

# Planning for Retirement Benefits

## Section Members Share Their Thoughts

### Conduit Share versus Accumulation Share: Difficult Choices, Important Consequences

Once a decision has been made to leave tax qualified assets such as IRAs, 401(k)s or other tax qualified accounts to a trust share at the death of the account holder, the next consideration the drafting attorney needs to discuss with his client is whether to create a trust share that is allowed to accumulate and reinvest withdrawals from the tax qualified account in the trust share (an "Accumulation Share"), or whether the trust share should be designed to require that withdrawals from the qualified account must be distributed to or for the benefit of the beneficiary of the trust from the trust share (a "Conduit Share").

The decision is important because it may affect both how quickly the qualified account must be withdrawn and who ends up with the proceeds. There is significant tension between the desire of the taxpayer, on one hand, to preserve the tax deferral of the qualified account ("stretch-out") as long as possible in order to grow the account and the desire of the Internal Revenue Service (IRS), on the other hand, to tax the account quickly. Because of these competing goals, the IRS has forced families to choose between protecting beneficiaries from ill-advised distributions and achieving maximum tax deferral. When there are contingent beneficiaries who may be older than the primary beneficiary or may not be individuals at all (a charity, for example), the IRS requires that withdrawals from qualified accounts be distributed to or for the benefit of the primary beneficiary if the goal is to use that beneficiary's life expectancy in calculating the Required Minimum Distributions (RMDs) from the qualified account. We refer to such trust shares as Conduit Shares, although that term is not used by the IRS.

If the goal of such a trust share is to allow the trustee to accumulate withdrawals from the qualified account inside the trust, then the IRS may require the trustee to use the oldest beneficiary's age or in some cases the five year withdrawal rule (if, for example, a

charity is a beneficiary at some point in the trust's life) for determining RMDs. Thus, when such an Accumulation Trust is drafted (again, the IRS does not use this term), the contingent remainder beneficiaries must be carefully considered unless the rapid liquidation of the qualified account is determined to be of minor concern.

The choice between the two types of trust shares can make tremendous differences in the growth of the trust and in who ultimately ends up with trust assets. Unfortunately, we often review trusts drafted by practitioners who never considered the consequences of their drafting in this regard. We have found many such trust shares lack the necessary language to create a Conduit Trust, and thus will be treated as Accumulation Trusts by the IRS. When that happens, the opportunity for a stretch-out of the qualified account is lost, and with it, the opportunity to grow the value of the qualified account over time.

With large qualified accounts, the difference in value over time can be hundreds of thousands or even millions of dollars. The difference is so significant that we routinely offer clients with large qualified accounts the option of planning the disposition of their tax qualified accounts in separate trust shares from the rest of their assets. These trusts may be known under various monikers, with a well known version being the "IRA Inheritance Trust."

Even when the size of a qualified account does not merit the use of separate trust planning, the drafting attorney should make a conscious and considered choice to either draft a Conduit Share or an Accumulation Share. Do not allow the choice to be made haphazardly. For example, in drafting a special needs trust share or supplemental needs trust share we often will choose an Accumulation Share in order to make sure that trust distributions will not be required from qualified accounts that might disqualify the beneficiary from public benefits such as Medicaid or Supplemental Security Income (SSI). If the trust is a credit-shelter trust, and the surviving spouse will have ample other assets of his or her own or in the Marital Trust, then we also may draft the credit shel-

ter trust as an Accumulation Share. On the other hand, if remote contingent beneficiaries include people who are older than the primary beneficiary, or if it includes charities, then we often draft the beneficiary's share as a Conduit Share. We also use Conduit Shares when the primary beneficiary is fiscally responsible and has no disabilities and no significant liability exposure.

Once the decision has been made to leave qualified accounts in trust, careful consideration must be made on how to structure the beneficiary designations and how to draft the distribution requirements in the trust. Lack of careful planning in this area is a disservice to the client; careful planning can distinguish the drafting attorney as an expert who will be sought out by quality conscious consumers and their other advisors.

LARRY S. HARTLEY IS BOARD CERTIFIED BY THE NATIONAL ELDER LAW FOUNDATION AS A CERTIFIED ELDER LAW ATTORNEY, AND PRACTICES WITH THE LAW FIRM OF STRAUSS & ASSOCIATES, P.A., IN ASHEVILLE, NORTH CAROLINA.