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Guest Article

PLR Reveals Planning Opportunities For Clients With Large IRAs

By Jeffrey A. Baskies

In January, the Internal Revenue Service issued Private Letter Ruling 200403094, approving an interesting testamentary general power of appointment plan. This testamentary general power of appointment plan can be a very valuable planning opportunity for couples where one spouse owns a large IRA and the other spouse owns marketable assets or where one spouse has assets in his or her name that cannot be placed in the other spouse's name. This plan may help clients avoid having to guess which of them will die first. It further may help avoid the need of funding a credit shelter trust with IRA assets.

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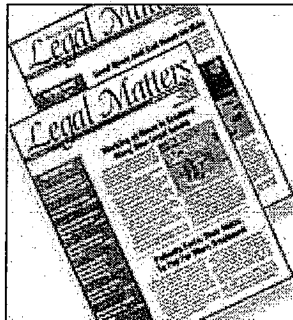

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The Ruling

In PLR 200403094, the IRS approved a revocable trust plan where the wife was given a general power to appoint assets from the husband's estate, if she died first. The appointive assets could then be used in her estate to utilize her applicable exclusion amount and fund a credit shelter trust.

Basically, the bulk of the assets were held by the husband in his individual name, and if the wife died first, she was given a general power to appoint assets owned in the husband's revocable trust. The power was designed by formula to be enough to utilize her unused applicable exclusion amount. And she had the power to appoint that property however she wanted, but in the proposed plan, she was appointing it to a family trust (a credit shelter trust) to support the husband and the descendants of the couple. Moreover, the husband had a limited testamentary power of appointment over the trust assets.

The IRS ruled that the amount of the husband's estate, which was subject to the testamentary general power of appointment by the wife, would in fact be taxable in her estate if she died first. At that point, the husband made a completed gift to the wife, which qualified for the unlimited marital deduction. Further the IRS ruled that the assets which then passed into the credit shelter trust would not be taxed on the husband's later death even though he was a beneficiary (subject

to ascertainable standards and a limited power of appointment) of the trust.

Married Couple Where One Spouse Has Large IRA

Let's take a hypothetical client case for an example. Assume that husband has $1.5 million in assets all in an IRA. Assume that husband and wife have a mutual investment account with another $1.5 million in securities. If we want to worry about the impending increases in the applicable credit, then we could assume they had $2 million or $3 million in each, but for our purposes it doesn't matter. To make things clean, assume they retired and sold their home and now rent in sunny south Florida.

If we knew which spouse would die first, the plan would be easy. Put the marketable securities in his or her name and create an estate plan with credit shelter trusts and they are all set. On the first death, the full applicable exclusion amount is used up with the marketable securities and the credit shelter trust is fully funded. The survivor has the large IRA and names the children as beneficiaries, so they can spread out the distributions for a longer period during the survivor's life and after the survivor's death.

But, we do not know which spouse will die first. If we advise the clients to put all the assets into the husband's name and he doesn't die first, then the applicable exclusion amount is wasted when the wife dies with no assets and the husband's estate is taxable since he has all the assets.

On the other hand, if we advise them to put all the non-IRA assets into the wife's name and the husband dies first, then the only asset available to fund a credit shelter trust is the IRA. For many reasons, that is not ideal.

Just to name a couple: (1) the IRA is a bad asset to fund a credit shelter trust since it is "income in respect of a decedent" ("IRD") and thus distributions to the credit shelter trust are subject to income tax (thus "wasting" part of the credit); and (2) naming the credit shelter trust as beneficiary of the IRA means making withdrawals based on the life expectancy of the wife, which is much shorter then the children, thus increasing the speed with which the IRA must be depleted (and losing the benefits of the tax deferral). Had the IRA passed directly to the surviving spouse, she could have rolled in into her own IRA and deferred the Required Minimum Distributions ("RMDs") until she reached her own required beginning date (April 1 of the year after she reaches age 70 1/2), and then at that time, the RMDs could be based on the "joint" tables, and on her death the children could take the RMDs based on the oldest of their lives. The value of this tax deferral could be significant.

The bottom line: funding a credit shelter trust with IRA assets is less advantageous then funding a credit shelter trust with non-IRA assets.

Planning Opportunity For Couple As AResult Of PLR

If the PLR accurately reflects the IRS' position on this type of plan (and it seems consistent with a few earlier PLRs), then the couple might avail themselves of a new technique. They could still move the assets so the husband has the IRA and the wife has the non-IRA assets, but in their revocable trusts (or wills) they can offer cross-testamentary general powers of appointment - just like in the PLR.

In this case, if the wife dies first, the assets are available to fully fund her credit shelter trust. So that's better than if we guessed and put the assets all in the husband's name.

But what's different is if the husband dies first, he can execute his power of appointment to use the non-IRA assets in the wife's trust to fund his credit shelter trust, while naming her as beneficiary of his IRA so she can roll it over and treat it as her own.

Now that affects a powerful change in circumstances. Whereas before the husband would have been funding his credit shelter trust with his IRA, and thus forcing the assets out under his wife's sole life expectancy while also wasting the value of his credit by applying it to an asset that is IRD, that is no longer the case under this plan.

Under this plan, the credit shelter trust gets funded with the non-IRA assets while the survivor winds up owning the IRA and being able to name the children as beneficiaries regardless of which spouse dies first. As stated above, this takes the guessing of which spouse will die first out of the equation.

And from a tax perspective, this plan is better than the first two alternatives (try to guess and possibly be wrong and put all non-IRA assets in wife's name).

Conclusion

While the law is clear that only the taxpayer requesting the PLR can rely on it, nevertheless, PLRs are seen as indicators of the IRS' positions. Moreover, this is not the first PLR to favor general power of appointment plans. Thus it may be the time to investigate this alternative plan for clients who are in situations like the one faced by our exemplary clients above. While it won't work perfectly for everyone, with the increasing applicable exclusion amount and the significant growth of clients' wealth in IRA accounts, there may be many clients for whom this type of plan will be very beneficial. For the sake of those clients, this new PLR is worth a look.

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