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Endnotes

1. Internal Revenue Code Section 170(e)(1)(B)(i)(I).
2. IRC Section 170(f)(11)(C).
3. Treasury Regulations Section 1.170A-13(c)(3).
4. Treas. Regs. Section 1.170A-1(g).
5. Treas. Regs. Section 1.170A-7(d) Ex. (1).
6. Treas. Regs. Section 1.170A-13(f).
7. Treas. Regs. Section 1.170A-13(f)(10).
8. *Van Dusen v. Commissioner*, 136 T.C. No. 25 (2011).
9. Treas. Regs. Section 1.170A-13(f)(2).
10. Treas. Regs. Section 1.170A-1(h)(4) and IRC Section 6115.

RETIREMENT BENEFITS

IRS Rules “No Problem” If IRA Trust Runs Out Of Beneficiaries

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If an individual retirement account is payable to a trust, the IRA benefits can, generally, be stretched out over the life expectancy of the oldest beneficiary of the trust.¹ For this purpose, any person who could receive amounts distributed from the IRA and accumulated in the trust is

considered a beneficiary. Therefore, remainder beneficiaries and permissible appointees are, generally, considered beneficiaries.²

For example, say an IRA is payable to the children in separate trusts, and one child dies without leaving any issue. If the balance of the deceased child’s trust is added to the other children’s trusts, then each child is a beneficiary of the other children’s trust.³

A permissible appointee is considered a beneficiary. Thus, in the above example, if each child has a power of appointment (POA), if the IRA owner wants to obtain a stretchout over the oldest child’s life expectancy, the class of permissible appointees must exclude anyone older than the oldest child.

Remote Contingent Beneficiary

The Internal Revenue Service considers even a remote contingent beneficiary as a beneficiary for this purpose. In Private Letter Ruling 200228025 (April 18, 2002), an IRA was payable to the grandchildren, subject to trusts to age 30. If both grandchildren died before age 30, the balance of the trust was payable to various contingent beneficiaries, the oldest of which was age 67. Even though the 67-year-old’s interest was remote (both grandchildren would have to die before age 30, and the 67-year-old would have to be living at the death of the surviving grandchild), the IRS ruled that the 67-year-old was a beneficiary, so the IRA had to be distributed over his life expectancy.

Conduit Trust

There’s an exception to the general rule whereby a “mere successor beneficiary” whose interest is contingent on the death of a prior beneficiary is disregarded. To come within this exception, all of the amounts distributed from the IRA must be paid out on a current basis. None of the distributions from the IRA can be accumulated in the trust for distribution to a subsequent beneficiary.⁴ This is known as a “conduit trust.”

Because a conduit trust allows subsequent beneficiaries to be disregarded, it facilitates qualification for the stretchout. However, it forces out the IRA benefits over the beneficiary’s life expectancy, thus pushing the IRA benefits into the beneficiary’s estate and exposing them to the beneficiary’s creditors and spouses.

PLR 201320021

For many years, there’s been a question as to what would happen if a trust were to run out of beneficiaries. No matter how many levels of contingent beneficiaries are


provided, that's always a possibility. One solution has been to terminate the trust when there's only one living issue of the IRA owner remaining. However, that could jeopardize the purpose of the trust in a small family. The last living issue could subsequently have children or exercise a POA, or that person's parent could also have another child.

A stricter solution has been to terminate the trust when only one beneficiary is alive at the IRA owner's death.⁵ However, this throws the trust assets into the estates of the youngest generation alive at the IRA owner's death and exposes it to their creditors and spouses.

In PLR 201320021 (Feb. 19, 2013), the IRS disregarded the persons who would receive the balance of the trust if there were a complete failure of the trust beneficiaries.

In this ruling, an IRA owner was survived by her mother, her brother and one child. She left her IRA in trust for her child. There were no contingent beneficiaries of the trust. If her child died without leaving any issue and without exercising any POA he might have had, the balance of the trust had to go to someone.

Nevertheless, the IRS ruled that since the child was the only beneficiary of the trust, he was the designated beneficiary, and his life expectancy would be used to determine the required distributions. It didn't matter that the IRA owner's mother or brother might receive the balance of the trust by operation of law on the child's death.

If PLR 201320021 is correct, it removes an obstacle to the use of discretionary trusts, particularly in smaller families. While PLRs aren't binding on the IRS, except with respect to the taxpayers to whom they're issued, because the taxpayer requested a ruling on this point, it provided a strong indication of the IRS' view on this issue. 

Endnotes

1. For a detailed discussion of trusts as beneficiaries of retirement benefits, see Bruce D. Steiner, "Trusts as Beneficiaries of Retirement Benefits," 29 *BNA Tax Mgmt. Estates, Gifts & Trusts J.* No. 2, at p. 108 (March/April 2004).
2. Treasury Regulations Section 1.401(a)(9)-5 A-7(c)(3), Example 1.
3. Private Letter Ruling 200235038 (June 4, 2002).
4. Treas. Regs. Section 1.401(a)(9)-5 A-7(c)(3), Example 2.
5. Natalie B. Choate, *Life and Death Planning for Retirement Benefits* (7th ed. 2011), par. 6.3.08.