

## Revenue Ruling 2000-2

### What does it Mean for You?

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Rev. Rul. 2000-2 rendered Rev. Rul. 89-89 obsolete. Under Rev. Rul. 89-89, a decedent's executor could elect to treat a decedent's IRA as qualified terminable interest property if: (1) the decedent elected an IRA distribution option which required distribution of the principal balance and the income earned on the undistributed balance in annual installments to the QTIP Trust; and (2) the QTIP Trust required that both the income earned on the undistributed portion of the IRA and the income earned by the QTIP Trust on the distributed portion be paid currently to the surviving spouse for life.

#### **Criticism**

Rev. Rul. 89-89 was criticized by practitioners since it required that all of the income earned by the IRA be distributed to the QTIP Trust and be paid currently to the surviving spouse even though that income may exceed the minimum required distribution. The Code does not require that all the income be distributed currently to qualify a trust for the marital deduction. The Code only requires that the surviving spouse be entitled to all the income from the property payable at least annually or have a usufruct interest for life in the property. The Code also requires that no person have a power to appoint any part of the property to any person other than the surviving spouse.

The regulations provide that the spouse must have such command over the income that it is virtually the property of the spouse.

#### **Rev. Rul. 2000-2**

#### **The Basic Requirements**

Rev. Rul. 2000-2 parallels more closely the requirements of the Code and the regulations. Under Rev. Rul. 2000-2, an IRA qualified as a QTIP Trust where: (1) the trustee of the QTIP Trust was named beneficiary of the decedent's IRA; (2) the QTIP Trust provided that the surviving spouse could compel the QTIP trustee to withdraw from the IRA an amount equal to all the income earned on the IRA assets at least annually and to distribute that amount to the spouse; (3) the QTIP Trust provided that no person had a power to appoint any part of the QTIP Trust to any person other than the spouse and (4) the IRA did not prohibit withdrawals from the IRA in excess of the MRDs. The result is that a QTIP Trust need not require that all income be distributed to the surviving spouse in order to qualify for a marital deduction. Instead, it will be sufficient for the QTIP Trust to give the surviving spouse the right to compel the QTIP trustee to withdraw all of the income earned by the IRA and to distribute it to the spouse. The IRS ruled that both the IRA and the QTIP Trust qualified for the marital deduction and that the executor needed to make a QTIP election for both.

#### **An Opportunity**

Why is Rev. Rul. 2000-2 seen as an opportunity? After all, the QTIP Trust will still be taxable in the surviving spouse's estate. What Rev. Rul. 2000-2 does is that it allows income to accumulate tax free in the IRA. The deferral of income tax in the surviving spouse's estate will presumably allow more property to pass to the remainder beneficiaries of the QTIP Trust. This result should not be overlooked. If a practitioner's customary practice is to draft a QTIP Trust which requires all IRA income to be distributed simply to qualify the QTIP Trust for the marital deduction, the practitioner may want to change that practice and draft the QTIP Trust now to allow for the tax free accumulation of income in the IRA to the extent the income exceeds the MRD. It is true that this same deferral result could have been achieved before Rev. Rul. 2000-2 as long as the surviving spouse rolled over to his or her own IRA that portion of the income received which exceeded the MRD. The problem with relying on the spousal rollover, however, is that the surviving spouse and not the deceased spouse names the beneficiaries. Consequently, Rev. Rul. 2000-2 is an improvement if one of the goals is to allow the deceased spouse to name the ultimate beneficiaries.

#### **Some Helpful and Some Troublesome Facts:**

#### **Testamentary Trust**

Rev. Rul. 2000-2 is interesting not only because of its result but also because of its facts. Some of the facts are helpful while others are troublesome. One helpful fact is that the beneficiary was a testamentary trust established under the decedent's Will. Some practitioners were puzzled by the D-5 regulations that required that a trust be valid under state law and that it be irrevocable or would by its terms become irrevocable upon the death of the employee in order for its beneficiaries to be treated as designated beneficiaries. Would this include a testamentary trust? Yes. Rev Rul 2000-2 clarifies that a testamentary trust can satisfy the D-5 regulations.

## **No Postponement of MRDs**

Another fact which is helpful resolves the issue of the spouse's ability to postpone payment of an MRD until the decedent would have been 70 years old. Under Code

401(a)(9), a surviving spouse may postpone MRDs until the date on which the decedent would have attained age 70. But what if the surviving spouse is the beneficiary of a trust? Can MRDs be postponed until the decedent would have been 70? The private letter rulings are inconsistent. Some have allowed postponement of MRDs and others have not. Under the facts of Rev. Rul. 2000-2, the decedent died at age 55 survived by his spouse who was age 50. The trustee elected to receive MRDs using the exception to the five-year rule by withdrawing MRDs over the spouse's life expectancy beginning no later than December 31 of the year immediately following the decedent's death. The ruling noted that because the spouse is not the sole beneficiary of the testamentary's trust interests in the IRA, the trustee elected to have the annual minimum required distributions from the IRA to the testamentary trust begin no later than December 31 of the year immediately following the year of the decedent's death. Rev. Rul. 2000-2 makes clear that where the spouse is not the sole beneficiary of a trust, MRDs may be postponed until the decedent would have been 70.

## **The Custodian as Plan Administrator**

One of the facts that is both helpful and troublesome is a statement that a copy of the testamentary trust and a list of the trust beneficiaries were provided to the custodian of decedent's IRA within nine months after decedent's death.

The fact is helpful because it clarifies the D-7 regulations which require that certain information be given to the plan administrator. The D-7 regulations refer only to the plan administrator although the preamble to the regulations equated IRA custodians with plan administrators. Rev. Rul. 2000-2 confirms that interpretation. Although it is helpful to know that the IRS equates IRA custodians with plan administrators for purposes of the required information, it is also troublesome. An earlier private letter ruling had noted that the requirement to deliver a copy of the trust document to the plan was satisfied where the owner of the IRA (the decedent) had a copy as part of his estate plan.

Why the change? It is clear that a plan administrator of a Qualified Plan the information because he or she has a duty to make MRDs timely to retain plan qualification. An IRA sponsor has no similar duty. Why equate them? Does the IRS really think that someone at the mutual fund or other IRA sponsor is going to correctly identify the designated beneficiary from reading a trust agreement or a list of beneficiaries? These folks have better things to do. They are not trained to read trust agreements or determine designated beneficiaries. Furthermore, the law places no obligation on an IRA sponsor to determine an MRD. Although IRAs differ, they all have one thing in common. They all disclaim any legal responsibility for determining the MRD. Why then does the IRS insist that either a trust document or a list of beneficiaries be sent to the IRA sponsor? If the IRS wants some paper record of a taxpayer's designated beneficiary, perhaps a simple filing with the Form 1040 in the year in which a taxpayer starts to take MRDs would be sufficient. After all, the buck stops with the taxpayer.

## **The Required Information**

One more troublesome fact is that both a copy of a testamentary trust and a list of trust beneficiaries were provided to the IRA custodian. The regulations require only that a copy of the trust instrument or a list of all trust beneficiaries including contingent beneficiaries and remainderman be provided to the plan administrator during the nine-month period after the employee's death. Both items need not be provided. Practitioners should not routinely provide both to an IRA custodian simply because it is one of the facts of the ruling.

## **A Lapsing Power of Withdrawal**

One more troublesome fact. The facts of Rev. Rul. 2000-2 indicate that the spouse has the right exercisable annually (or more frequently) to require distribution to the spouse of the trust income, and otherwise the trust income is to be accumulated and added to corpus. A QTIP Trust need not provide that the spouse's power to withdraw income lapses if not exercised. Indeed, the lapse of the power could give rise to a completed gift if the power exceeded the 5 by 5 limitations. It might also lead to adverse tax consequences under Code 2519 which provides that any disposition of the income interest is treated as a transfer of all interest in the property. Of equal importance is the effect of a lapse on the spouse. If failure to withdraw income in one year means that year's income becomes principal which is never available to the spouse, the spouse may not be inclined to forego exercising the power. None of these issues is new. The important lesson is not to automatically draft the QTIP Trust with a lapsing power just because such a QTIP Trust is the subject of Rev. Rul. 2000-2.

## **Summary**

Rev. Rul. 2000-2 is a step in the right direction because it parallels more closely the Code and regulations and also clarifies certain unresolved issues. Unfortunately, it also perpetuates the myth that IRA sponsors use and need copies of trust agreements and lists of beneficiaries.

## **Questions for Discussion**

*Rev. Rul. 89-89 was declared obsolete. Do documents which were drafted*

*to comply with Rev. Rul. 89-89 need to be amended to comply with Rev. Rul. 2000-2?*

*An IRA custodian has no legal duty to determine the MRD. What is the reason*

*for the requirement that a copy of the trust document or a list of beneficiaries be provided to the IRA custodian?*

*Is the lapse of a power to withdraw income from a QTIP Trust a completed gift? Do we have to worry about Code ?*