

The Complex World of Distributing IRAs from a Marital Trust

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A recent New York Surrogate Court case highlights the complexities that arise when someone names a Marital Trust as beneficiary of a retirement account. *Matter of Canandaigua National Bank & Trust Co.* (Maloy), 162 N.Y.S. 3d 688, 2022 WL 599897 (N.Y. Surr. 2022). Naming a trust as beneficiary in lieu of an individual can be a key part of an estate plan for many reasons. Here, it was important to strike a balance between the needs of a surviving spouse and those of the children from a prior marriage.

The complexity arises from the multiple rules which apply to this situation. One set of rules establishes the requirements for making distributions to a surviving spouse in order to obtain an estate tax marital deduction for the value of the trust. Generally, a surviving spouse must receive all of the net income from the Marital Trust at least annually. An IRS Revenue Ruling addresses what is required regarding distributions from an IRA held by a Marital Trust. Generally, the Trustee must withdraw the income from the IRA each year, or give the surviving spouse the right to compel the distribution of this amount. To the extent that the IRA income is less than the minimum required IRA distribution in any year, the surviving spouse must also receive enough additional funds from the Trust and the IRA to meet the IRA minimum distribution requirement.

A second set of rules that apply are the IRA distribution requirements. These rules have required certain minimum annual distributions from the IRA and then from the Trust. These rules are now in flux, based on a lengthy, complex set of proposed regulations recently issued by the IRS.

In this case, the Trust initially provided that the Trustee should distribute all of the net income of the Trust to the surviving spouse from the non-IRA assets, plus the greater of the IRA income or the required minimum annual IRA distribution that year.

The terms of the Trust were changed by agreement of the beneficiaries and a resulting Court decree entered after the Trust settlor's death. The new terms provided for distributing a 4% unitrust amount to the surviving spouse, adopting the state's unitrust conversion statute. No specific provision regarding the IRA was included in the Court decree. This conversion meant that generally the surviving spouse was entitled to receive 4% of the Trust's value each year, in lieu of his prior distribution rights. For many, using or converting to a unitrust payment makes sense as it allows a trustee to invest for the best total return of a trust. Utilizing a unitrust helps eliminate the conflict between the need to invest

for income for a surviving spouse and the need to invest for growth for the future remainder beneficiaries—in this case, the stepchildren of the surviving spouse.

After this unitrust conversion, a disagreement arose as to the proper amount of Trust distributions to the surviving spouse. The Trustee contended that the Trust should distribute 4% of the value of the non-IRA Trust assets, plus 4% of the value of the IRA, plus the IRA minimum distribution. The Trustee contended that this approach was necessary to comply with the IRS Revenue Ruling regarding the marital deduction requirements for IRA distributions from the Trust.

The children contended that the Trustee should distribute the 4% unitrust amount from both the IRA and from the other Trust assets. Based on the original will terms, they agreed that the Trust should also distribute more from the IRA if necessary to meet the IRS rules on minimum annual distributions from the IRA.

The Court ruled that the Trustee was required by the terms of the unitrust conversion to distribute the amounts contended by the children. The Court noted that the IRS Revenue Ruling specifically addressed a unitrust conversion of a Marital Trust. In the Court's view, the children's

proposed approach to the Trust distributions from the IRA did comply with the unitrust conversion terms approved in the IRS Ruling.

This case involved the very complex intersection of the marital deduction, the IRA distribution and the unitrust conversion rules. Care should be taken when planning in this situation or whenever a trust is named as a beneficiary of a retirement account, particularly if the children of the IRA owner are not the children of the surviving spouse. Any unitrust conversion should expressly deal with IRA distributions from the Trust, to avoid disagreement among the beneficiaries and the Trustee.

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