

TOP TEN TAX TIPS SENIORS NEED TO KNOW

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Elder Law attorneys encounter tax issues with their clients – in almost each and every case – and these issues are often missed. The purpose of this presentation is to provide a check list for Elder Law Attorneys of ten key tax issues that should be considered in each Elder Law matter. Attention to these tax details cannot only prevent tax mistakes, but also add value to the Elder Law representation.

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There are, of course, far more than ten tax issues about which senior citizens need to know. We have selected ten of the more important ones. Our selection criteria for the ten tax topics are: (1) exclude the obvious, (2) exclude those issues which appear infrequently, and (3) include the easily missed and frequently encountered tax issues.

We have intentionally excluded federal estate tax issues because the current \$3.5 million exemption will exclude most of our Elder Law clients and the topic is far too expansive to be treated here. Our prediction is that Congress will extend the \$3.5 million exemption through 2010 – preventing the scheduled repeal.

1. Selling The Home Tax Free – Section 121
2. Capturing The Stepped-Up Tax Basis
3. Capital Gains Planning
4. Gift Tax (IRS Form 709)
5. Taxation Of Social Security Benefits
6. Section 529 College Funding
7. Roth IRA Conversion
8. Naming A Trust As Beneficiary of IRA
9. Navigating IRS Rules After Death of IRA Owner
10. Naming Trust As Beneficiary Of A Nonqualified Annuity

1. SELLING THE HOME TAX FREE – SECTION 121

A. Basic Rule

Under IRC Section 121, a homeowner can exclude gain from the sale of his/her/their “principal residence.”

B. Five-Year Rule

To qualify, the home must be owned by and used by the taxpayer **two years** or more out of the five-year period before the sale.

C. Dollar Limit

The exclusion is limited to \$500,000 for married couples filing joint, and \$250,000 for singles.

D. Compared to Prior Rule

This exclusion is not a one-time exclusion as under the prior law for persons over 55 years of age. There is no longer any age limit and the exclusion can be elected every two years.

E. Special Rule for Disabled Persons

For our clients who must leave the home because of a chronic illness, Section 121 can be lost by failing the two-out-of-five-year “use” requirement. However, when a client is forced to enter a nursing home or other licensed care facility, then he/she only needs to satisfy a “one year” of use out of five years.

F. Estate and Medicaid Planning Traps

Certain estate planning with the home can hurt the Section 121 exclusion by disrupting the “ownership test.” Joint property titling may do this. A revocable living trust and a life estate will not disrupt the ownership test. Certain *irrevocable* trusts may disrupt the ownership test.

- In certain states which have enhanced Estate Recovery, it may be difficult to have your “tax” and “Medicaid” cake at the same time.
- This becomes a big problem when the home needs to be sold when the owner enters a nursing home. By capturing the full Section 121 exclusion, the full sale proceeds will become the nursing home resident’s and may have to be spent down for cost of care or otherwise under Medicaid rules.

A possible exception may be the use of the MIDGT (Medicaid Intentionally Defective Grantor Trust) In a MIDGT, the sales proceeds may qualify under Section 121 and yet may be deemed to belong to the primary beneficiaries who are not the original owner/nursing home resident.

G. The Future in 2010

Under Section 121(d)(9), for tax years after December 31, 2009, the exclusion can be used by the beneficiary who inherits the decedent's home from a probate estate and certain other inheritance methods, e.g. revocable trust, as specified under new IRC 1022.

H. Child Sells Life Estate Parent

The deficit Reduction Act contains a planning opportunity when a parent buys a life estate in a child's home and the parent satisfies the residency period. It appears that such a partial sale by the child does not satisfy section 121, and would be taxable.

2. CAPTURING THE STEPPED-UP TAX BASIS – SECTION 1014 AND NEW SECTION 1022

A. Current Section 1014

Current Section 1014 of the Internal Revenue Code provides an **income-tax free** inheritance for land, stocks, mutual funds and tangible personal property (capital-type assets) received by your surviving loved ones after your passing through the following common strategies:

1. Revocable Living Trust (which was revocable up until death)
2. Life Estate (or life lease) deed
3. Certain Irrevocable Trusts in which you retained income rights and/or a power of appointment
4. Joint Property with Survivorship if the first-to-die paid for the property
5. Other arrangement subject to estate tax inclusion

When the *stepped-up tax basis* applies, the deceased owner's purchase price (original tax basis) is disregarded, all pre-death capital gain disappears, and the recipient's new tax basis is stepped up to the Fair Market Value at time of death. This means that recipients can sell the property without a capital gains tax as to pre-death capital appreciation. Appraisals are recommended.

EXAMPLE: Sally bought a home for \$60,000 in 1970. She deeds her home into a revocable Living Trust in 2007, naming her three children as beneficiaries. Sally passes away in 2009, when the Fair Market Value is \$160,000, according to an appraisal, and her children sell the home soon thereafter. Their tax basis is \$160,000 and the capital gains tax is zero. If they sold the home in 2010, one year later, for \$163,000, there would be a \$3,000 capital gain. If the home was sold for a loss at \$157,000, the children would receive a long-term taxable loss of \$3,000. The recipients take the decedent's holding period.

B. Beware of New Section 1022

For persons dying after December 31, 2009, Section 1014 will be replaced by the more restrictive rules of new Section 1022.

Whether Congress intended it or not, several important stepped-up tax basis strategies, traditionally used by clients to pass on capital assets to heirs, will be gone in full or in part when the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") is fully phased in for clients dying after December 31, 2009. The strategies at risk include the use of life estate deeds, joint revocable trusts for married couples, A/B Trusts, and general powers of appointment incorporated into certain trusts.

Elder law attorneys should take the matter seriously because of the ease in which a mistake can be made and the potential difficulty in correcting it. For example, suppose

you draft a life estate deed for a client in 2002 to avoid probate and provide a stepped-up tax basis after death; but in 2008, when the new law will soon go into effect, your client has a stroke or other illness which makes corrective action impossible. When your client's children sue you for malpractice, you certainly can not argue that EGTRRA took you by surprise when it has been in place since 2001. Remember that deeds, when recorded, are a matter of public record and changes to them require strict execution formalities.

Some tax practitioners have told me not to worry about the problem because of the likelihood Congress before 2010 will change EGTRRA. However, the likely changes will be either permanent estate tax repeal or a substantial increase in the applicable exemption after EGTRRA sunsets. In either of these likely scenarios, the tax basis rules of EGTRRA may likely continue. Rather than to put our heads in the sand, we need to discuss these issues, lobby Congress for corrective amendments, advise our clients of these potential future problems, and draft corrective measures.

- Under the current tax law, qualification for such stepped-up basis treatment, although not automatic, has always been easy to achieve. IRC § 1014 (b) provides broad opportunities to achieve qualification, to wit: use of the probate process in intestacy or with a Will, use of a revocable or amendable living trust, possession of a general power of appointment, possession of a life estate in a deed, and use of joint property with rights of survivorship when the decedent furnished consideration.

Under EGTRRA for decedents dying after December 31, 2009, the stepped-up basis rules of IRC § 1014 will be repealed, and will be replaced by the more restrictive stepped-up basis rules of new IRC § 1022. Although new IRC § 1022 ostensibly provides a stepped-up basis of \$1.3 million for non-spouse recipients and a \$4.3 million for surviving spouses, these benefits are only available if the death-time transfer satisfies the limited qualification requirements of IRC § 1022(d).

These limited qualification methods include:

- (a) Property owned by the decedent at the time of death.
- (b) Jointly held property with rights of survivorship if the decedent furnished the consideration.
- (c) Revocable Trusts and certain other trusts in which decedent reserved the right to change enjoyment through use of a power to alter, amend, or terminate; and
- (d) Community property.

C. Retained Life Estate at Risk

With regard to the use of deeds conveying land to loved ones in which the owner retains a life estate, no specific provision of IRC § 1014 mentions the use of the life estate as a qualification method for a stepped-up basis.

However, IRC § 1014(b)(9) states that any property which is required to be included in the value of decedent's gross estate for estate tax purposes shall receive a stepped-up basis. Since IRC § 2036 makes the *full value* of land subject to a retained life estate subject to inclusion into decedent's gross estate, IRC § 1014(b)(9)'s catch-all provision provides a full stepped-up basis for life estate deeds.

Since the estate tax will theoretically be repealed in 2010, the catch-all qualification method of IRC § 1014(b)(9) will similarly be repealed. As a result, retention of a life estate may not provide a full stepped-up basis for decedents dying after December 31, 2009. IRC § 1022 does not contain a specific qualification provision for life estates.

However, an argument can be made that the death-time value of a decedent's life estate is an "ownership interest" under IRC § 1022(d)(1)(A), and thus a *partial* stepped-up basis can be obtained. The value of a decedent's life estate is based on the actuarial life expectancy at time of death according to the applicable IRS tables (Publication 1457, actuarial values). By contrast, under IRC § 1014(b)(9) a *full* stepped-up basis would have been available.

Planning Consideration: This problem can be solved for existing life estate deeds by preparing a corrective deed into a joint tenancy with rights of survivorship or into a revocable trust, which are expressly approved qualification methods under IRC § 1022 (d).

D. Joint Revocable Trusts For Married Couples at Risk

New IRC § 1022(d) provides that "revocable trusts" receive a stepped-up tax basis, but only if the decedent transferred the property to a revocable trust during decedent's lifetime.

Since IRC § 1022 (d)(1)(A) requires the property in question to be owned by the decedent "at the time of death", it could be interpreted that the power to revoke the trust must have existed at the time of decedent's death in order to obtain a stepped-up basis. What if a married couple establishes a revocable trust, which become *irrevocable* upon death of first spouse? This would appear to disqualify a stepped-up basis at death of second spouse, thereby depriving secondary beneficiaries of this important tax benefit.

However, if both spouses transferred jointly-owned property, such as land, into a revocable trust during life, it would appear that only 50% of a stepped-up basis would be available to secondary beneficiaries after death of second spouse. This is because IRC § 1022(d) states that the decedent (second spouse dying) must be the one who transferred the land into the trust. In this case, the second spouse dying only transferred 50% of land into the trust.

Planning Considerations: If both spouses are alive, they should amend the trust to provide the surviving spouse with a power to revoke and amend the trust. Sample language is: "Settlors acting together, or the surviving Settlor after the death of the first

Settlor, shall have the right to revoke and amend this Trust.” Second, after the first spouse dies, the surviving spouse, acting as Trustee, should transfer the land out of trust into his/her name, and then transfer the land back into trust.

E. Trust A of A/B Trust at Risk

The restrictions of new IRC § 1022(d) just discussed regarding the joint marital trust, can be interpreted to deny a stepped-up basis for the *secondary beneficiaries* of Trust A of an A/B Trust *upon the death of second spouse*. Trust B assets under existing and future rules receive no stepped-up basis.

New IRC § 1022(d) would appear to permit a stepped-up basis for the benefit of the *surviving spouse* upon death of the spouse establishing the trust. This is because the decedent spouse establishing the trust maintained the power to revoke during life. This rule was also true under existing IRC § 1014. Under existing IRC § 1014(b)(9), capital assets in Trust A receive a stepped-up basis for the *secondary beneficiaries* upon death of surviving spouse even though the surviving spouse did not have any power to revoke the Trust A. This is because Trust A assets were includable in the surviving spouse’s estate.

When new IRC § 1022 replaces IRC § 1014, a stepped-up basis for Trust A assets will be denied for *secondary beneficiaries* because the surviving spouse did not have a power to revoke.

Planning Consideration: This problem can be corrected by transferring Trust A assets directly to the surviving spouse after death of first spouse. The surviving spouse can keep the assets individually or place them into his/her own revocable trust. This, however, would defeat the purposes of the QTIP Trust A, which provides protection for original secondary beneficiaries.

F. General Power of Appointment Planning Gone

The use of General Powers of Appointment in estate plans has been used to provide heirs with stepped-up basis opportunities, such as the defective trust for Medicaid planning purposes. Although the assets in these trusts may be exempt from Medicaid spend down, the assets receive a stepped-up basis under current tax law after death of the Medicaid recipient. This planning opportunity has expressly been voided by IRC § 1022(d)(1)(B)(iii) which will apply after December 31, 2009.

Planning Consideration: This problem could be corrected by transferring the subject capital asset out of the defective trust into a joint ownership arrangement or a revocable trust. Such a transfer, however, could trigger Medicaid disqualification.

G. Conclusion

Elder Law attorneys need to remember that the tax basis rules of EGTRAA are not future proposed legislation and are likely to remain in future Congressional changes. Active discussion, lobbying efforts, client explanation, and pro-active corrective drafting are needed.

3. CAPITAL GAINS TAX PLANNING

A. Flat Rate

First, keep in mind that long term capital gains are generally taxed at flat rate of 15 percent.

B. Tip #1

If you are considering selling appreciated non-homestead real property, stocks, bonds and/or mutual funds containing them, consider doing it in 2009, before Congress changes its minds.

For 2009 and 2010, there's *no* tax on capital gains for people in tax brackets up to 15 percent. For 2009, that's taxable income of \$67,900 for couples and \$33,950 for single persons (including the gains from asset sales). Since these figures represent the total of the taxpayer's capital gain and ordinary income, you cannot incur much capital gain if you want to capture the zero tax opportunity.

C. Tip # 2

Another tip is to give appreciated capital assets to young adult children or grandchildren (those out of the kiddie-tax range) to repay their college loans or other purposes before they start earning a big paycheck. If the children are in the 15 percent bracket or lower, and they sell the asset, then the tax will be zero to them. Remember that a form 709 gift tax return may be needed for gifts above the \$13,000 exemption.

D. Tip # 3

Another tip for early or prospective retirees is to delay collecting social security for a year or more and live on tax-free sales of capital assets when income slides into the 15 percent bracket or lower. By deferring the receipt of social security, retirees will receive a higher monthly benefit later. (See Section 5, later).

E. Tip #4

Harvest some capital losses to keep net taxable income below the top of the 15% bracket. (See Tip #1 above).

4. GIFT TAX (IRS FORM 709)

A. Annual Exclusion vs. Lifetime Exemption

- The annual exclusion from gift tax is \$13,000 per donor per recipient.
- But to the extent that the value of a gift exceeds \$13,000, the excess will be absorbed by the donor's lifetime \$1 million exemption to eliminate current gift tax.

EXAMPLE: Sally gives her son John \$23,000 in cash. The first \$13,000 is excluded by the annual exclusion and the \$10,000 excess is not taxed it merely uses \$10,000 of Sally's \$1 million lifetime exemption. Sally's exemption from gift tax is now reduced to \$990,000 for the future.

B. IRS Form 709: "To File or Not to File, That is the Question"

There is a technical requirement to file a Gift Tax Return (IRS Form 709) when the value of the gift exceeds the \$13,000 annual exclusion.

However, there is a penalty for not filing if there is no gift tax due. The real reason for the filing requirement is for the IRS to keep track of the draw-down of the lifetime gift tax exemption and the estate tax unified exemption amount. So if the donor is never subject to estate tax, then there will never be a penalty for not filing IRS Form 709, but is still better to file Form 709 just in case, the donor dies later with an estate subject to tax.

C. Avoiding Gift Taxes in Estate Planning

- Irrevocable Trusts
A gift tax can be avoided by including enough retained powers in a MIDGT (Medicaid Intentionally Defective Grantor Trust), e.g. income interest, a power of appointment or a power to substitute.
- Revocable Trust
Assets in a revocable trust are not subject to gift tax at all, because the transfer, has not been completed for gift tax purposes.
- Life Estate with a Special Power of Appointment
In a deed, the owner can retain a life estate and a special power of appointment (SPA). The retained SPA prevents the gift tax by preventing a completed transfer from occurring.
- Lady Bird Deed
Lady Bird deed is a deed to others with the owner retaining a retained power of sale. This deed does not trigger gift tax because the transfer is incomplete.

5. TAXATION OF SOCIAL SECURITY BENEFITS

A. Basic Rules

There are two maximum inclusion levels of taxation of Social Security benefits: 50 percent or 85 percent of benefits.

- For married couples in 2009, when half of Social Security benefits, plus “modified” adjusted gross income, exceed the threshold shown below a certain percent of Social Security benefits must be included in taxable income:

	<u>Percent</u>
○ Between \$32,000 and \$44,000	50
○ Above \$44,000	85

- For singles in 2009, the following apply:

	<u>Percent</u>
○ Between \$25,000 and \$34,000	50
○ Above \$34,000	85

Note: Under the IRS calculation formula, the 50 percent and 85 percent inclusion levels are maximum levels. The actual percent of includible benefits can be less than the 50 or 85 percent.

B. Traps and Planning

- When cashing in assets for Medicaid qualification, or other purposes, the resulting capital gains could cause unintentional Social Security benefit taxation.
- By buying tax-deferred assets, e.g. annuities or bonds, tax on Social Security benefits could be reduced.
- Consider accelerating income tax before collecting Social Security – after retirement when income declines. An acceleration idea might be to sell stock, or convert a traditional IRA to a Roth/IRA.
- Consider placing some assets that are now producing taxable income- and that are not currently needed to live in- into a Section 529 account(s) for grandchild or grandchildren.

6. SECTION 529 COLLEGE FUNDING

A. Use of a Section 529 College Plan

A grandparent can set up a 529 plan for a grandchild. If used for college, the earnings are tax-free.

- The grandparent can transfer the 529 Plan to a more deserving grandchild.
- The grandparent can revoke the 529 Plan.
- The gift is subject to gift tax, but up to five years of annual exclusion can be accelerated into the year of the gift. Thus \$65,000 (5x \$13,000) can be gifted in one year to a 529 account for one grandchild without using any of the grandparent's \$1 million lifetime gift tax exemption.

B. Medicaid Risk

If the grandparent names herself/himself as account owner, the 529 could be considered "countable" under Medicaid rules because he/she could revoke the account.

7. ROTH IRA CONVERSION

A. Good News!

Starting on **January 1, 2010**, Roth conversions will become easier. The prior law prohibited Roth conversions for anyone making more than **\$100,000**. The new law eliminates the \$100,000 income limit and allows tax paid on the conversion to be deferred (half in 2011 and half in 2012).

B. Roth Advantage When Long-Term Care Is Needed

Compare the tax effect of being forced to cash in an \$80,000 taxable traditional IRA in one tax year, compared with cashing in an \$80,000 tax-free Roth IRA when long-term care is needed.

C. No RMD After Age 70 ½

There is no RMDs required after age 70 ½.

D. Tax Free

After a five-year waiting period, all withdrawals by the owner, the owner's surviving spouse and the spouse's beneficiaries are TAX FREE! Paying tax on the conversion is often well worth this incredible tax benefit.

E. No Affect On Social Security Taxation

Tax free withdrawals from a Roth will not push a senior citizen into taxation of Social Security benefits.

8. NAMING A TRUST AS BENEFICIARY OF AN IRA – THE PROS AND CONS

1. Introduction

The official word has been out on the streets since April 16, 2002. That is when the IRS issued its final regulations, approving the use of a trust as a qualified beneficiary of an IRA or Qualified Retirement Plan, such as a 401(k), 457, or 403(b) plan, as a device to permit individual trust beneficiaries to enjoy stretched-out distributions based upon life expectancy. For our purposes, the term IRA shall also include a Qualified Retirement Plan. Despite this, lack of awareness among IRA providers and other professionals still persists.

Keep in mind that stretch-out tax deferral opportunities are also available when individuals are named as direct beneficiaries of IRAs.

This article will examine the pros and cons of naming a trust as beneficiary and provide details of the qualification rules when the strategy is desired.

The pace at which the IRA must be depleted following the death of the IRA owner depends directly on whether he or she designated a qualified Designated Beneficiary (DB), and, if so, the identity of that beneficiary.

2. The Importance of Satisfying the “Designated Beneficiary” Rule: The Prize is Life-Time Stretch-Out

Less Stretch When There is No DB

If a qualified DB isn't designated (or if the taxpayer isn't treated as having designated one), and the IRA owner dies before Required Minimum Distributions (RMD) begin, that is, after the owner turns 70½, or the Required Beginning Date (RBD), then the IRA must be paid out within five years of the death of the owner. If the IRA owner dies after his/her RBD, the IRA is paid out over the remaining life of the owner/decedent.

3. The Advantages of Naming a Trust as Beneficiary of IRA

A. A Trust Can Achieve Greater Assurance for Life Expectancy Stretch-out

A trust can discipline the beneficiaries into making sure that only the minimum required is distributed based upon a life expectancy payout. If a child or other loved one is named as a direct beneficiary, the beneficiary, without tax advice, may make excessive withdrawals from the IRA and impair the ability to maximize tax deferral and minimize tax.

B. A Trust Can Prevent Guardianship When a Minor Beneficiary is Desired

If a minor inherits IRA funds in his or her own name, an unnecessary and expensive, court-ordered supervision in the form of a guardianship/conservatorship will be required until the minor turns 18 even older in some states, at which time remaining IRA funds must be turned over to the minor. By naming a trust, the funds

can be controlled outside of court supervision even after the beneficiary attains the age of majority.

C. A Trust Can Protect Beneficiaries From Some of Life's Problems

- Addiction and bad behavior of a child or spouse.
- Marital problems of a child.
- Creditor problems of a child or spouse.
- Disability of beneficiary of a child or spouse.
- To preserve benefits for children if surviving spouse remarries use of QTIP trust to hold IRA for surviving spouse, to protect children and save on estate taxes.

D. The Disadvantages of Naming a Trust as Beneficiary of IRA

1. IRA Funds are Insubstantial

When the amount of IRA funds involved is insubstantial, it may not be cost effective to set up a trust. A rule of thumb is that an IRA in trust should be at least \$75,000 to make it worthwhile.

2. Compliance Rules are a Complicated Burden

Compliance with the trust rules of IRC § 401(a)(9) and its regulations and the extra initial and annual expense may not be worth the cost and effort.

3. Depriving the Beneficiary of Control and Flexibility

A beneficiary may resent the loss of control. A tax-smart beneficiary can exercise self-discipline. Also, there is more flexibility in varying distributions when the IRA is paid directly to the beneficiary.

4. Lack of Cooperation from IRA Providers

Some IRA providers are hesitant to cooperate with a trust set up. Of course, a tax-free trust-to-trust rollover to a new IRA provider can save the day.

E. Multiple Trust Beneficiaries Can Result in Shortening Stretch-Out

Must use the life expectancy of eldest beneficiary to determine stretch for all beneficiaries.

F. Surviving Spouse May Lose Spousal Rollover Advantage When Trust is Named

- Spouse cannot defer RMDs until age 70 ½
- Spouse cannot use Uniform Table to minimize RMDs

9. NAVIGATING IRA RULES AFTER DEATH OF IRA OWNER

Most non-spouse designated beneficiaries do not understand their distribution rights when they inherit a taxable traditional IRA or employer-provided retirement plan. Most are surprised that they need not take a lump sum distribution but can minimize income tax by spreading the “inherited IRA” over several years – and even can set up a “stretch” IRA over their life expectancy. A stretch IRA can double or even triple their money if they just follow the Required Minimum Distribution (RMD) rules – annually withdrawing the required minimum over their life expectancy.

The post-death IRS rules that apply to inherited IRAs are complicated and tax traps can easily cost beneficiaries unnecessary taxes. This is why it is critical to obtain the advice of an experienced tax adviser as soon as possible after the death of the IRA owner and before you make any distribution decisions.

Keep in mind that recent tax law changes allow greater flexibility in stretching distributions and in rolling the beneficiary’s share of the IRA or employer-provided retirement plan into another IRA plan – tax free. We can help in accomplishing this.

Before electing final distribution or doing a rollover/transfer, step one, described below, is to withdraw the decedent owner’s last RMD if required.

Step one: Handling year-of-death RMD for owners aged 70 1/2 or older

- Last RMD for decedent owner aged 70 1/2 or older, if not taken, must be withdrawn before Dec. 31 of year of death by the designated beneficiary(ies).
- If not done before this date, a 50-percent penalty applies.
- On the date of death, ownership rights transfer to the beneficiary(ies).
- Thus, withdrawal must be done by beneficiary(ies) and tax will be owed by them in the year of death.
- Last RMD cannot be stretched.
- Any one beneficiary may take the RMD or it can be shared among the beneficiaries.
- Take withdrawal under beneficiary’s Social Security number, not decedent’s.

Step two: Beneficiary considers option to disclaim

- Must be done within nine months of death.
- Cannot receive any funds before disclaiming.

Step three: In the Year after the year of death beneficiary distribution decisions should be made

- In general, these decisions should be made no later than Sept. 30 of the year after the year of death.
- Surviving spouses: Option of choice is rollover in own name, but may elect 5-Year Rule or life-expectancy stretch.
- Non-spouse beneficiary: Elect 5-Year Rule or life-expectancy stretch.
- If beneficiaries fail qualification test, then they are stuck with 5-Year Rule if owner died before 70 ½ or owner’s remaining life expectancy if owner died after 70 ½.

Step four: Comply with September 30 Beneficiary Designation Date (DD)

By Sept. 30 of the year after the year of death the designated beneficiary(ies) should be established so that the applicable life expectancy(ies) can be established for the length of “the stretch” are for figuring life expectancy to use for stretch (if any).

- Shake-out period is from death until DD.
- Cash-out or disclaim undesirable beneficiaries (e.g. charity or older person) If multiple beneficiaries, try to avoid oldest beneficiary within Beneficiary Club (that is whose life expectancy is used to calculate distributions for all beneficiaries).
- Correct account titling:
 - Must leave decedent's name on account.
 - Must add beneficiary's Social Security number and name.
 - Example: “James Johnson IRA (deceased 7/10/09) FBO Mary Johnson (her SSN).”
- Notify IRA plan of official beneficiaries and distribution options selected for each (certified mail with return receipt).
- Notify IRA plan of successor beneficiary designation.

Step five: October 31 trust deadline

- If trust is named, the trust document or its summary must be sent to IRA plan by October 31 of year after year of death.

Step six: December 31 deadline

- Separate shares for multiple beneficiaries must be set up by Dec. 31 of year after year of death – but this may be too late to correctly handle last RMD or beneficiary identification on Sept. 30 (DD).
- If stretch is selected, first RMD must be received by beneficiary by Dec. 31. If not done by Dec. 31, then 5-Year Rule will apply and the “stretch” option will be lost..

10. NAMING THE TRUST AS BENEFICIARY OF A NONQUALIFIED ANNUITY

A. Disadvantages

When accrued interest has built-up inside a tax deferred annuity, the use of a trust may result in acceleration of income tax when the owner dies. The “look-through” rule for trusts as beneficiaries of qualified plans under Treasury Regulation Section 1.401(a)(9)-4,A-5 does not apply to IRC section 72 annuities. Moreover, when a trust is named as beneficiary of an annuity, the following tax-advantaged payout options, will be lost:

1. Spousal continuation; and
2. Ability to elect an annuity payout over life expectancy.

Finally, some companies will even deny the five-year deferral option allowed by IRC section 72(s) for trust beneficiaries.

B. Advantages

On the other hand, naming a trust as beneficiary has these advantages:

1. Spousal continuation may not be desired because of a second marriage or a spendthrift or disabled spouse;
2. An annuity payout over the beneficiary’s life expectancy option may not be desired because of the existence of little taxable accrued interest;
3. Often the flexibility and protective provision of a trust are more important than any income tax savings available from an annuity stretch; and
4. Naming a trust as beneficiary for minors avoids probate conservatorship. For example, when an owner wants a minor child or grandchild to receive an annuity, naming the minor directly will likely necessitate court proceedings so that the funds can be managed and accessed for the minor beneficiary. A trust as beneficiary would be a better option.

C. Planning Considerations

Before naming a revocable living trust as a primary beneficiary or as a contingent beneficiary, all desired outcomes and tax consequences must be assessed. Clients should understand that beneficiary designation for annuities, as with life insurance and qualified plans, is a controlling testamentary disposition that should be reviewed with the financial planner and the Elder Law Attorney. Written confirmation of the accepted beneficiary designation should be part of the client’s and attorney’s permanent records.