

ESTATE PLANNING FOR A COMMUNITY PROPERTY INTEREST IN IRAs¹

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Attorneys who represent clients in community property jurisdictions are spending more time pondering tough questions regarding estate planning for a married person's community property interest in an IRA that has been established by his or her spouse. If the spouse dies first, can the spouse's community property interest in an IRA that was established by his or her husband or wife (as the case may be) be used to fund the spouse's unified credit? And if so, is there a way to preserve the tax-free growth of the spouse's interest in the IRA after the spouse's death? Greater attention has been focused on these issues because of (i) the tremendous growth in the amounts invested in IRAs, (ii) the increase in the applicable unified credit amount available to each taxpayer and (iii) the U.S. Supreme Court's recent decision in *Boggs v. Boggs*, 117 S.Ct. 1754 (1997). To date, there has been no clear consensus on the best way to accomplish these important planning objectives. The purpose of this article is to suggest one possible approach to this dilemma

Assume the client (herein referred to as "Taxpayer") is married and resides in the State of Wisconsin, a community property state. Taxpayer and Spouse are both age 70. Taxpayer is the owner of two IRAs. Both IRAs are attributable to a rollover of his account balance from an employer sponsored qualified plan (hereinafter referred to as "Rollover IRAs"). Taxpayer's spouse has also established her own IRA (hereinafter referred to as the "Spousal IRA"). However, the Rollover IRAs represent the vast majority of the parties' total assets. Taxpayer's IRAs total over \$2,000,000, while the Spousal IRA has a balance of approximately \$50,000. The couple's assets outside the IRA total approximately \$200,000.

The couple would like to be in a position to fund wife's unified credit with part of Taxpayer's IRA benefits if Spouse dies first and to allow their children to continue the tax-free growth inside the IRAs for as long as the minimum distribution rules allow. In an effort to accomplish this objective, the couple executes an estate plan which provides as follows:

1. The parties execute a marital property agreement that classifies the Rollover IRAs as marital property. The Spousal IRA is classified as Spouse's individual property by the marital property agreement.
2. The marital property agreement provides that Wisconsin's terminable interest rule does not apply to the Rollover IRAs and, therefore, Spouse's interest will not be terminated at her death by application of state law. (This is relevant only to Wisconsin residents.)
3. The estate plan provides that if Spouse is the first to die, her one-half interest in the Rollover IRAs should be transferred directly to the Spousal IRA. (In Wisconsin,

¹ This article is current as of 1999. Please contact Willms, S.C. for current information on this topic.

this can be done outside of probate by a direction in the marital property agreement pursuant to the transfer at death provisions of the Wisconsin statutes.)

4. The beneficiary designation of the Spousal IRA names a trust for the benefit of their children (hereinafter referred to as the "Children's Trust") as the primary beneficiary. The Children's Trust will be a qualified beneficiary, as defined by Prop. Treas. Reg. 1.401(a)(9)-1 (as modified).

5. On or before her Required Beginning Date (RBD), Spouse will direct the custodian of the Spousal IRA to make annual distributions to her during her lifetime based on her and the oldest trust beneficiary's joint life expectancies, subject to the minimum distribution incidental death benefit rule. For this purpose, neither life expectancy will be recalculated.

In the author's opinion, the effect of such an estate plan should be as follows:

1. Classification of the Rollover IRA of Taxpayer as marital property is not considered a taxable distribution for purposes of I.R.C. Sec. 408(d)(1). (See PLRs 8007024, 8929046, 94190396 and 9439020.)

2. If Spouse dies first, her applicable unified credit amount may be allocated to her marital property interest in the Rollover IRAs.

3. If Spouse predeceases Taxpayer, Spouse's marital property interest in the Rollover IRAs may be transferred to the Spousal IRA in accordance with state law, and such transfer is not barred by the anti-alienation rules I.R.C. §401(a)(13) and the corresponding provisions of the Employee Retirement Income Security Act, 29 U.S.C. 1001 et seq. The anti-alienation rules of ERISA and I.R.C. 401(a)(13) govern qualified retirement plans, but should not apply to IRAs. The facts of the *Boggs* case make clear that the decision in that case does not result in the anti-alienation rules of ERISA applying to IRAs.

4. If Spouse dies first, the direct trustee to trustee transfer of amounts held by the Rollover IRAs to the Spousal IRA is permissible under Revenue Ruling 78-406. Note that the proposed transfer is a transfer of Spouse's interest in the Rollover IRA to the Spousal IRA at her death. Taxpayer's interest in the Rollover IRA is not being transferred.

5. If Spouse dies first, the transfer of Spouse's one-half interest in Rollover IRAs to the Spousal IRA does not constitute a taxable distribution for purposes of I.R.C. Sec. 408(d)(1). (See PLRs 8040101 and 9439020.)

6. So long as the trust which is designated as the beneficiary of the Spousal IRA meets the requirements of proposed Treasury Regulations § 1.401(a)(9)-1 (as modified), then after the death of Spouse, minimum distributions from the Spousal

IRA can be taken on the remaining joint life expectancy of the Spouse and the oldest trust beneficiary.

A private letter ruling has been requested by the author that is intended to confirm these opinions. If the Service grants the requested rulings, then there will be a relatively straight forward methodology that can be followed in those circumstances where a spouse's community property interest in a rollover IRA may be needed to fund the spouse's unified credit, should the spouse die first. In addition, the application of the minimum distribution rules to the spouse's community property interest will have been clarified.