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IRA Administration for High Net Worth Clients and Their Beneficiaries -- Unique Challenges and Best Practices for Financial Institutions

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IRA Administration for High Net Worth Clients and Their Beneficiaries—Unique Challenges and Best Practices for Financial Institutions[1]

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I. Introduction

According to the Investment Company Institute ("ICI"), Individual Retirement Accounts ("IRAs") held $6.5 trillion in assets at the end of 2013, up from $5.6 trillion at the end of 2012.[2] As the aggregate pool of IRA assets grows, so do individual IRAs.

IRAs often represent a large proportion of the total wealth of high net worth professionals.[3] Mitt Romney is one vivid data point: relative to his total wealth, his IRA was reported to constitute between 24 and 38 percent of his net worth[4] and to be valued between $20.7 and $101.6 million.

In today's economic climate, investors are searching for nontraditional investments[5] because of the relatively low returns on publicly-traded stocks and bonds. As the portfolios of the wealthy come to hold nontraditional investment products such as interests in privately-held companies, hedge funds, private equity funds,[6] and real estate, so do their IRAs.[7] These individuals wish to maximize their retirement sav-

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1 While the author is a member of the Legal Department of The Northern Trust Company ("Northern Trust"), she is not an official spokesperson for the company. The ideas and observations expressed in the article reflect the author's day-to-day experiences, but do not necessarily reflect official policies and procedures of Northern Trust.

2 http://www.ici.org/pdf/2014_factbook.pdf.

3 This statement is based upon the author's observations.

4 Mark Maremont, *Romney's Unorthodox IRA*, Wall Street Journal, January 19, 2012.

5 Nontraditional assets will also be referred to in this article as "nonmarketable."

6 *See* William I. Sanderson, *Challenges in Trust Departments Working with Family Offices*, McGuire Woods LLP Fiduciary Advisor Services Fall Seminar, October 10, 2013, p. 4-5. 2007, 2009 and 2010 estate tax return data compiled by the IRS shows increasing ownership by wealthy decedents of private equity, hedge fund and limited partnership interests. The data reveal a 50% increase in ownership of these nontraditional assets from 2007 to 2010.

7 Maremont, *supra* note 4. The article reported that many of Mr. Romney's IRA holdings were Bain Capital private equity vehicles. ICI reports that fifty-five percent of

ings by investing their IRAs in nontraditional assets. Having been created for estate planning purposes, assets such as interests in family limited partnerships ("FLPs") and family limited liability companies ("family LLCs") are often readily at hand.

Not only do IRAs serve as wealth accumulation vehicles during the IRA owner's lifetime but, thanks to the income tax rules permitting continued income tax deferral, also after the IRA owner's death.

This article will address issues that arise in the course of administration of IRAs owned by high net worth individuals and inherited by their family members from the perspective of the institutions administering the IRAs, and offer ideas for best practices.

As suggested above, a wealthy client's IRA is likely to hold nontraditional assets which require special handling and reporting. Determination of the required distributions from the IRA during the IRA owner's lifetime is relatively straightforward. The pattern of service established during the IRA owner's lifetime will influence the expectations that his family will have regarding administration of the decedent's IRA (the "Inherited IRA").

Administration of Inherited IRAs of high net worth clients is complex. The IRA owner's death does not impact the protocol for handling and reporting nontraditional assets. However, the beneficiary of the Inherited IRA is likely to be a trust, rather than an individual (or individuals) outright. To the extent possible, the IRA beneficiary trust will want to "stretch" the distributions. The rules for minimum distributions payable to trusts are complicated and unclear. The extent to which the institution administering the Inherited IRA should assume responsibility for, or assist with, the calculation of the minimum distributions becomes a critical issue, requiring careful balancing of risk and client expectations.

II. During Life

The IRA first comes to the financial institution, and the relationship with a high net worth client begins, when the IRA owner is alive. This Section of the article examines administration of an IRA holding nonmarketable assets during the client's lifetime.

IRA assets at the end of 2013 were invested in assets other than mutual funds. http://www.ici.org/pdf/2014_factbook.pdf

A. Trusteed or Custodial IRA

IRAs can be established in one of two legal forms: a custodial account[8] or a trust account.[9] For income tax purposes, custodial IRAs and trust IRAs ("trusteed IRAs") are treated identically.[10] The document governing the trusteed IRA must comply with the minimum distribution rules and other requirements of Section 408 of the Code. Otherwise, it can confer on the institution administering the IRA a variety of trustee powers.[11] For example, the trustee of an IRA can be authorized to use assets for the benefit of the IRA owner when he is disabled.[12] The custodian of an IRA will not perform such duties. The trustee of an IRA can also have investment discretion, in whole or in part, over the IRA,[13] whereas the custodial IRA is entirely self-directed. For a higher fee than is charged for its custodial counterpart, a trusteed IRA will offer more flexibility regarding a beneficiary designation. Thus, the IRA owner can use a custom-drafted beneficiary designation.[14]

Discussion of other benefits (and drawbacks) of a trusteed IRA is beyond the scope of this article.[15] However, for purposes of this article, if an institution offers both legal forms of the IRA, the accounts with nontraditional assets will likely be trusteed IRAs, administered by the same personnel as the client's trust and investment management accounts. Therefore, this article will refer to the institution administering the IRA as the "IRA Trustee."

B. Nondiscretionary Assets

A trusteed IRA can be partly or entirely self-directed. If the IRA owner wishes to invest his IRA in a nontraditional product which the IRA Trustee does not follow, review or recommend, the IRA owner can

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8 Internal Revenue Code § 408(h) (1986), as amended ("IRC" or "Code"). Symbol "§" will from time to time be used interchangeably with "Section." IRS provides Form 5305-A, which is a model Traditional Individual Retirement Custodial Account form (http://www.irs.gov/pub/irs-pdf/f5305a.pdf).

9 I.R.C. § 408(a). IRS provides Form 5305, which is a model Traditional Individual Retirement Trust Account form (http://www.irs.gov/pub/irs-pdf/f5305.pdf).

10 I.R.C. § 408(h).

11 Form 5305, Article VIII ("Article VIII may be used for any additional provisions.")

12 Exhibit A: Northern Trust Traditional Individual Retirement Account Trust Agreement ("NT IRA Agreement"), Article VIII(3).

13 Exhibit B: Individual Retirement Trust Account Agreement (Ascensus, Inc., 2012), ¶ 8.06(b).

14 Exhibit C: Northern Trust Traditional Individual Retirement Account Trust Adoption Agreement, Beneficiary Designation and Payment Direction.

15 *See* Edwin P. Morrow III, *Trusteed IRAs: An Elegant Estate-planning Option*, TRUSTS & ESTATES, Sept. 2009; Bruce D. Steiner, *Before Setting Up a Trusteed IRA*, TRUSTS & ESTATES, Sept. 2009.

direct the IRA Trustee to purchase the product, while relieving it of the investment responsibility. The IRA Trustee will hold the investment in the IRA but will not monitor its performance or make recommendations to the IRA owner. The IRA Trustee will deal with the asset only as and when directed by the IRA owner.[16]

C. Prohibited Transactions

Nonmarketable assets in an IRA raise a red flag of a prohibited transaction. Through careful documentation and communication with the IRA owner, the IRA Trustee can insulate itself from liability related to a potential prohibited transaction.

1. *Income Tax Rules, Generally*

Only two categories of assets are statutorily prohibited to the IRAs: life insurance contracts[17] and collectibles (e.g., works of art, antiques, metals, stamps, and most coins).[18] However, an acquisition of an asset by an IRA, while not disallowed, can constitute a "prohibited transaction." Generally speaking, a prohibited transaction ("PT") is a transaction between the IRA and a disqualified person.[19]

"Disqualified persons" include the IRA owner, members of his family (e.g., the spouse and children of the IRA owner), and certain entities (e.g., corporations, partnerships, trusts) that are owned by the IRA owner and his family (the interests of the IRA owner and his family are aggregated, and ownership must be 50 percent or more for the entity to be considered "owned").[20]

The consequences of an IRA owner directing the IRA Trustee to engage in a PT are disastrous. For example, if an IRA owner directs the IRA Trustee to acquire an asset worth $500,000 by an IRA valued at $2 million, and the acquisition is deemed a PT, the IRA owner will realize $2 million of ordinary income in one year and the IRA will cease to be an IRA.[21]

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16 Self-directed IRAs are very common. It is well established that if the IRA owner retains full investment discretion over the IRA, and the documents governing the IRA waive any advisory or oversight responsibilities on the part of the IRA trustee, the IRA trustee will not be held liable for bad investment results. *See*, *e.g.*, Brown v. California Pension Administrators & Consultants, Inc., 45 Cal. App. 4th 333, 348 (1996).

17 I.R.C. § 408(a)(3).

18 I.R.C. § 408(m).

19 I.R.C. § 4975(c).

20 I.R.C. § 4975(e)(2).

21 I.R.C. § 408(e)(2). For a detailed discussion of adverse income tax consequences triggered if an IRA engages in a prohibited transaction, *see* David J. Cartano, *Taxation of Individual Retirement Accounts*, § 17.06, Penalties (2009).

Sometimes, a PT is easy to spot. For example, a PT occurs if an IRA owner directs the IRA Trustee to purchase an asset from the IRA owner's spouse,[22] or if an IRA owner directs the IRA Trustee to lend money to the IRA owner's child.[23]

More often, however, the determination of whether the transaction directed by the IRA owner is a PT calls for specialized legal judgment. For example, the IRA owner directs the IRA Trustee to purchase interests in an LLC in which the IRA owner holds 10 percent and of which he acts as manager. The purchase of the LLC interests is not a PT under Section 4975(c)(2)(A) of the Code because, under the constructive ownership rules of Sections 4975(e)(2)(E) and (G) of the Code, less than 50 percent of the LLC interests are owned by disqualified persons and related parties and the LLC is therefore not a disqualified person. However, the purchase of the LLC interests could be a PT under Section 4975(c)(1)(D) of the Code[24] and/or Section 4975(c)(1)(E) of the Code[25] which prohibit the use of IRA assets to benefit a disqualified person. Following the IRA's purchase of the LLC interests, the IRA owner, as manager of the LLC, could cause the LLC to enter into a transaction which would favor his personal interests over those of the IRA.[26]

2. *IRA Trustee Exposure*

Suppose that an IRA owner contacts the IRA Trustee to discuss an investment opportunity for the IRA involving a nonmarketable asset. The IRA Trustee's internal policies may allow investments only in publicly-traded securities or other traditional investments. However, if the IRA Trustee is willing to accept a nontraditional investment, the issue is what, if any, obligation the IRA Trustee has to investigate whether the proposed transaction is a PT and/or whether a PT may occur in the future.

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22 I.R.C. § 4975(c)(1)(A).

23 I.R.C. § 4975(c)(1)(B).

24 I.R.C. § 4975(c)(1)(D) prohibits any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of an IRA.

25 I.R.C. § 4975(c)(1)(E) prohibits a fiduciary, such as the IRA owner, from dealing with the income or assets of an IRA in his or her own interest or for his or her own account.

26 ERISA Opinion Letter 2000-10A (2000), http://www.dol.gov/ebsa/regs/AOs/ao2000-10a.html. *See also* ERISA Opinion Letter 2011-04A (prohibited transaction found where self-directed IRA purchased promissory note and deed of trust held by a bank, with IRA owner and his wife as obligors on note, and title to real property encumbered by deed of trust was held by IRA owner's and wife's revocable trust), http://www.dol.gov/ebsa/pdf/ao2011-04a.pdf. For a detailed discussion of transactions that may constitute a PT, *see* David J. Cartano, *Taxation of Individual Retirement Accounts*, § 17.04, Types of Prohibited Transactions.

Neither the Code nor the applicable Treasury Regulations impose a direct duty on the IRA Trustee of a self-directed IRA to identify a PT. The IRA Trustee is not liable for the excise taxes and penalties triggered by a PT if, under a self-directed IRA, the Trustee unknowingly participated in a PT at the direction of the IRA owner.[27] The courts have ruled that Section 408 of the Code does not give rise to any independent cause of action or actionable duties.[28]

In a case most on point, *Metz v. Independent Trust Corporation*, the Seventh Circuit Court of Appeals held that a trustee of a self-directed IRA did not have a duty to inform the IRA owner that the loan of IRA funds to the IRA owner's financial advisor would constitute a PT. In this case, the IRA owner had sole investment discretion over IRA investments, directed the loan from the IRA, and signed a statement attesting that the transaction did not violate the Code, and various IRA-governing documents exonerated the IRA Trustee from any liability in connection with IRA investments.[29]

Although not required to identify a PT, the IRA Trustee is required to report it. The IRA Trustee must file Form 1099-R with the IRS by February 28 of the year following the year in which distributions from the IRA occur.[30] If the distribution is caused by a PT, the IRA Trustee must enter Code 5 in box 7.[31]

Another filing that touches on a PT is Form 5498, which the IRA Trustee must file with the IRS by May 31 of each year.[32] Form 5498 contains information regarding contributions to, and distributions from, the IRA, as well as the December 31 fair market value. If a total distribution was made from the IRA during the year, it is not necessary to file Form 5498 or to furnish the annual statement to reflect the December 31 zero value.[33] By filing Form 5498 with the IRS, the IRA Trustee effectively tells the IRS that a qualified IRA is in existence.

If an IRA Trustee files Form 1099-R or Form 5498 and later discovers that it contains an error, the IRA Trustee must correct it as soon as possible and furnish statements to the IRA owner showing the correc-

27 Private Letter Ruling ("PLR") 8137061.

28 Burns v. Delaware Charter Guarantee & Trust Co., 805 F. Supp. 2d 12, 19 (S.D.N.Y., 2011) ("Section 408 does not give rise to any independent cause of action or actionable duties, and any claim that it does is 'frivolous.'").

29 994 F.2d 395, 402 (7th Cir. 1993). *Metz* will be discussed in detail in Section III(D)(2) of this article.

30 Treasury Regulations, 26 CFR 1.408-7 ("Reg" or "Regulations").

31 2014 Instructions for Forms 1099-R and 5498 (http://www.irs.gov/pub/irs-pdf/i1099r.pdf), p. 2.

32 Reg. § 1.408-5; 2014 Instructions for Forms 1099-R and 5498.

33 Rev. Proc. 91-70, 1991-2 C.B. 899; 2014 Instructions for Form 1099-R and 5498, p. 18.

tion.[34] If a PT occurred, the IRA Trustee would have had to report it on Form 1099-R. If the IRA Trustee was not aware of a PT, did not file Form 1099-R, but later learns about a PT, the instructions are silent as to what the IRA Trustee must do.

Failure to file either form results in a penalty of $30/$60/$100, depending on the timing of correction of the oversight.[35] If the failure to file (or the failure to provide correctly all of the information required by the form) is due to "intentional disregard," then the penalty is at least $250 per failure.[36] No penalty is imposed if it is shown that the failure to file is due to reasonable cause and not willful neglect.[37]

Interestingly, the instructions for completing Form 1099-R note that if the IRA owner controls the investment, there is a greater likelihood of a prohibited transaction:

> IRAs that include, or consist of, non-marketable securities and/or closely held investments, in which the IRA owner effectively controls the underlying assets of such securities or investments, have a greater potential for resulting in a prohibited transaction.[38]

Yet, no suggestion is made that the IRA Trustee oversee or review the IRA owner's activities.

The IRS' model Traditional Individual Retirement Trust Account form provides that "the grantor agrees to provide the trustee with all information necessary to prepare any reports required by section 408(i) and Regulations sections 1.408-5 and 1.408-6."[39] Section 408(i) of the Code calls for the trustee to make such reports regarding contributions, distributions and such other matters as the Secretary may require, and to furnish by each January 31, to the individual for whose benefit the IRA is maintained, a statement with respect to the account balance as of the close of, and the account activity during, the previous year.[40]

Section 1.408-6 of the Regulations requires the trustee to furnish to the person for whom an IRA is established a disclosure statement in nontechnical language that contains certain information, including a concise explanation of the tax laws applicable to IRAs[41] and a statement

34 2014 Instructions for Form 1099-R and 5498, pp. 8 and 20.
35 I.R.C. § 6721.
36 I.R.C. § 6721(e).
37 I.R.C. § 6724(a).
38 2014 Instructions for Forms 1099-R and 5498, p. 2.
39 Form 5305, Article V(1).
40 I.R.C. § 408(i). Section 1.408-5 of the Regulations essentially repeats § 408(i) of the Code, and adds a provision that the report must contain such information as the Commissioner may require.
41 Reg. § 1.408-6(d)(4)(iii)(A).

of the consequences of engaging in a prohibited transaction.[42] In lieu of providing this information in a disclosure statement, the trustee may furnish an IRS publication containing that information.[43]

In summary, the structure put in place by Congress and the IRS, and interpreted by the courts, does not require the IRA Trustee to monitor the IRA owner's activities relative to self-directed assets to prevent a PT. If such obligation lay with the IRA Trustee, it would have been expressly stated and backed by strict enforcement mechanisms. Rather, the responsibility for avoiding a PT is placed on the IRA owner with the investment discretion over the IRA assets. It is therefore reasonable for the IRA Trustee to rely on the IRA owner to avoid a PT and to notify the IRA Trustee if one occurs. When and if informed, the IRA Trustee will report the PT to the IRS.

3. *Managing Risk*

In the absence of a duty under tax law to identify a PT, whether the IRA Trustee has an obligation to police the IRA owner's investment activities to prevent or search for a PT depends on the provisions of the IRA trust agreement and other documents governing the IRA.[44] Therefore, to manage risk in this area, the IRA Trustee must ensure that the IRA documents clearly bifurcate the responsibility and liability between the IRA Trustee and the IRA owner as to the tax consequences of acquiring and holding a nonmarketable asset directed by the IRA owner. The IRA agreement must make it clear, for example, that if the IRA owner has discretion to direct the acquisition of an asset and investment responsibility for the asset going forward, he also has full responsibility to determine that the acquisition and retention of the asset will not constitute a PT. The IRA Trustee will not make this determination, will not provide tax advice to the IRA owner with regard to the asset, and will not be liable for any adverse impact on the tax status of the IRA or the IRA owner caused by the asset.[45]

In addition, when the IRA owner directs the IRA Trustee to engage in a transaction involving a nontraditional asset, the direction document should reiterate the above disclosures and exculpations. Further, the document should request the IRA owner to affirmatively represent

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42 Reg. § 1.408-6(d)(4)(iii)(B)(1).

43 Reg. § 1.408-6(d)(4)(iii))(B)(15). Currently, the information is in IRS Publication 590.

44 *See Metz* discussed above and further, in Section III(D)(2) of this article.

45 Exhibit A: NT IRA Agreement, Article XIV(3).

that the directed transaction does not constitute a PT under Section 4975 of the Code.[46]

D. MRDs Begin During Lifetime

After the IRA owner attains age 70½, his first minimum required distribution ("MRD") must be distributed by April 1 of the following calendar year. April 1 is the taxpayer's required beginning date ("RBD").[47] Many people, not wishing to take into income two MRDs in one tax year, withdraw the first MRD by December 31 of the year they attain age 70½, rather than wait until April 1 of the following year.

While the IRA owner is alive, the MRD is a fraction, the numerator of which is the value of the IRA as of December 31 of the preceding year, and the denominator is a factor derived from the Uniform Lifetime Table.[48] The Uniform Lifetime Table uses only the age of the IRA owner in the year of distribution and calculates the joint life expectancy of a person that age and another person 10 years younger.[49]

1. *Numerator*

The numerator of the MRD fraction is the value of the IRA as of December 31 of the preceding year.[50] The responsibility for determining the value of the IRA lies with the IRA Trustee. This obligation arises under federal tax law. As already mentioned, by May 31 of each year, the IRA Trustee must file Form 5498 with the IRS and provide a copy of the form to the IRA owner.[51] In Box 5, Form 5498 calls for the fair market value of the IRA account as of December 31 of the prior calendar year.

If the IRA holds securities, mutual funds, bonds, cash and other marketable assets, valuation information is readily available to the IRA Trustee. If the IRA holds nontraditional assets, fulfilling the valuation obligation is more complicated.

For many years, IRA Trustees reasoned that since the IRA owner directed acquisition of the nonmarketable asset and exercised sole investment discretion over it, the IRA Trustees could rely on the IRA owner to furnish the value of the nonmarketable asset for tax reporting and MRD purposes.

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46 Exhibit D: Direction to Purchase and/or Retain IRA Non-Discretionary Asset (Non-Marketable).
47 Reg. § 1.401(a)(9)-2, A-2.
48 Reg. § 1.401(a)(9)-5, A-1.
49 Reg. § 1.401(a)(9)-5, A-4(a).
50 Reg. § 1.401(a)(9)-5, A-3.
51 Prop. Reg. § 1.408-5.

In 2011, the IRS stated that such reliance would no longer be acceptable. The instructions for Form 5498 now provide that the "[t]rustees and custodians are responsible for ensuring that all IRA assets (including those not traded on established markets or with otherwise readily determinable market value) are valued annually at their fair market value."[52]

The IRS continues to scrutinize nontraditional assets in IRAs. On June 20, 2013, the IRS issued draft Forms 5498 and 1099-R.[53] The draft instructions revealed significant changes in the manner the IRA assets would be reported. A new Box 15a would report the fair market value of the IRA investments, while the new Box 15b would categorize the investments listed in Box 15a through the use of code(s). The codes would include the following:

> A - Stock or other ownership interest in a corporation that is not readily tradable on an established securities market.
>
> B - Short or long-term debt obligation that is not traded on an established securities market.
>
> C - Ownership interest in a limited liability company or similar entity (unless the entity is traded on an established securities market).
>
> D - Real estate.
>
> E - Ownership interest in a partnership, trust, or similar entity (unless the interest is traded on an established securities market).
>
> F - Option contract or similar product that is not offered for trade on an established option exchange.
>
> G - Other asset that does not have a readily available fair market value.
>
> H - More than two types of assets (listed in A through G) are held in the IRA.[54]

The fair market value of the IRA account as of December 31 of the prior calendar year is still required to be reported in Box 5, but nonmarketable assets must now be called out and identified by one or more category codes.

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52 2014 Instructions for Forms 1099-R and 5498, p. 21.

53 2014 Instructions for Forms 1099-R and 5498, "What's New."

54 *Id.* The new Form 1099-R would require characterization of distributions other than cash using new distribution codes.

The new forms were slated to go into effect on January 1, 2014. The Securities Industry and Financial Markets Association and the American Bankers Association asked for clarification of certain terms as well as delay of implementation until January 1, 2015 at the earliest.[55] The IRS responded with an extension: "To give financial institutions reasonable time to fully implement the new requirements, the additional reporting for hard-to-value IRA investments will be optional for 2014."[56]

In view of the continued regulatory focus, the IRA Trustee is well advised to institute and observe robust policies and procedures around nontraditional assets in IRAs. For example, the IRA Trustee should inform the IRA owner wishing to direct the purchase of a nontraditional asset that the IRA Trustee will require specific information regarding the asset[57] in order to establish an independent annual value of the asset and will charge the IRA (or the IRA owner) fees related to the valuation. The IRA Trustee should emphasize that if the necessary information is not forthcoming in a timely fashion, the IRA Trustee may be forced to take action, including distributing the nonmarketable asset to the IRA owner or another IRA Trustee selected by the IRA owner. Finally, the agreement governing the IRA should clearly reflect the IRA Trustee's policy regarding nontraditional assets.[58]

2. *Denominator*

The denominator of the MRD fraction is a factor derived from the Uniform Lifetime Table and is based upon the age of the IRA owner in the year of distribution.[59] Typically, while the IRA owner is alive, the identity of the IRA beneficiary is not considered in calculating the MRDs.[60]

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55 Letter to Mr. Danny Werfel, Acting Commissioner, IRS, dated August 20, 2013, https://www.aba.com/Advocacy/commentletters/Documents/ABASIFMACommentLetterReIRSDraftFormsforIRAs.pdf.

56 *See* http://www.irs.gov/Retirement-Plans/Reporting-for-Hard-to-Value-IRA-Investments-is-Optional-for-2014.

57 Exhibit E: Special Assets in Individual Retirement Accounts—Information Cover Sheet.

58 Exhibit A: NT IRA Agreement, Article XIV(3).

59 Reg. § 1.401(a)(9)-5, A-4(a).

60 Reg. § 1.401(a)(9)-5, A-4(b). If the spouse is the sole designated beneficiary of the IRA, during the IRA owner's lifetime, the applicable distribution period for the IRA is the longer of (1) the distribution period in the Uniform Lifetime Table or (2) the joint life expectancy of the IRA owner and spouse, with their joint life expectancy being recalculated each year. The joint life expectancy period provides a longer distribution period only when the spouse is more than ten years younger than the IRA owner.

3. *IRA Trustee Obligation*

The IRS imposes certain duties relative to the MRDs on the IRA Trustee administering the IRA for a living owner. The regulations that currently govern MRDs came into effect in 2002 and significantly simplified prior rules. The IRS hoped to further lighten the burden on the taxpayer by shifting it to the IRA providers:

> Because these regulations substantially simplify the calculation of required minimum distributions from IRAs, IRA trustees, custodians, and issuers determining the account balance as of the end of the year can also calculate the following year's required minimum distribution for each IRA. To improve compliance and further reduce the burden imposed on IRA owners and beneficiaries, under the authority provided in section 408(i), these proposed regulations would require the trustee, custodian, or issuer of each IRA to report the amount of the required minimum distribution from the IRA to the IRA owner or beneficiary and to the IRS at the time and in the manner provided under IRS forms and instructions. This reporting would be required regardless of whether the IRA owner is planning to take the required minimum distribution from that IRA or from another IRA, and would indicate that the IRA owner is permitted to take the required minimum distribution from any other IRA of the owner.[61]

The Regulations describe the IRA Trustee's obligation with regard to the MRD as follows:

> [T]he trustee, custodian, or issuer of an IRA is required to report information with respect to the minimum amount required to be distributed from the IRA for each calendar year to individuals or entities, at the time, and in the manner, prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter) as well as the applicable Federal tax forms and accompanying instructions.[62]

What is the "information with respect to the minimum amount required to be distributed from the IRA?" Who are the "individuals or entities" to whom the IRA Trustee must provide information? When

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61 Internal Revenue Bulletin ("I.R.B.") 2001-11 794, 870, http://www.irs.gov/pub/irs-irbs/irb01-11.pdf.

62 Reg. § 1.408-8, A-10.

must the IRA Trustee provide such information? Notice 2002-27[63] answers these questions.

If the IRA owner is alive at the beginning of a calendar year during which an MRD is required, the IRA Trustee that held the IRA as of December 31 of the prior year must provide a statement to the IRA owner by January 31 of the calendar year regarding the MRD.[64]

The IRA Trustee has two alternatives for fulfilling this obligation. Under the first alternative, the statement must contain the amount of the MRD and the date by which it must be withdrawn by the IRA owner. If the IRA Trustee elects this method, the MRD may be calculated under certain assumptions: that the sole beneficiary of the IRA is not the IRA owner's spouse more than 10 years younger than the IRA owner and that no amounts received by the IRA after December 31 of the prior year are required to be taken into account to adjust the value of the IRA as of December 31 of the prior year for purposes of determining the MRD.[65]

The second alternative allows the IRA Trustee to provide a statement to the IRA owner that (i) informs the IRA owner that an MRD is required for the calendar year and the date by which it must be distributed, and (ii) offers to provide the IRA owner, upon request, with a calculation of the amount of the MRD. If the IRA owner requests such a calculation, the IRA Trustee must calculate the MRD and furnish it to the IRA owner.[66]

The IRA Trustee must report to the IRS on Form 5498 that an MRD is due but is not required to disclose the MRD amount.[67]

The IRA Trustee administering an IRA for a high net worth client should select the first alternative and calculate the MRD without being asked. The client will appreciate help in complying with income tax rules. While the risk of an erroneous calculation exists, due, for example, to the use of an incorrect birthdate, the income tax rules for calculating the MRD for a living IRA owner are straightforward, and the IRA Trustee may calculate the MRD under certain default assumptions. Even if the IRA Trustee uses the second alternative, the IRA owner is entitled to request the calculation and will likely do so. The benefit of proactively providing the MRD to the IRA owner outweighs the small additional risk to the IRA Trustee. The quality of service the financial institution provides is paramount in retaining the client.

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63 2002-18 I.R.B. 814, http://www.irs.gov/pub/irs-irbs/irb02-18.pdf.

64 *Id.*

65 *Id.*

66 *Id.*

67 *Id.*

A comfortable routine will develop between the IRA owner and the IRA Trustee, whereby, on an annual basis, the IRA Trustee values the IRA assets, both marketable and nonmarketable, and calculates the MRD. The IRA owner receives a letter from the IRA Trustee by January 31 of each calendar year, reminding him of the MRD, informing him of the amount and confirming the IRA owner's previously chosen account into which the MRD should be deposited. The MRD is distributed in a timely fashion, and all is well with the world.

III. After Death

A. Year of Death

The IRA Trustee is advised to have a procedure for identifying and addressing issues that arise in the year of the IRA owner's death.[68] Upon receipt of a death certificate, the IRA Trustee should modify its records so that, after the year of the IRA owner's death, MRDs are no longer calculated with reference to the Uniform Lifetime Table.

If the deceased IRA owner was receiving MRDs at the time of his death, and had not taken the entire MRD for the year of death, the beneficiary of the IRA must take the balance.[69] The deadline for the beneficiary to withdraw the MRD balance is December 31 of the year of death.[70] The executor of the decedent's estate (or the trustee of his revocable trust) will, on occasion, demand that the MRD balance be paid to him. While the executor may well be entitled to know the date-of-death value of the IRA due to his tax reporting responsibilities, only the beneficiary (or beneficiaries) are entitled to the balance of the year-of-death MRD. The executor would be entitled to this payment only if the estate is named as the beneficiary.[71]

All distributions made from an IRA, including to an IRA beneficiary, are subject to federal income tax withholding of 10%, unless the distributee elects not to have the withholding apply.[72] When establishing the IRA account, the IRA owner would have opted out of the withholding or elected to have more than 10% withheld. Upon the IRA owner's death, the choice he made regarding income tax withholding will no longer be effective. Therefore, prior to distributing the balance of the IRA owner's MRD to the IRA beneficiary, the IRA Trustee must provide the IRA beneficiary a notice of his right to elect not to have the

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68 Special tax reporting procedures apply with respect to a deceased IRA owner. *See* Rev. Proc. 89-52, 1989-2 C.B. 632.

69 Reg. § 1.401(a)(9)-5, A-4(a).

70 *Id.*

71 PLR 199930052, http://www.irs.gov/pub/irs-wd/9930052.pdf.

72 I.R.C. § 3405(a).

withholding apply.[73] The IRA beneficiary can make the election by completing Form W-4P.[74]

If the IRA beneficiary is someone other than the decedent's spouse (who may roll over the decedent's IRA into her own IRA), the decedent's IRA is likely to continue, albeit with a different owner (or owners) taking distributions from the IRA at a different rate. There is no tax law requirement that a new account agreement be executed after the IRA owner's death. Therefore, distributions to the beneficiary can be made from the IRA owner's account. However, for ease of administration and avoidance of confusion, the beneficiary should complete an Inherited IRA agreement. The IRA Trustee will then retitle the decedent's IRA accordingly.[75]

There is no IRS-prescribed convention regarding the titling of the Inherited IRA. However, the name should reflect that the IRA was originally owned by the decedent and that it is now owned by the beneficiary. When reporting the value of and distributions from the Inherited IRA to the IRS, the IRA Trustee must show the name of the decedent, as well as the name and taxpayer identification number of the beneficiary.[76] The following is an example of a name of an Inherited IRA payable to a trust: "Inherited IRA of John Smith, deceased, f/b/o James Smith Trust under the John Smith Revocable Trust."

Depending on the timing of the IRA owner's death (whether at the beginning, middle or the end of the calendar year) and the identity of the beneficiary (whether an individual or a trust), the retitling of the IRA from the decedent to the beneficiary may not occur until the year following the year of death or later. There is no deadline for the retitling. The deadline for the first MRD to be withdrawn by the beneficiary is December 31 of the year following the year of death of the IRA owner[77] and must be correctly calculated irrespective of the IRA's title.

B. MRD for Trust-Beneficiary

The high net worth individual's estate plan likely includes trusts. Therefore, the beneficiary of the IRA is probably also a trust (the "Trust-Beneficiary"). A detailed analysis of the rules for distributing an IRA to a trust after the death of the IRA owner is beyond the scope of

73 Reg. § 35.3405-1T, Q&A D-21 through 26.
74 *See* http://www.irs.gov/pub/irs-pdf/fw4p.pdf.
75 *See* Rev. Proc. 89-52.
76 *Id.*; *see also* 2014 Instructions for IRS Forms 1099-R and 5498, p. 19.
77 Reg. §§ 1.401(a)(9)-2, A-5; 1.401(a)(9)-3, A-3(a).

this article. There are many excellent resources.[78] The following summary will provide the context for the issues addressed bellow.

The inquiry must start with the concept of "designated beneficiary" and the consequences in the event that an IRA lacks a designated beneficiary. If the IRA owner leaves his IRA to an individual beneficiary, then the beneficiary is deemed a designated beneficiary.[79] Regardless of the IRA owner's age at death, a designated beneficiary is allowed to stretch the Inherited IRA distributions over his life expectancy.[80]

If the Inherited IRA does not have a designated beneficiary, then the rule for MRDs depends on the age of the IRA owner when he died. If the IRA owner had reached his RBD at death, then the MRDs must be distributed over the remaining life expectancy of the deceased IRA owner.[81] If the IRA owner had not reached his RBD, then the IRA is subject to the five-year rule and must be distributed in full by the fifth anniversary of the IRA owner's death.[82]

The general rule is that a trust does not qualify as a designated beneficiary for MRD purposes because a designated beneficiary must be an individual.[83] However, income tax deferral is available to a Trust-Beneficiary if it satisfies requirements of a "look-through trust."[84]

A look-through trust must meet the following requirements: (1) the trust is valid under state law; (2) the trust is irrevocable or will, by its terms, become irrevocable upon the death of the IRA owner; (3) the trust has identifiable beneficiaries; and (4) a copy of the trust instrument (or a list of all trust beneficiaries, including contingent and remaindermen beneficiaries) is provided to the IRA Trustee by October 31 of the year following the death of the IRA owner.[85] If the Trust-Beneficiary meets the look-through test, then its beneficiaries will be treated, for most purposes, as if the IRA owner named them directly as IRA beneficiaries.[86] The next hurdle on the way to income tax deferral is for all beneficiaries of the Trust-Beneficiary to be "designated beneficiaries,"

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78 *See*, *e.g.*, Natalie Choate, Life and Death Planning for Retirement Benefits (7th ed. 2011).

79 Reg. § 1.401(a)(9)-4, A-1.

80 I.R.C. § 401(a)(9)(B)(iii). At the discretion of the IRA Trustee, when the IRA owner dies before his RBD, his designated beneficiary may elect into the five-year rule, i.e., no annual distributions are required, but the entire account must be distributed by the end of the fifth year following the IRA owner's death. *Id.*

81 Reg. §§ 1.401(a)(9)-4, A-3; 1.401(a)(9)-5, A-5(a)(2).

82 Reg. § 1.401(a)(9)-3, A-2.

83 Reg. § 1.401(a)(9)-4, A-1, 3.

84 Reg. § 1.401(a)(9)-4, A-5(a).

85 Reg. § 1.401(a)(9)-4, A-5(b). The term "identifiable" means that, on the date of the IRA owner's death, it must be possible to determine the identity of the oldest individual who could receive IRA proceeds. Reg. § 1.401(a)(9)-4, A-1.

86 Reg. § 1.401(a)(9)-4, A-5(a).

i.e., individuals.[87] If so, then the life expectancy of the oldest beneficiary of the Trust-Beneficiary will be used to determine the MRDs to be distributed from the Inherited IRA.[88]

In many cases, having a look-through trust translates into substantially longer income tax deferral than does distribution over the IRA owner's remaining life expectancy or the five-year period. Therefore, achieving look-through status is important for the Trust-Beneficiary.

The Trust-Beneficiary that serves estate planning purposes other than being an IRA beneficiary (as it almost always does) will have multiple beneficiaries. For example, a charity and an older relative of the IRA owner may be given a pecuniary bequest in the provisions of the document governing the Trust-Beneficiary. The IRA owner's spouse and children will be the residuary beneficiaries. To create flexibility, the children may be given testamentary powers of appointment in favor of their descendants and spouses. Heirs-at-law of the IRA owner and/or charities are typical choices as contingent remaindermen. Do all of these beneficiaries of the Trust-Beneficiary "count" for purposes of the MRD rules? If none can be disregarded, and one or more of the estate, charities, descendants' spouses, and heirs-at-law are deemed beneficiaries of the IRA, then it would appear that this typical trust structure would flunk the look-through test.[89]

The Regulations regarding which beneficiaries must be taken into account when applying the look-through rules are unclear,[90] having been written without special consideration of estate planning goals,

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87 Reg. § 1.401(a)(9)-4, A-1.

88 Special MRD rules apply if the IRA owner's spouse is a sole beneficiary of the Trust-Beneficiary and is entitled to all distributions withdrawn by or distributed to the Trust-Beneficiary from the IRA. Reg. § 1.401(a)(9)-5, A-5(c)(2), A-7(c)(3), Example 2(ii).

89 PLR 201203033 (to satisfy look-through rules, release of power of appointment in favor of any non-individual), http://www.irs.gov/pub/irs-wd/1203033.pdf; PLR 200438044 (to satisfy look-through rules, power to appoint to descendants' spouses disclaimed), http://www.irs.gov/pub/irs-wd/0438044.pdf; PLR 200228025 (where trust distributes to two children upon attaining age 30, otherwise to remainder beneficiary who is 67 year-old, distributions to trust must be over the life expectancy of 67 year-old), http://www.irs.gov/pub/irs-wd/0228025.pdf. Admittedly, this dire result presumes that post-mortem elimination of problematic beneficiaries via distribution, disclaimer, release, etc. was not possible or was not done. *See* § 1.401(a)(9)-4, A-4(a).

90 Reg. § 1.401(a)(9)-5, A-7(c)(1) states as follows: "A person will not be considered a beneficiary for purposes of determining who is the beneficiary with the shortest life expectancy . . . or whether a person who is not an individual is a beneficiary, merely because the person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. However, the preceding sentence does not apply to a person who has any right (including a contingent right) to an employee's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death."

techniques and documents. The disconnect between MRD rules and estate planning means that competent estate planning drafting can raise questions as to whether the Trust-Beneficiary passes the look-through rules without offering answers upon which the trustee of the Trust-Beneficiary can comfortably rely.

The Regulations expressly endorse one particular type of trust as passing the look-through test.[91] Practitioners have dubbed this structure a "conduit trust." A conduit trust provides that all distributions (including MRDs and all other distributions) that the Trust-Beneficiary receives from the Inherited IRA must be paid to a particular individual beneficiary of the Trust-Beneficiary. The IRA benefits are deemed paid "to" that individual and the "all beneficiaries must be individuals" requirement is met.[92] For MRD purposes, only the individual who will necessarily receive all of the Inherited IRA proceeds will be deemed the beneficiary of the Inherited IRA. All other beneficiaries will be ignored.[93] Thus, a remainderman or an appointee of a power of appointment under a conduit Trust-Beneficiary can be an older individual or a non-individual without placing in jeopardy the look-through status.

It is comforting to know that a conduit Trust-Beneficiary will satisfy the look-through rules. However, this trust design has limited application in a typical estate plan, where the norm is to confer on the trustee the discretion to distribute and/or accumulate trust assets, rather than force distribution.

Analyzing a recent private letter ruling,[94] in which the trust named as IRA beneficiary was drafted without contingent beneficiaries, a commentator remarked:

> Less is more for IRA trusts. Clients leaving IRA benefits in trust shouldn't name remote contingent beneficiaries older than the person whose life expectancy they want to use to measure the required distributions. If PLR 201320021 is correct, they need not worry about what happens if the trust runs out of beneficiaries.[95]

While this approach may improve the income tax result, leaving a gap in the dispositive provisions of a trust is not best practice for estate planning attorneys.

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[91] Reg. § 1.401(a)(9)-5, A-7(c)(3), Example 2.

[92] Reg. § 1.401(a)(9)-4, A-5(b).

[93] *Id.*

[94] PLR 201320021, http://www.irs.gov/pub/irs-wd/1320021.pdf.

[95] Bruce Steiner, *LISI Employee Benefits and Retirement Planning Newsletter #625* (August 8, 2013), http://www.leimbergservices.com.

C. Transferring Intact IRA

Before discussing how the IRA Trustee should handle MRDs payable to a Trust-Beneficiary, let us consider a legal question with a clear answer which, nonetheless, continues to confound IRA Trustees and to frustrate their clients: whether a transfer of the Inherited IRA from a terminating Trust-Beneficiary to the beneficiaries of that trust or following trusts is a taxable event.

Often, the IRA owner will name his revocable trust as beneficiary of the IRA. The revocable trust terminates upon the death of the IRA owner, distributing its assets to beneficiaries outright or in further trust. Although the revocable trust will remain intact during estate administration, it will cease to exist after the trustee pays taxes and expenses and funds the bequests using the various assets of the revocable trust. Accordingly, the trustee of the revocable trust named as IRA beneficiary will want to assign the IRA to the beneficiaries (whether outright or in trust).

The IRS has privately and consistently held on numerous occasions that when a trust terminates, the trustee can transfer the IRA to the beneficiaries of the trust without triggering income tax. The following conclusion is typical: the IRS allowed the transfer of IRA Y from the terminating Trust X to the beneficiaries of Trust X, the children of the IRA owner, C and D.[96] The IRS held that:

> [t] he provision of Trust X which provides for its termination does not change either the identity of the individuals who will receive the IRA Y proceeds or the identity of the designated beneficiary of IRA Y who remains Taxpayer D. . . . Furthermore, the Trust X termination language which results in distributions from IRA Y being made directly to Taxpayers C and D instead of initially to Trust X and then to Taxpayers C and D was language in Trust X approved by Taxpayer A during his lifetime which reflects Taxpayer A's intent to pay his children directly instead of through Trust X.[97]

The legal basis for the IRS's conclusion in these favorable private letter rulings is as follows. First, federal tax law does not prohibit transfer of an IRA.[98] Indeed, the Code acknowledges that IRAs can be assigned, since it discusses transfer of an IRA in connection with divorce[99]

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[96] PLR 200131033 (Rulings 5, 6, and 7).

[97] *Id*. *See also* PLRs 200013041, 200109051; 200329048; and 200433019.

[98] By contrast, qualified retirement plans governed by ERISA are subject to its "anti-alienation rule" and generally "may not be assigned or alienated." IRC § 401(a)(13)(A).

[99] I.R.C. § 408(d)(6).

and pledging the account as security for a loan.[100] Second, the favorable private letter rulings look to Revenue Ruling 78-406 which established the principle that a transfer from one IRA to another is not a taxable distribution.[101] Unfortunately, this Revenue Ruling addressed a transfer from one IRA to another in the name of the same IRA owner.[102] The facts at hand involve a very different scenario: an assignment of an IRA in the name of a Trust-Beneficiary to an IRA in the name of an individual, charity, or a following trust as successor beneficiary.

Because the favorable private letter rulings "may not be used or cited as precedent"[103] and because Revenue Ruling 78-406 is not direct authority, some IRA Trustees insist that the transfer is impermissible. If the trustee of the Trust-Beneficiary cannot transfer the Inherited IRA, he can either withdraw the IRA assets and accelerate income tax or keep the revocable trust account in existence until the end of the distribution period. Some IRA Trustees will agree to honor the transfer request only subject to a favorable private letter ruling obtained by the trustee of the Trust-Beneficiary. These alternatives are costly in terms of income tax deferral loss, administrative expenses, or both.

Therefore, if the IRA Trustee refuses to implement the transfer, it will likely lose the business. The trustee of the Trust-Beneficiary is free to move the Inherited IRA (still in the name of the revocable trust ("Trust 1")) to a cooperative IRA Trustee. Once there, the trustee of Trust #1 can assign the IRA to the following trust or trusts ("Trust #2) or the individual beneficiaries of Trust #1. In this article, the focus is on the administration of the Inherited IRA payable to Trust #2.

It is important not to confuse the transfer of the Inherited IRA from Trust #1 to Trust #2 with the ability of Trust #2 to defer income tax on the Inherited IRA distributions. Notwithstanding the tax-free transfer from Trust #1 to Trust #2, Trust #2 may not be able to satisfy the look-through requirements discussed above.

D. MRD Calculation

1. *Formula*

Generally speaking, MRDs after the death of the IRA owner must commence no later than December 31 of the year following the year of the IRA owner's death.[104] As is the case during the IRA owner's lifetime, each year's MRD payable from an Inherited IRA is a fraction.

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100 I.R.C. § 408(e)(4); *see also* CCA 200644020 (Treasury's Chief Counsel confirming that IRA is transferable).

101 1978-2 C.B. 157.

102 *Id.*

103 I.R.C. § 6110(k)(3).

104 Reg. § 1.401(a)(9)-2, A-5; Reg. § 1.401(a)(9)-3, A-3(a).

The numerator is the value of the Inherited IRA as of December 31 of the preceding year.[105] The responsibility, arising under federal tax law, for determining the value of the IRA lies with the IRA Trustee. If the Inherited IRA continues to hold nonmarketable assets, the IRA Trustee should follow the same valuation, reporting, and prohibited transaction risk management protocol it did during the IRA owner's lifetime.[106]

The denominator is known as the "applicable distribution period" ("ADP"). If the Trust-Beneficiary satisfies the look-through rules, then the ADP for the first year of distribution is the life expectancy of the oldest beneficiary of the trust based on his age in the year following the IRA owner's year of death. The life expectancy is obtained from the Single Life Table.[107] The ADP for each subsequent year of distribution is the prior year's ADP reduced by one.[108]

2. *IRA Trustee Obligation*

In contrast to the obligation to provide to the living IRA owner the amount and the due date of an MRD,[109] the IRA Trustee is not required to provide (or to offer to provide) the same information to the non-spouse beneficiaries of an IRA.[110] According to Notice 2002-27, if reporting is required in the future for IRAs of deceased owners, additional guidance will be effective prospectively.[111]

The IRA Trustee's obligation to file Form 5498 annually with the IRS continues after the IRA owner's death. However, unlike during the IRA owner's lifetime, the IRA Trustee does not need to report that an MRD is required to be distributed from an Inherited IRA.[112]

The IRA Trustee has an obligation to report to the IRS all taxable distributions from an Inherited IRA, including MRDs, by filing Form 1099-R.[113] The IRA Trustee must give the same form to the IRA beneficiary. However, neither the Form nor the instructions require that the IRA Trustee calculate or verify the MRD amount.

The IRS model Traditional Individual Retirement Trust Account Form 5305 meets the requirements of Section 408(a) of the Code for

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105 Reg. § 1.401(a)(9)-5, A-1(a).

106 *See* discussion above in Sections II(C) and II(D)(1) of this article.

107 Reg. § 1.401(a)(9)-9, A-1.

108 Reg. § 1.401(a)(9)-5, A-5(c)(1).

109 *See* discussion above in Section II(D)(3) of this article.

110 Notice 2002-27, I.R.B. 2002-18. If the spouse of a deceased IRA owner elects to treat the IRA as her own, the IRA Trustee is required to send the MRD-related report to the spouse. However, the IRA Trustee is not required to send the MRD-related report to the surviving spouse until she elects to treat the IRA as her own.

111 *Id.*

112 *Id.*; 2014 Instructions for Forms 1099-R and 5498, p. 22.

113 I.R.C. § 408(i). *See* discussion above in Section II(D)(3) of this article.

trusteed IRAs and has been pre-approved by the IRS. The model form contains Articles I through VIII, of which Articles I through III are mandatory: "Notwithstanding any other articles which may be added or incorporated, the provisions of Articles I through III and this sentence will be controlling."[114] The model form contemplates modifications and additions, subject to Articles I through III and compliance with the relevant federal law: "Any additional articles inconsistent with section 408(a) and the related regulations will be invalid."[115]

Article IV of the model form mandates that

> [n]otwithstanding any provision of this agreement to the contrary, the distribution of the grantor's interest in the trust account shall be made in accordance with the following requirements and shall otherwise comply with section 408(a)(6) and the regulations thereunder, the provisions of which are herein incorporated by reference.

The rest of Article IV summarizes the MRD rules during the IRA owner's life and after his death. The tone of the provisions is mandatory: "If the grantor dies before the required beginning date, the remaining interest *will be* distributed;"[116] and "the minimum amount that *must be* distributed each year" (italics added).[117] However, nowhere is there a requirement that the IRA Trustee ensure that the legally correct MRD is distributed.

In summary, federal law does not impose an obligation on the IRA Trustee to ensure that the IRA beneficiary withdraws the correct MRD. The most compelling evidence for this conclusion comes from the IRS Notice 2002-27[118] which imposes an obligation on the IRA Trustee to inform the living IRA owner that an MRD must be distributed by a certain date and to offer to calculate the MRD, but specifically states that this "[r]eporting is . . . not required at this time with respect to IRAs of deceased owners."[119] Subject to the IRA Trustee's obligation to provide the IRA beneficiary the December 31 value of the Inherited IRA, the responsibility to comply with the MRD rules rests with the taxpayer, i.e., the IRA beneficiary.

There are no cases in which an IRA owner or beneficiary criticized the IRA Trustee for failing to distribute the correct MRD. There are,

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114 Form 5305, Article VI.

115 Form 5305, Article VII. Article VIII states that "[i]f provisions are added, they must comply with applicable requirements of state law and the Internal Revenue Code." *See also* discussion above in Section II(A) of this article.

116 Form 5305, Article IV(3)(b).

117 Form 5305, Article IV(5).

118 I.R.B. 2002-18.

119 *Id.*

however, cases in which an IRA owner seeks to hold the IRA Trustee of a self-directed IRA liable for following the owner's directions to enter into a bad investment. The plaintiffs frame their claims as, among others, a breach of fiduciary duty. In all cases, the courts have concluded that the source of the IRA Trustee's duties to the IRA owner is the IRA agreement and related documentation, which govern the extent of such duties.

The most relevant case is *Metz v. Independent Trust Corporation* because it examines the IRA trustee's duties in the context of adverse federal income tax consequences. In *Metz*, the IRA lost its tax-exempt status because of a prohibited transaction. The IRA owner, Metz, established a self-directed IRA trust with Independent Trust Corporation ("Intrust") as trustee. Metz signed an IRA trust agreement and other documents containing broad provisions exculpating Intrust from any liability for investing at Metz' direction. Subsequently, Metz directed Intrust to lend IRA assets to Scott Serfling ("Serfling") who absconded with the loan proceeds. Metz sued Intrust for, among other things, breaching Intrust's duty to advise Metz that the loan to Serfling was a prohibited transaction. Metz also asserted that Illinois law prohibited enforcement of the exculpatory provisions contained in the IRA agreement.[120]

The Court of Appeals for the Seventh Circuit affirmed the grant of summary judgment to Intrust and rejected all of Metz's arguments. Having examined the IRA trust agreement and related documentation, the Court found that they authorized Intrust to invest the IRA assets only at the direction of the IRA owner, gave the IRA owner sole authority to direct IRA investments, stated that the IRA owner agreed to hold trustee harmless for actions taken in reliance upon the IRA owner's instructions, and included disclaimers and acceptance of liability and responsibility by the IRA owner. The Court upheld the validity of the exculpatory clauses, finding them compatible with Illinois trust law in the absence of a showing of "bad faith" or "reckless indifference" on the part of Intrust. The Court concluded that as a nondiscretionary IRA trustee, Intrust did not have a duty to inform the IRA owner that the loan would constitute a prohibited transaction and therefore did not breach that duty when distributing IRA assets to Serfling at Metz' direction.[121]

As reinforcement for its conclusion, the Court cited the principle set forth in Section 216 of the Restatement 2nd of Trusts that a benefici-

120 994 F. 2d 395 (7th Cir. 1993). *See also* discussion above in Section II(C)(2) of this article.

121 *Id.*

ary cannot hold the trustee liable for a transaction that the beneficiary "directed."[122]

Although not dealing with income tax consequences, three other cases support the proposition that the duties and responsibilities of the IRA Trustee are controlled exclusively by the relevant governing instruments: *Mandelbaum v. Fiserv, Inc.*[123] *Grund v. Delaware Charter Guarantee & Trust Co.*[124] and *Burns v. Delaware Charter Guarantee & Trust Company*.[125]

In *Mandelbaum*, the plaintiffs directed the IRA trustee to transfer assets to Bernard Madoff's brokerage firm for investment in securities. The plaintiffs raised a number of federal and state claims,[126] all of which the Court dismissed. Examining (and ultimately dismissing) the state law claims—breach of contract, breach of fiduciary duty, and negligence—the Court stated that the defendants' "duties of care do not have an existence independent of the IRA Agreements[ ] themselves."[127] Even if there were any pre-existing duties, "the IRA Agreements exculpate Defendants of any such duties."[128]

In *Grund* and *Burns,* the plaintiffs directed the IRA trustee to invest in a fund that turned out to be a Ponzi scheme. While the plaintiffs in *Grund* and *Burns* were represented by different counsel, both cases were heard by the same Judge. The Court dismissed all of the federal claims. Some of the state law claims survived summary judgment, however, because the exculpatory language in the relevant trust agreements did not clearly abrogate the duties which the plaintiffs claimed the IRA trustee breached. For example, in *Burns*, the plaintiffs asserted that the IRA trustee breached its duties under the IRA agreements to (1) provide plaintiffs with annual reports of all transactions related to the IRA, (2) provide accurate annual statements to plaintiffs regarding the annual profit or loss in their accounts, or (3) provide accurate statements of the activity in plaintiffs' accounts in the fund. The Court left these claims to the trier of fact, holding that "the exculpatory language in the agree-

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122 *Id.* at 401.

123 787 F. Supp. 2d 1226 (D. Colo. 2011).

124 788 F. Supp. 2d 226 (S.D.N.Y. 2011).

125 805 F. Supp. 2d 12 (S.D.N.Y. 2011).

126 The plaintiffs asserted breach of contract, ordinary and gross negligence, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and unjust enrichment, all based on federal common law, and implied right of action under I.R.C. § 408. 787 F. Supp. 2d at 1232.

127 787 F. Supp. 2d at 1241.

128 *Id.*

ment does not clearly apply to Plaintiffs' claims regarding annual reports."[129]

3. *Client Expectations*

Against the background of ambiguous IRS guidance on whether a Trust-Beneficiary satisfies the look-through rules and case law that limits the IRA Trustee's duties to those set forth in the governing document, and in the absence of an obligation under tax law to determine the MRD, the IRA Trustee can shift this responsibility onto the trustee of the Trust-Beneficiary. The following example provision does just that:

> It is . . . the beneficiaries' responsibility after grantor's death, to direct the trustee to make distributions from the account in a manner consistent with the minimum distribution rules set forth in Article IV. . . . The trustee will not be liable (a) for following any direction made . . . after grantor's death[ ] by a beneficiary, with respect to minimum required distributions, even if as a result of such directions less than the minimum amount required to be distributed is paid from the account in any year; (b) for failing to make payments from the account in the minimum required amounts or for distributing amounts in excess of the minimum required amount in the absence of such direction; or (c) for miscalculating the minimum amount required to be distributed in any year as a result of erroneous information provided or made available to the trustee. The trustee shall be entitled to rely on information provided . . . after the grantor's death [by] the beneficiary named by the grantor or under this agreement in making any such calculation.[130]

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129 805 F. Supp. 2d at 19-20. In *Grund*, the Court also did not feel it appropriate to dismiss at the complaint stage the plaintiffs' contention that the IRA trustee owed them fiduciary duties independent of the IRA agreements by reason of its role as trustee. 788 F. Supp. 2d at 250. The case cited by the *Grund* court as support for this proposition (*Adams v. Fiserve*, 2008 WL 3890036 (Cal. App. Dist. 4 Aug. 22, 2008)) is designated in Westlaw as "noncitable." By contrast, Brown v. California Pension Administrators & Consultants, Inc., 45 Cal.App.4th 333 (1996), held that investors in self-directed IRAs could not state a breach of fiduciary duty claim against an IRA trustee based on the IRA trustee's failure to notify the investors that the borrower of investors' funds had defaulted on loans from other IRA owners because the relationship between the IRA owners and the IRA trustee was confined to performance by trustee of transactions selected by their customers, and relationship did not give rise to a duty to notify investors of poor performance of similar investments held by different customers.

130 Exhibit F: Northern Trust Traditional Inherited IRA Trust Agreement ("NT Inherited IRA"), Article XI(2).

While from the risk management standpoint, this "hands off" approach is appealing, it may present a client relations problem for the IRA Trustee. The trustee and the beneficiaries of the Trust-Beneficiary are likely the spouse and the descendants of the deceased IRA owner. Having grown accustomed to the IRA Trustee's role in determining and timely distributing the MRD to the IRA owner, the family probably expects the same service, especially since the IRA Trustee will continue to charge the same fee (which is based upon the IRA assets under management). If the client owned assets other than the IRA, the IRA Trustee may well be competing with other institutions over the larger relationship—either seeking to retain it or to bring it in-house—and will therefore not want to disappoint the family.

4. *Having It Both Ways?*

It is possible to assist the trustee of the Trust-Beneficiary with the MRD calculation without incurring liability for determining the MRD incorrectly:

> It is . . . the beneficiaries' responsibility after grantor's death, to direct the trustee to make distributions from the account in a manner consistent with the minimum distribution rules set forth in Article IV. . . . For any year after the year in which the death of the grantor occurs, the trustee will calculate the minimum amount required to be distributed from the account only upon receipt of information from the beneficiary named by the grantor or under this agreement confirming the following (i) whether there is a Designated Beneficiary for the account as defined in Treas. Reg. §1.401(a)(9)-4, A-1, (ii) the identity of the person deemed to be the Designated Beneficiary and the relationship of the person deemed to be the Designated Beneficiary to the deceased grantor, and (iii) the birth date of the person deemed to be the Designated Beneficiary. The trustee will not be liable (a) for following any direction made . . . after grantor's death[ ] by a beneficiary, with respect to minimum required distributions, even if as a result of such directions less than the minimum amount required to be distributed is paid from the account in any year; (b) for failing to make payments from the account in the minimum required amounts or for distributing amounts in excess of the minimum required amount in the absence of such direction; or (c) for miscalculating the minimum amount required to be distributed in any year as a result of erroneous information provided or made available to the trustee. The trustee shall be entitled to rely on information provided . . . after the grantor's death [by]

> the beneficiary named by the grantor or under this agreement in making any such calculation.[131]

The above provision clearly communicates that the legal analysis as to whether the Trust-Beneficiary satisfies the look-through rules is the duty of the trustee of the Trust-Beneficiary (or, more likely, his income tax adviser), not of the IRA Trustee. If the trustee of the Trust-Beneficiary wishes the IRA Trustee to compute the MRD and takes the position that the Trust-Beneficiary fulfills the look-through requirements, then the trustee must provide the IRA Trustee the identity and the date of birth of the designated beneficiary. Having received this information, the IRA Trustee will determine the ADP by reference to the Single Life Table. Finally, the IRA Trustee will derive the MRD by plugging into the formula the ADP and the applicable Inherited IRA value. The exoneration language ensures that the IRA Trustee will not be held liable for any adverse income tax consequences resulting from performing this computation and distributing the MRD based upon the information provided by the trustee of the Trust-Beneficiary.

May the IRA Trustee rely, without further investigation, on the characterization by the trustee of the Trust-Beneficiary of the Trust-Beneficiary's status as a look-through trust? The IRA Trustee should review the trustee's determination to ensure that it is legally supportable. In the absence of clear legal standards, reasonable professionals with relevant expertise can disagree as to whether the Trust-Beneficiary satisfies the look-through rules. The IRA Trustee need not substitute its own judgment for that of the trustee of the Trust-Beneficiary. The IRA Trustee must, however, be satisfied that such judgment is viable in light of the Code, the Regulations and the private letter rulings.

The IRA Trustee's participation in the MRD calculation gives rise to the obligation to undertake the above-described due diligence. If, instead, the trustee of the Trust-Beneficiary does not request the IRA Trustee's assistance with the calculation of the MRD but simply withdraws from the Inherited IRA a specific amount by December 31, then no due diligence on the part of the IRA Trustee would be required.

IV. Conclusion

As demonstrated above, an IRA Trustee can develop policies and procedures to manage risk involved in administering IRAs holding nonmarketable assets during the IRA owner's lifetime. The death of the IRA owner marks a turning point—the family decides whether to "stay or go," time-sensitive steps must be taken, and the relevant in-

131 Exhibit F: Northern Trust Traditional Inherited IRA Trust Agreement ("NT Inherited IRA"), Article XI(2).

come tax rules become more complex and less clear. While many of the policies and procedures that apply during the IRA owner's lifetime will also apply after his death, new ones come into play. The relationship of the financial institution with the decedent has shaped the IRA owner's family's expectations. The IRA Trustee must work to adjust those expectations in line with increased risk. Administration of Inherited IRAs can be so challenging that the IRA Trustee is right to wonder whether it is worth the bother.

Here, it should be noted that income tax deferral after the IRA owner's death—and therefore, Inherited IRAs as we currently know them—may end up on the legislative chopping block. Congress created IRAs and afforded them tax-favored treatment to stimulate saving for retirement. Harkening to that intent, one of the proposals in the Obama Administration's Green Book for fiscal year 2014 stated that

> [t]he Internal Revenue Code gives tax preferences for retirement savings accounts primarily to provide retirement security for individuals and their spouses. The preferences were not created with the intent of providing tax preferences to the non-spouse heirs of individuals. Because the beneficiary of an inherited account can be much younger than a plan participant or IRA owner, the current rules allowing such a beneficiary to stretch the receipt of distributions over many years permit the beneficiary to enjoy tax-favored accumulation of earnings over long periods of time.[132]

Echoing a proposal by Senator Max Baucus (D-Mont),[133] the Green Book recommended that so-called "stretch IRAs" inherited by beneficiaries other than the deceased IRA owner's spouse be limited to a term of five years.[134] Based upon the recently issued proposal by the Committee on Ways and Means of the U.S. House of Representatives, the idea seems to be gaining traction.[135]

Whatever the future holds in terms of changes in the law, professionals responsible for Inherited IRAs today have a pressing need for clear and detailed protocols. The risk profile of Inherited IRAs can be reduced through best practices discussed in this article, allowing for profitable continuation of long-standing client relationships.

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132 General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals ("Green Book") at 164.

133 Description of The Chairman's Modification to the Proposals of the "Highway Investment, Job Creation and Economic Growth Act of 2012," February 7, 2012, at 14-16.

134 Green Book at 164.

135 Tax Reform Act of 2014, Discussion Draft, Section-by-Section Summary at 40-41.

EXHIBITS

Notice and Disclaimer

Although the following provisions are the product of thought and effort, the attorney advising a particular client must make an independent determination as to whether and to what extent a provision is appropriate for his/her client and, further, how the provision may need to be modified to meet any special circumstances and objectives of the client.

Northern Trust does not guarantee that any of the following provisions effectively accomplish their purpose, and assumes no responsibility for any provision or its use. By using any of the following provisions, the attorney acknowledges that he or she (and not Northern Trust) is responsible for any document which the attorney prepares which incorporates the provision.

EXHIBIT A

ARTICLE VIII
Distributions During Grantor's Lifetime

1. **Right to Withdraw.** The grantor may withdraw any part or all of the balance in grantor's account at any time on notice to the trustee. Any withdrawal made before the grantor reaches age 59-1/2 must be accompanied by a written statement describing how the grantor intends to dispose of the amount distributed, and the grantor shall assume full responsibility for any tax penalties which may result from such early distribution.

2. **Payment of Benefits in Absence of Election.** If the grantor does not elect a method of distribution under paragraph 2 of Article IV by grantor's required beginning date, distribution to the grantor will begin on his or her required beginning date and will be made in quarterly payments over the longest period allowed under paragraph 2(b) of Article IV. The aggregate value of all payments made during each year shall equal the minimum amount required to be distributed that year as provided in paragraph 5 of Article IV.

3. **Discretionary Payments During Lifetime.** Whenever the trustee considers that the grantor is incapacitated in any way so as to be unable to manage grantor's financial affairs, the trustee may pay to the grantor, or apply for grantor's benefit, such additional sums from this account as the trustee considers necessary or advisable from time to time for grantor's comfortable maintenance, health, best interests and welfare, considering grantor's other income known to the trustee to be available for those purposes from all sources.

* * * * * * *

ARTICLE XIV
Account Investments

. . . .

3. Non-Discretionary Assets.

(a) In General. The grantor (or an Outside Manager) shall have sole investment discretion and responsibility for (i) any assets purchased or retained at the direction of the grantor (or such Outside Manager),

(ii) any assets designated in the Special Instructions section of the Adoption Agreement, or by a separate writing delivered to the trustee, as assets for which the grantor (or an Outside Manager) has investment responsibility, (iii) any securities issued by NTC, except those purchased or retained in accordance with Section 2(l), and (iv) "Special Assets", which shall include annuities, personal notes or mortgages, real estate, interests in proprietorships, corporations, partnerships and limited liability companies that are not publicly traded, coins or precious metals that are not defined as collectibles as described in Article III, and other assets for which a value is not readily available on an established public exchange or which cannot be readily exchanged for cash or cash equivalents. Any assets specified in (i) – (iv) above shall be referred to in this agreement as "Non-Discretionary Assets." A Non-Discretionary Asset shall not be deemed an asset of the account for purposes of Section 2 of this agreement; and accordingly the trustee shall have no investment responsibility for that asset and the trustee shall not review the asset or make investment recommendations with respect to it, nor shall the trustee have any obligation to question grantor's (or Outside Manager's) directions.. The trustee shall sell a Non-Discretionary Asset or purchase more of it, and shall vote such asset, only as directed by the grantor (or Outside Manager). The grantor (or Outside Manager) also shall have investment responsibility for any securities received by reason of ownership of any Non-Discretionary Asset, such as by merger, reorganization, sale, exchange or spin-off. In the event the grantor becomes incapacitated as defined in Article XVI(12) and at such time there is no Outside Manager, Agent of the grantor as described in Article XVI(14), or person authorized in Article XVI(15) to act on behalf of the grantor to exercise investment responsibility for Non-Discretionary Assets, the trustee shall retain indefinitely with no investment responsibility any Non-Discretionary Assets until the grantor is found to have regained legal capacity or a guardian, conservator or other personal representative for the grantor is appointed by a court of competent jurisdiction, regardless of whether the trustee has notice of the grantor's incapacity. The trustee shall have no duty to exercise any investment responsibility or oversight for any Non-Discretionary Asset as a result of the grantor's incapacity. After grantor's death this Section shall apply to each beneficiary who has investment responsibility for his or her share of the account. The trustee shall not be liable for any loss that may result from acting in accordance with this Section.

(b) Special Assets In the Account (if any). If the account holds any Special Assets,

(i) The trustee will not investigate whether a Special Asset in the account is a prohibited transaction, will generate unrelated business taxable income, or will be considered a pledge of IRA assets as security for a loan. That investigation is grantor's responsibility and the trustee will not be responsible for the consequences of any such events. The trustee will not provide tax advice to the grantor as to the consequences of the purchase of any Special Asset and will not be liable for any adverse impact on the tax status of the IRA or on the grantor, including the change in tax status of any IRA account or the imposition of any tax, interest, or penalty, arising out of or occurring because of the purchase of any Special Asset.

(ii) The grantor acknowledges that an additional per asset annual fee will be charged by the trustee in the event a Special Asset is transferred to the account from any source or purchased for the account at the direction of the grantor or an Outside Manager. Such fee will be charged in each calendar year the Special Asset is held in the account and will not be prorated for part years. The current schedule of fees charged by the trustee for Special Assets held in the account will become applicable to the account upon any direction to purchase a Special Asset, or the transfer of any Special Asset to the account. A copy of the fee schedule will be provided to the grantor or, after the grantor's death, to each beneficiary of the account at any time it is requested by the grantor or beneficiary.

(iii) The grantor recognizes that the aggregate value of all of the assets in the account must be reported to the Internal Revenue Service annually as of December 31. Beginning in 2011 for assets held in the account on or after December 31, 2010, the trustee will obtain an annual written Opinion of Value for each Special Asset in the account during each calendar year. The grantor agrees to cooperate in all such valuations and to provide information necessary to conduct such valuation to the trustee or to the trustee's agent. In the event that the grantor, or any other person other than the trustee, does not cooperate with the appraiser such that a valuation cannot be made, and the prior year's valuation (or the purchase price if there is no prior year's valuation) is used, then, to the extent such valuation is required to be disclosed to the grantor or any governmental entity, it may be noted that the prior year's valuation (or the purchase price, as applicable) is being used and the reasons therefor. After the grantor's death, it will be the obligation of each beneficiary of the account to provide such information. In consideration of the trustee's agreement to hold Special Assets in the account, the grantor agrees to indemnify the trustee for any expense, fine, penalty, fee or tax, including interest on such amount, assessed because of the trustee's use of an inaccurate value in making any required report to the Internal Revenue Service or other regulator, to the extent that the information or lack of information provided by the grantor or any beneficiary of the account or any third party causes the trustee to incur such expense. The trustee is entitled to engage outside valuation experts for the purpose of preparing an Opinion of Value for any Special Asset held in the account. The cost of such Opinion of Value will be borne by the grantor while the grantor is living, and by the beneficiaries of the account after the death of the grantor and paid as described in Article XVI(8)(a). The trustee, the agents of the trustee, and any outside valuation expert engaged by the trustee to prepare an Opinion of Value shall be entitled to rely without independent verification upon information provided by the grantor, any beneficiary of the account, any Outside Manager, any officer, director, manager or agent of any entity any interest of which constitutes a Special Asset, or any other third party.

(iv) For each calendar year beginning after December 31, 2010, the trustee will use the most recent available Opinion of Value obtained as described in Article XIV(3)(b)(iii) in reporting December 31 values for the account to the grantor. By obtaining the Opinion of Value, the trustee does not assume any responsibility for determining whether or not the grantor has complied with income tax law requirements that certain minimum required distributions be taken from the account in years beginning with the year in which the grantor attains age 70-1/2, or for the 50% penalty tax imposed in the event of an under-distribution from the account. The grantor recognizes that it is the grantor's responsibility while the grantor is living and the beneficiary's responsibility for years following the grantor's death to comply with income tax law requirements regarding minimum required distributions. It is the grantor's or the beneficiary's responsibility in that event to determine what the fair market value of each asset in

> the account is for purposes of computing any such minimum required distributions in order to avoid penalty taxes.

Special Assets include such assets held in the account after contribution by the grantor or other direct transfer to the account and those the grantor (or an Outside Manager) directs the trustee to purchase.

EXHIBIT B

8.06 Investment of Amounts in the IRA –

a. . . . .

b. **Trustee Management of Investment.** If any portion of this IRA is a managed IRA, as indicated on the application or any other supporting documentation, we will manage the investment of the applicable IRA assets. Accordingly, we can manage, sell, contract to sell, grant, or exercise options to purchase, convey, exchange, transfer, abandon, improve, repair, insure, lease for any term, and otherwise deal with all property, real or personal, in your IRA in such manner, for such prices and on such terms and conditions as we will decide.

We will have the power to do any of the following as we deem necessary or advisable.

1. To invest your IRA assets in a single trust fund, and to collect the income without distinction between principal and income
2. To invest your IRA assets in a common trust fund or common investment fund within the meaning of Code section 408(a)(5)
3. To invest your IRA assets into savings instruments that we offer
4. To invest your IRA assets in any other type of investment permitted by law, including, but not limited to, common or preferred stock, open- or closed-end mutual funds, bonds, notes, debentures, options, U.S. Treasury bills, commercial paper, or real estate
5. To hold any securities or other property under this agreement in our own name, in the name of a nominee, or in bearer form
6. To make, execute, acknowledge, and deliver any and all documents of transfer and conveyance (including documents for the transfer and conveyance of real estate), and any and all instruments that may be necessary or appropriate to carry out our powers

EXHIBIT C

BENEFICIARY DESIGNATION and PAYMENT DIRECTION

Use of this form to name a beneficiary or to direct a payment option is not mandatory. The grantor may give the trustee a custom-drafted beneficiary designation, or the grantor may choose to rely on the back-up beneficiary designation in Article IX(2) of the IRA Trust Agreement.   **The designation of a beneficiary and direction as to the manner of payment for the account have important property, estate planning and tax consequences. The grantor should consult with his or her tax adviser or attorney before completing this section, or making any other Beneficiary Designation or Payment Direction.**

The grantor hereby designates the following as beneficiaries of grantor's Northern Trust Traditional Individual Retirement Account Trust, and the grantor revokes all prior beneficiary designations and payment directions made by the grantor with respect to the account:

1. Primary Beneficiary

☐ Custom-drafted beneficiary designation: The grantor has a custom-drafted beneficiary designation which is attached to this agreement.

☐ Grantor's spouse at the time of grantor's death, if living.

If grantor's spouse survives the grantor but disclaims a part or all of the IRA, the beneficiary of the disclaimed part of the IRA shall be:

☐ The trustee of the trust created under grantor's will or revocable trust agreement in effect at grantor's death that receives grantor's applicable exclusion amount for federal estate tax purposes ($5,000,000 for the years 2011 and 2012).

- ☐ The Secondary Beneficiary designated in the following #2.

- ☐ The trustee of the marital deduction trust created under grantor's will or revocable trust agreement in effect at grantor's death, if grantor's spouse at the time of grantor's death is then living.

- ☐ Grantor's children who are living at the death of the grantor, in equal shares, except that the then living descendants of a deceased child of the grantor shall take per stirpes the share which the child would have received if living.

- ☐ Grantor's children who are living at the death of the grantor, in equal shares, except that the then living descendants of a deceased child of the grantor shall take per stirpes the share which the child would have received if living, and except further that if grantor's will or revocable trust agreement in effect at grantor's death creates a separate trust for a child or descendant, his or her share of the IRA shall be allocated to that trust.

- ☐ The then acting trustee under grantor's revocable trust agreement dated _______________, _________, between the grantor and ___________________________________, as trustee (of which _____________________________________ now is designated as successor trustee), as in effect at grantor's death.

(Caution: Naming a trust as beneficiary of an IRA often can inadvertently cause the loss of a stretch-out for required minimum distributions from the IRA. Consult with your professional adviser.)

- ☐ Other: ____
____

2. <u>Secondary Beneficiary</u>

If grantor's primary beneficiary is not living or in existence at the death of the grantor, then the beneficiary of grantor's IRA account shall be:

☐ Grantor's children who are living at the death of the grantor, in equal shares, except that the then living descendants of a deceased child of the grantor shall take per stirpes the share which the child would have received if living.

☐ Grantor's children who are living at the death of the grantor, in equal shares, except that the then living descendants of a deceased child of the grantor shall take per stirpes the share which the child would have received if living and except further that if grantor's will or revocable trust agreement in effect at grantor's death creates a separate trust for a child or descendant, his or her share of the IRA shall be allocated to that trust.

☐ Grantor's spouse at the time of grantor's death, if living.

☐ The trustee of the marital deduction trust created under grantor's will or revocable trust agreement in effect at grantor's death, if grantor's spouse at the time of grantor's death is then living.

☐ The then acting trustee under grantor's revocable trust agreement dated _______________, _________, between the grantor and ____________________________________, as trustee (of which ______________________________________ now is designated as successor trustee), as in effect at grantor's death.

(Caution: Naming a trust as beneficiary of an IRA often can inadvertently cause the loss of a stretch-out for required minimum distributions from the IRA. Consult with your professional adviser.)

☐ Other: ____
____

3. <u>Payment Direction</u>

General Rule: Beneficiaries are Unrestricted

Except as otherwise provided below, on grantor's death each of grantor's beneficiaries shall own the share of the IRA account allocated to him or her. Accordingly:

1. Each beneficiary may withdraw any part or all of his or her share of the account at any time by notice to the trustee.

2. Upon the death of an individual beneficiary, his or her share of the account shall be owned by the beneficiaries named by the individual beneficiary, or if none, by the individual beneficiary's estate.

3. Any person who receives a beneficiary's share of the account (by reason of the death of the beneficiary, the distribution of the share from an estate or trust, or otherwise) shall be considered the new beneficiary of the share and shall have all of the original beneficiary's ownership rights with respect to the share, including the right to withdraw any part or all of it at any time.

If the grantor wants to restrict an individual beneficiary's right to withdraw his or her share of the account, complete the rest of this section 3 as appropriate.

☐ **Restricted Beneficiaries**

The following individual beneficiaries shall **<u>not</u>** have the unrestricted right to withdraw their shares of the account, or to elect the manner of payment. Their shares of the account shall be distributed as follows:

1. ____ in installments over
[insert name of beneficiary, or state
"All individual beneficiaries"]

☐ the longest permitted period

☐ _________________ years

If this beneficiary dies before the complete distribution of his or her share of the account, the balance shall be payable to

☐ beneficiary's descendants living on the date of each installment payment, per stirpes, or, if none ____________________
____

☐ beneficiary's estate

☐ other ____________________
____

2. ____________________ in installments over
[name of beneficiary]

☐ the longest permitted period

☐ __________ years

If this beneficiary dies before the complete distribution of his or her share of the account, the balance shall be payable to

☐ beneficiary's descendants living on the date of each installment payment, per stirpes, or, if none ____________________
____

☐ beneficiary's estate

☐ other ____________________
____

☐ **Special Provisions if Spouse is Restricted Beneficiary**

If grantor's spouse is a restricted beneficiary, the grantor intends to qualify the spouse's share for the federal estate tax marital deduction in grantor's estate.

☐ **Yes** ☐ **No**

If yes, marital deduction qualification shall be obtained by

☐ paying any undistributed balance at the spouse's death to the spouse's estate.

- ☐ requiring annual installments to equal the greater of the minimum amount required to be distributed annually and all of the income earned in the account (a "QTIP distribution election").

- ☐ treating grantor's spouse as an unrestricted beneficiary with respect to income only.

* * * *

Northern Trust has advised the grantor that in making a beneficiary designation or payment direction, the grantor should consult with his or her attorney for assistance in drafting the language. The grantor understands and agrees that Northern Trust does not review beneficiary designations and payment directions and is not responsible for any loss or other problem which may result from unclear or incomplete instructions given by the grantor regarding the distribution of the account.

Northern Trust has not advised the grantor with respect to any beneficiary designation or payment direction made in this instrument, and has not provided the grantor with any tax or legal advice. The grantor understands that the grantor may change or add beneficiaries at any time by completing and delivering a proper form to the trustee.

This beneficiary designation will not defeat any community property or marital property rights that grantor's spouse may have in the account.

Northern Trust shall not be obliged to inquire into the validity, existence or provisions of any trust named as a beneficiary under this instrument, or the application of any benefits paid to the trustee.

EXHIBIT D

DIRECTION TO PURCHASE AND/OR RETAIN IRA NON-DISCRETIONARY ASSET (NON-MARKETABLE)

Client Name:	
Account Number:	
Account Name	

I, the undersigned Client, direct you to [purchase/retain] until further notice the following in my account noted above.

shares/par	Asset description/name

If I decide to sell the above named security held in my account, I will direct you to do so in writing.

Northern shall vote this asset only as I direct. Until I notify Northern otherwise in writing, Northern shall:

- ○ send all proxies to me for voting
- ○ vote for, or as recommended by, the management of the company

If I do not check a box, then Northern shall send all proxies for this security to me for voting. Also, any notice of a proposed corporate change involving such stock, including a tender offer, shall be forwarded to me so that Northern can act on such notice pursuant to my written instructions.

These special instructions shall apply to those provisions of the Account agreement pertaining to Non-Discretionary Assets.

<u>REPRESENTATIONS, WARRANTIES AND ACKNOWLEDGEMENTS</u>

I hereby acknowledge that (i) I have the sole responsibility to direct the investment of the assets of my IRA or to appoint an Outside Manager,

(ii) I have reviewed or had reviewed all pertinent information relating to the above - directed transaction and represent and warrant that (a) I meet the specified suitability or other requirements for such investment (b) the transaction directed above does not constitute a transaction prohibited by section 4975(c) of the Internal Revenue Code (or any successor provision thereto) or a transaction which would cause all or any part of my account to be treated as distributed to me and (c) if the transaction directed above generates unrelated business taxable income, I have made the decision to accept such tax consequences. I understand that Northern will not and has no responsibility to review, evaluate or investigate the above-directed transaction for any reason, including but not limited to, determining whether it is prudent, is a prohibited transaction under section 4975 of the Internal Revenue Code, will generate unrelated business taxable income or will be considered a pledge of IRA assets as security for a loan or to provide me with any advice with respect to this investment. I understand that I should consult with my independent legal and financial advisors about these issues.

I further understand that each asset held in my account must be valued annually and by directing this transaction I hereby authorize and empower the Northern, as trustee of my IRA, to obtain a third party valuation and to pay for such valuation from the account. In connection with such valuation, I hereby authorize and empower Northern and/or the appraiser to communicate with any third parties, including, but not limited to general partners, managing members, officers, and directors of an entity that is an asset or such entity's or my accountant in order to obtain the information necessary to make the valuation. In the event that the I, or any other person other than Northern, does not cooperate with the appraiser such that a valuation cannot be made, I understand and acknowledge that Northern will take any and all steps it deems appropriate, including but not limited to, distributing the asset or using the prior year's valuation (or the purchase price if there is no prior year's valuation) and, to the extent such valuation is required to be disclosed to the grantor or any governmental entity, it may be noted that the prior year's valuation (or the purchase price, as applicable) is being used and the reasons therefore.

I hereby agree to hold Northern Trust harmless and to indemnify it from all liabilities, expenses and costs (including attorney's fees) incurred by it in connection with any action taken or failure to act (i) in reliance upon my or my Outside Manager's written instructions, designations and/or representations, and (ii) in the exercise of any right, power, or duty of the trustee taken in good faith and with reasonable care.

Date ______________________ , 20_______

Client Signature(s):

Owner:: ____

Print Name:

Co-owner: (if any) ____

Print Name:

Co-owner: ____

Print Name:

EXHIBIT E

Special Assets In Individual Retirement Accounts
Information Cover Sheet

Asset Name	
Account Description	**Account Number**
Entity Contact Name	
Phone	**E-mail**
Submitter Name	
Phone	**E-mail**

Select the appropriate asset type listed below and mark the specific information that is being provided:

Corporation (check here) ______ Information Required: Name, address and phone # Contact person Number of shares held in IRA Description of Business Prior appraisal or other evidence of value Financial statements or corporate tax returns for prior five years Corporate By-Laws and Article of Incorporation Shareholder agreements (if any) Copy of recent management letter or interim financial statements, if available **Partnerships or LLC's (check here) ______** Information Required: Name, address and phone # Contact person	**Direct Real Estate Investments ______** Information Required: Property Location and Description Name & contact information for access Recent income statement and lease abstract, if applicable **Mineral Interests/ Oil & Gas ______** Information Required: Description of Interest Net revenue for past 12 months Revenue check detail for at least 3 recent months Mineral deeds **Bonds, Mortgages, Notes (check here) ______** Information Required: Copy of Instrument

# of units or % of partnership owned Description of Business Prior appraisal or other evidence of value Financial statements or tax returns for o prior two years Schedule K-1's for prior two years Partnership agreement Buy/Sell agreement (if any) Copy of recent partners' status report or interim financial statements, if available **Annuities (check here) ______** Information Required: Copy of Annuity Contract Copy of recent Annuity Statement	Payment history Nature and description of collateral and/or guarantees, if any Description of borrower and any financial information, if available **Other Sundry Assets (check here) ______** Information Required: Description of asset Name of Contact person Address and phone # Any available financial information Any prior appraisals/evidence of value

EXHIBIT F

ARTICLE XI
Minimum Distribution Rules

1. **Calculation of Minimum Required Distributions.** Beginning in the calendar year in which grantor's required beginning date occurs, the minimum amount required to be distributed each year will be determined in accordance with Article IV.

2. **Duty to Direct Trustee to Make Required Payments.** It is grantor's responsibility during his or her lifetime, and the beneficiaries' responsibility after grantor's death, to direct the trustee to make distributions from the account in a manner consistent with the minimum distribution rules set forth in Article IV. If requested, the trustee will calculate the minimum amount required to be distributed from the account in any year based on the information available to it, and in doing so may rely without liability or duty of further inquiry on any information provided to it by the grantor or by any beneficiary named by the grantor or under this agreement. With respect to any Special Assets, as that term is defined in Article XIV(3), the Opinion of Value obtained by the trustee in accordance with Article XIV(3)(b)(iii) will be used to make the calculation. For any year after the year in which the death of the grantor occurs, the trustee will calculate the minimum amount required to be distributed from the account only upon receipt of information from the beneficiary named by the grantor or under this agreement confirming the following (i) whether there is a Designated Beneficiary for the account as defined in Treas. Reg. §1.401(a)(9)-4, A-1, (ii) the identity of the person deemed to be the Designated Beneficiary and the relationship of the person deemed to be the Designated Beneficiary to the deceased grantor, and (iii) the birth date of the person deemed to be the Designated Beneficiary. The trustee will not be liable (a) for following any direction made by the grantor or, after grantor's death, by a beneficiary, with respect to minimum required distributions, even if as a result of such directions less than the minimum amount required to be distributed is paid from the account in any year; (b) for failing to make payments from the account in the minimum required amounts or for distributing amounts in excess of the minimum required amount in the absence of such direction; or (c) for miscalculating the minimum amount required to be distributed in any year as a result of erroneous information provided or made available to the trustee. The trustee shall be entitled to rely on information

provided by the grantor or, after the grantor's death, the beneficiary named by the grantor or under this agreement in making any such calculation.