted. Nevertheless, it appears that the Service now requires that no one other than the spouse have any discretion as to either the allocation or the distribution in order for the spouse to be able to accomplish a rollover.

In *Ltr. Rul.* 9235058, the decedent left his IRA to his estate. His estate poured over into his revocable trust, which in turn was divided into a marital trust and a credit shelter trust. His wife was the trustee; she intended to allocate the IRA to the marital trust, distribute its assets (including the IRA benefits) to herself, and roll the IRA benefits over into her own IRA. The Service ruled that she could do so. It is not clear from the ruling by what authority she was permitted to distribute the assets of the marital trust to herself.

The facts of *Ltr. Rul.* 8909065 are sparse, but it appears that the decedent left his IRA to his estate. He then established a basket trust under his will, which was divided into several trusts. His wife had the right to withdraw all the assets of one such trust, in which the IRA was placed. The Service permitted the spouse to withdraw and roll over into her own IRA the assets which were allocated to that trust. Again, it would appear necessary today that no one other than the spouse have any discretion as to the allocation.

Powers of withdrawal

In *Ltr. Rul.* 9649045, the decedent left his IRA to a trust over which the spouse had the right to withdraw $50,000 per year. The trust had no other assets. The spouse also had the right to determine the method of distribution of the IRA. The spouse proposed to withdraw $50,000 per year from the trust. The Service allowed the spouse to roll over the IRA benefits (presumably only to the extent they exceed the required minimum distributions) distributed from the IRA to the trust and then from the trust to the spouse.

While the facts of *Ltr. Rul.* 9649045 at first glance appear to have limited application, they may be applicable to analogous situations. For example, if the spouse has the right to withdraw the greater of $5,000 or 5% of the value of the trust each year (commonly called a five-and-five power), the spouse may be able to exercise the five-and-five power each year and roll over the amounts in excess of the required minimum distributions. In the case of a QTIP trust, to the extent the income of the trust (i.e., the internal income of the qualified plan or IRA benefit) distributed to the spouse[4] exceeds the required minimum distribution, the spouse may be able to roll this excess into her own IRA. In either case, if the only designated beneficiary is the spouse, distributions are not required to begin until the date the decedent would have attained age 70½.[5] Accordingly, the spouse should be able to roll over all distributions of income or distributions pursuant to a withdrawal power prior to the date the decedent would have reached age 70½.

Despite the foregoing, a rollover was not permitted in *Ltr. Rul.* 9145041, where the spouse had the power to withdraw up to the greater of $100,000 or 10% of the principal of the trust each year. In view of *Ltr. Rul.* 9649045, however, a rollover would likely be permitted today under the facts of *Ltr. Rul.* 9145041.

Joint revocable trust. In each of *Ltr. Ruls.* 9611057, 9515042, 9423039, and 9302022, the decedent and his spouse created a trust that could be revoked by either of them. Each decedent left his qualified plan, Section 403(b), and/or IRA benefits to the joint revocable trust. In each case, because the

[4] Rev. Rul. 89-89, 1989-2 CB 231.
[5] Section 401(a)(9)(B)(iv).

decedent's spouse had the power to withdraw all the trust assets, the Service treated her as receiving the retirement benefits from her husband. Therefore, she could roll them over into her own IRA.

Revocable trust; spouse had power to withdraw. In a number of cases, decedents left their qualified plan and IRA benefits to a revocable trust. These benefits were then allocated to a trust over which the spouse had a power of withdrawal. In each of these instances, the Service allowed the spouse to receive the benefits through the trust and to roll them over into her own IRA.

For example, see *Ltr. Rul.* 9533042 (a court ordered the benefits allocated to the marital share); *Ltr. Rul.* 9509028 (an independent trustee allocated the benefits to the marital share); *Ltr. Rul.* 9350040 (an independent trustee was required to allocate the qualified plan benefits to the marital share); *Ltr. Ruls.* 9633042, 9623056, and 9416039 (the marital trust was first funded with other assets, or the credit shelter share was first funded with qualified plan or IRA benefits, to the extent possible); *Ltr. Ruls.* 9401039, 9234032, and 8920045 (a trust originally was created by both spouses; the surviving spouse, as surviving trustee, allocated the benefits to the marital share); *Ltr. Rul.* 9034067 (a Section 403(b) annuity was allocated to the marital share); *Ltr. Rul.* 9016067 (the spouse, as trustee, was to allocate the IRA to the marital share); and *Ltr. Rul.* 9608036 (the marital trust was funded with IRA benefits to the extent possible; the spouse controlled the allocation).

Despite some of these rulings, it would appear that the Service would now require that the allocation of the IRA benefits to an outright marital share or a trust over which the spouse has a complete right of withdrawal not be subject to the discretion of anyone other than the spouse. In *Ltr. Rul.* 9633043, the spouse was able to satisfy this requirement by exercising her power to remove the bank trustee and name herself trustee, and then by allocating the qualified plan benefits to the marital share over which she had a power of withdrawal.

No rollover where spouse did not have complete power to withdraw trust assets. In several rulings, decedents left their qualified plan or IRA benefits to their estate or revocable trust. The fiduciaries sought to allocate the benefits to the marital trust and then distribute them from the marital trust to the spouse. Rollovers were not permitted, though, where the spouse did not have a unilateral right to withdraw the marital trust assets.

For example, see *Ltr. Rul.* 9445029 (IRA was payable to the estate; the executor and trustee were not the spouse); *Ltr. Rul.* 9416045 (IRA was payable to a revocable trust; the wife and two other individuals were the trustees); *Ltr. Rul.* 9145041 (profit-sharing benefits were payable to a revocable trust; the spouse had the power to withdraw up to the greater of $100,000 or 10% of the principal of the marital trust each year, and sought to make the maximum permitted principal withdrawal from the marital trust and roll that amount over into her own IRA).

No spousal rollover after spouse's death

In *Ltr. Rul.* 9237038, the decedent named his wife as the beneficiary of his IRA. He was taking distributions over his and his wife's joint and survivor life expectancy, and was recalculating both of their life expectancies annually. The decedent died in 1989, having received a portion of his minimum required distribution (MRD) for that year. His wife received the balance of the MRD for 1989, based on her and her husband's joint and survivor life expectancy. She also received her MRD for 1990, based on her own life expectancy. She had made an appointment with the bank where the IRA was established, to elect to treat the IRA as her own. But she died in 1991 prior to keeping the appointment.

The wife's estate sought to make the election to treat the IRA as the wife's IRA, and to designate a beneficiary and payout period. The Service ruled, however, that the wife's death extinguished her right to make the election.

By electing to treat her husband's IRA as her own (or by rolling the benefits over into her own IRA), the decedent's wife could have designated new beneficiaries and substantially extended the payout period. This would have achieved significant income tax deferral. But this opportunity was lost when she died. The lesson here is that if the surviving spouse wishes to treat the decedent's IRA as her own, or to roll the proceeds over into her own IRA, she should act as quickly as possible.

Conclusion

If the spouse is not named as the beneficiary of qualified plan or IRA benefits, taxpayers and their advisors should promptly and carefully examine the situation to determine if a spousal rollover can be accomplished, if desired. In such cases, obtaining a private ruling should be considered. ■