

## Chapter 5: Life Estate Beneficiaries

---

A life estate interest is the right on the part of a beneficiary to receive income from a trust during the beneficiary's lifetime. In some cases, this life estate interest consists solely of the right to receive payments of interest or income. In other cases, the life estate interest includes the right to receive some or all of the trust assets (perhaps at the discretion of the trustee). For deposit insurance purposes, the FDIC does not distinguish between these cases.

While a life estate beneficiary is a beneficiary under the trust agreement, the entitlement is different from a typical beneficiary who is receiving either a specific percentage or dollar distribution. The FDIC considers a life estate beneficiary to be a primary beneficiary for calculation of deposit insurance coverage, except when the life estate beneficiary is also an owner of the trust. Under the FDIC's rules, the owner of a revocable trust will not be treated as a beneficiary of his or her own trust for deposit insurance purposes. (See discussion below.)

When a revocable trust creates a life estate interest for a life estate beneficiary, the trust also will create remainder interests for remainder beneficiaries. Following the death of the life estate beneficiary, any remaining trust funds will be payable to the remainder beneficiaries. A remainder beneficiary is therefore defined as one or more beneficiaries who are entitled to residual assets upon the death of the life estate beneficiary. The FDIC considers a remainder beneficiary to be a primary beneficiary (along with the life estate beneficiary) for calculation of deposit insurance coverage.

Residual assets are defined for the purpose of deposit insurance coverage as the percentage or dollar amount that remains after specifically calculating the life estate beneficiary's interest in the trust assets.

### FDIC Rule on Calculation of Life Estate Interests

The FDIC cannot predict the amount of funds that will be distributed in the future to a life estate beneficiary and remainder beneficiaries. In many cases, these amounts will depend upon discretion by a trustee. Because these amounts cannot be predicted, the FDIC has adopted the following special rule:

*For living trusts accounts that provide for a life estate interest for designated beneficiaries and a remainder interest for other beneficiaries, unless otherwise indicated in the trust, each life estate holder and each remainder-man will be deemed to have equal interests in the trust assets for deposit insurance purposes. 12 C.F.R. § 330(f)(3).*

The FDIC has interpreted this rule to mean that a life estate interest shall be equal to the *average* interest of the trust beneficiaries (including the life estate beneficiary). The total amount of remainder interests shall be equal to the account balance less the life estate interest. Even though a life estate beneficiary may have the right under the trust agreement to use 100% of the assets and leave nothing for a remainder beneficiary, the FDIC's rule provides for equal recognition of the interests of the life estate beneficiary and the potential interests of the remainder beneficiaries.

Under the FDIC's regulations, a life estate beneficiary's interest is calculated by adding the total number of life estate beneficiaries and the total number of remainder beneficiaries named in the trust, then dividing this combined total into 100. This provides the percentage interest of the life estate beneficiary. Subtracting this percentage from 100% will provide the percentage of residual assets to be divided among the remainder beneficiaries.

## Note About Other FDIC Requirements for Revocable Trusts

All of the FDIC's regulatory requirements for coverage of revocable trust deposits, discussed in Chapter 4, apply to the discussion of coverage for life estate and remainder beneficiaries of formal revocable trusts. The examples and analyses in this chapter assume that the trust deposits meet the FDIC's requirements for coverage of trust deposits under the revocable trust ownership category. These requirements are:

- The account title at the bank must indicate that the account is held pursuant to a trust by including terms such as "trust," "living trust," "family trust," "revocable trust" or similar language in the account title.
- The beneficiaries must be qualifying, meaning that the beneficiaries must be the owner's spouse, children, grandchildren, parents or siblings.
- The trust agreement must provide that the trust assets will belong to the beneficiaries upon the last owner's death. When determining coverage, FDIC will ignore any trust beneficiary who will have a trust interest only if another beneficiary dies.

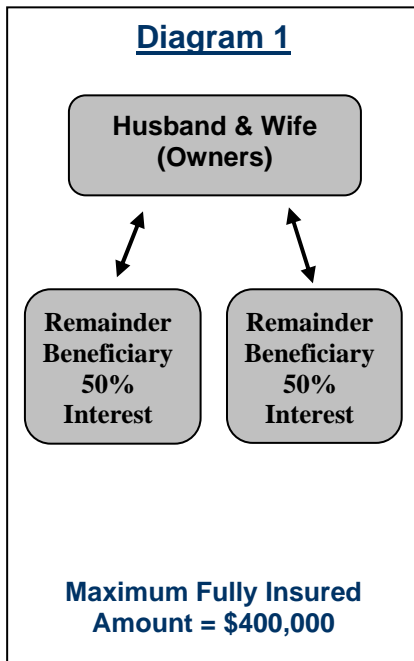
## Common Family Trusts Involving Life Estate Interests

The following are the two most common scenarios of formal revocable trusts involving married couples that provide a life estate interest for a surviving spouse:

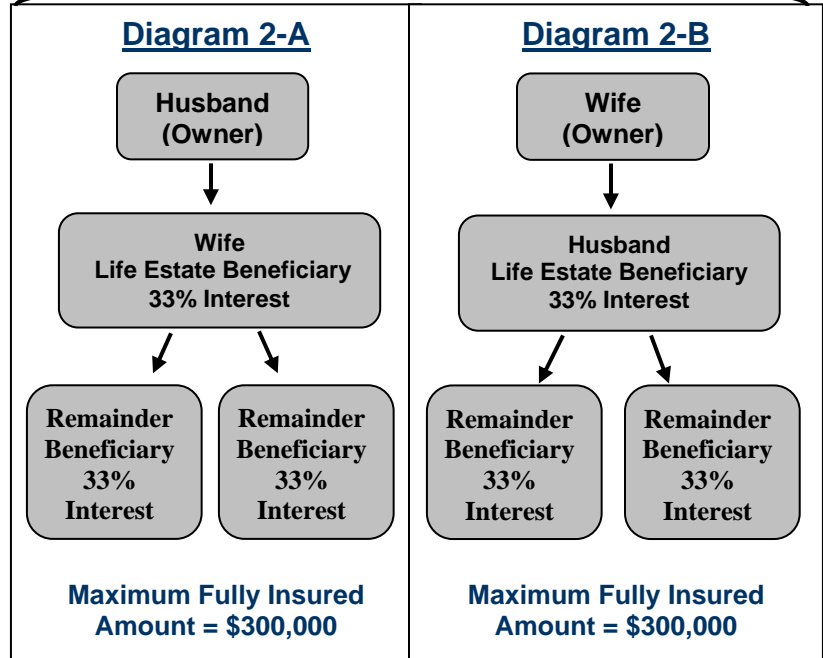
1. Jointly Owned Trust for Husband and Wife: A husband and wife are co-owners under a single trust agreement. Under the trust, when one of the two spouses dies, the surviving spouse will possess the right to receive interest and possibly the principal. In this scenario, while both owners are living, neither owner is treated as a life estate beneficiary for FDIC purposes. After both spouses have died, the funds pass to one or more beneficiaries.
2. Separate Trust for Each Spouse: Each spouse is the owner of his/her own trust. That is, the husband is the sole owner of a revocable trust; his wife is the sole owner of a separate revocable trust. Under the terms of both trust agreements, following the death of the owner, the surviving spouse will possess the right to receive interest and possibly principal from the other spouse's trust. In this scenario, while an owner is living, each trust owner's spouse is recognized as a life estate beneficiary for FDIC purposes. After both spouses have died, the funds pass to one or more beneficiaries.

The following diagrams illustrate how these two different types of formal revocable trusts are structured and the treatment of life estate beneficiaries under these different trust structures:

## Jointly Owned Trust



## Separate Spousal Trusts



In Diagram 1, the husband and wife are co-owners of the trust assets. When one spouse dies, the trust funds first go to the surviving spouse as a life estate beneficiary. Upon the death of the second spouse, any residual assets will then be distributed to the remainder beneficiaries.

Under the FDIC's rules for insurance coverage of revocable trust deposits, the owner of a trust will not be treated as a beneficiary of his or her own trust. Therefore, in the case of a revocable trust that is jointly owned by a husband and wife (Diagram 1), neither owner is treated as a beneficiary for FDIC deposit insurance purposes while both owners are living. In such cases, insurance coverage is based on the interests of the remainder beneficiaries who will receive the remaining trust assets after both owners die.

In contrast, in the case where a husband and wife each establish a separate trust, then the owner's spouse is considered a life estate beneficiary for deposit insurance purposes. Under Diagrams 2-A and 2-B, each spouse has established a separate formal revocable trust. Under Diagram 2-A, if the husband predeceases his wife, then the husband's trust provides that the trust funds first go to his wife as a life estate beneficiary, then any remaining funds go to the remainder beneficiaries. Under Diagram 2-B, if the wife predeceases her husband, then the wife's trust provides that the trust funds first go to her husband as a life estate beneficiary, and then any remaining funds go to the remainder beneficiaries.

While Diagrams 2-A and 2-B are similar to Diagram 1 in terms of the beneficial interests provided the surviving spouse and remainder beneficiaries, the deposit insurance coverage provided for these two revocable trust structures is very different.

### If all of the remainder beneficiaries are qualifying beneficiaries, then:

- The maximum insurance coverage available for the trust shown in Diagram 1 is \$400,000, which is derived as follow: \$100,000 X 2 Owners X 2 Beneficiaries. No insurance coverage is provided for the life estate interests since owners may not be beneficiaries of their own trust for deposit insurance purposes.

- In the case of Diagram 2-A and 2-B, the couple’s maximum insurance coverage for deposits at one bank is \$600,000, provided the funds are split evenly in the names of the husband’s trust and the wife’s trust as follows:
  - \$300,000 maximum insurance coverage for the husband’s trust deposits (\$100,000 per beneficiary including the wife as a life estate beneficiary)
  - \$300,000 maximum insurance coverage for the wife’s trust deposits (\$100,000 per beneficiary including the husband as a life estate beneficiary)

## Determining Beneficiaries’ Interests When Remainder Beneficiaries Have Equal Interests

If all remainder beneficiaries named in the formal revocable trust agreement receive equal percentages under the trust agreement (and all beneficiaries meet the FDIC kinship requirement), then the maximum fully insured amount is easy to calculate. Simply multiply the number of beneficiaries (life estate beneficiary and remainder beneficiaries) by \$100,000 (assuming one owner).

For example, when a revocable trust provides for one life estate beneficiary and one remainder beneficiary, the maximum fully insured amount is \$200,000 in total deposit insurance coverage (assuming one owner). If a trust agreement provides that there is one life estate beneficiary and two remainder beneficiaries with equal shares of the residual amount, then the maximum fully insured amount is \$300,000 (assuming all of the beneficiaries are qualifying beneficiaries). Under this scenario, each qualifying remainder beneficiary increases the amount of insurance coverage by \$100,000.

The following example illustrates how the FDIC’s rule on life estate interests is applied to a specific trust:

<b>Example 27 Formal Revocable Trust – One Owner One Life Estate Beneficiary and One Remainder Beneficiary</b>	
<b>Account Title</b>	<b>Balance</b>
Sam Shaw Living Trust	\$200,000

**Facts:** Sam Shaw has a living trust that gives his wife, Kate, a life estate interest. Upon Kate’s death, the sole remainder beneficiary is Sam’s son, Henry.

### **Analysis:**

1. *Who are the owners of the trust?* Sam Shaw is the sole owner of the trust.
2. *Who are the primary beneficiaries upon the death of the owner?* Sam’s wife, Kate, and his son, Henry, are the beneficiaries named in the trust agreement.
3. *Are the primary beneficiaries qualifying or non-qualifying beneficiaries?* Both the wife and son are qualifying beneficiaries.
4. *Is everyone named in the trust living – both owners and beneficiaries?* Yes. Everyone is living.
5. *What is the dollar amount or percentage interest each owner has allocated to each primary beneficiary?* The wife has a life estate interest. The son has a remainder interest in the trust and will

receive all the funds left in the trust after the wife dies. Under the FDIC's special rule for life estate interests, the wife and the son are treated as equal beneficiaries of the trust for deposit insurance purposes. Therefore, to calculate FDIC insurance coverage, assume that the two beneficiaries each have a 50% beneficiary interest in the trust.

6. *Is the trust properly identified in the bank's records?* The account title "The Sam Shaw Living Trust" would meet the FDIC's regulatory requirement.

<b>Coverage for Example 27 can be stated as:</b>		
<b>Owner to Beneficiary</b>	<b>Balance</b>	<b>Insured Amount</b>
Sam to Kate (wife) – 50% interest in the deposit	\$100,000	\$100,000
Sam to Henry (son) – 50% interest in the deposit	100,000	100,000
<b>Total</b>	<b>\$200,000</b>	<b>\$200,000</b>

Since there are two beneficiaries named and the life estate interest by definition is an equal interest, then the wife and the son are considered to each have a 50% interest for calculation of deposit insurance coverage. Therefore, the maximum amount of deposit insurance coverage available for deposits held by the Sam Shaw Living Trust at one bank is \$200,000.

## Determining Trust Interests: One Life Estate Beneficiary and Multiple Remainder Beneficiaries With Equal Interests

The following chart shows the calculation of beneficiary interests for formal revocable trusts with one life estate beneficiary and up to nine remainder beneficiaries who each have an equal beneficiary interest.

<b>Determining Beneficiary Interests for Formal Revocable Trusts With One Life Estate Beneficiary and Remainder Beneficiaries</b>				
<b>Number of Life Estate Beneficiaries</b>	<b>Number of Remainder Beneficiaries</b>	<b>Total Number of Primary Beneficiaries</b>	<b>% Interest of Life Estate Beneficiary in Trust Assets</b>	<b>% Interest of Residual Beneficiaries in Trust Assets</b>
1	1	2	100%/2 = <b>50.0%</b>	<b>50.0%</b>
1	2	3	100%/3 = <b>33.3%</b>	<b>66.7%</b>
1	3	4	100%/4 = <b>25.0%</b>	<b>75.0%</b>
1	4	5	100%/5 = <b>20.0%</b>	<b>80.0%</b>
1	5	6	100%/6 = <b>16.7%</b>	<b>84.3%</b>
1	6	7	100%/7 = <b>14.3%</b>	<b>85.7%</b>
1	7	8	100%/8 = <b>12.5%</b>	<b>87.5%</b>
1	8	9	100%/9 = <b>11.1%</b>	<b>88.9%</b>
1	9	10	100%/10 = <b>10.0%</b>	<b>90.0%</b>

**Example 28**  
**Formal Revocable Trust – One Owner**  
**One Life Estate Beneficiary and Three Remainder Beneficiaries**  
**Who Have an Equal Beneficiary Interest**

Account Title	Balance
Mark Carter Living Trust	\$400,000

**Facts:** Mark Carter has a living trust that gives his wife, Ruth, a life estate interest. Upon Ruth's death, the couple's three children are designated as remainder beneficiaries.

**Analysis:**

1. *Who are the owners of the trust?* Mark Carter is the sole owner of the trust.
2. *Who are the primary beneficiaries upon the death of the owner?* Mark's wife, Ruth, and his three children are the beneficiaries named in the trust agreement.
3. *Are the primary beneficiaries qualifying or non-qualifying beneficiaries?* Both the wife and three children are qualifying beneficiaries.
4. *Is everyone named in the trust living – both owners and beneficiaries?* Yes. The owner and all four beneficiaries are living.
5. *What is the dollar amount or percentage interest the owner has allocated to each primary beneficiary?* The wife has a life estate interest. The three children have remainder interests in the trust and will receive equal shares of the remaining trust funds after the wife dies. Under the FDIC's special rule for life estate interests, the wife and the son are treated as equal beneficiaries of the trust for deposit insurance purposes. Therefore, to calculate FDIC insurance coverage, assume that the four beneficiaries each have a 25% beneficiary interest in the trust.
6. *Is the trust properly identified in the bank's records?* The account title "The Mark Carter Living Trust" would meet the FDIC requirement.

**Coverage for Example 28 can be stated as:**

Owner to Beneficiary	Balance	Insured Amount
Mark to Ruth (wife) – 25% interest in the deposit	\$100,000	\$100,000
Mark to Child 1 – 25% interest in the deposit	100,000	100,000
Bill to Child 2 – 25% interest in the deposit	100,000	100,000
Bill to Child 3 – 25% interest in the deposit	100,000	100,000
<b>Total</b>	<b>\$400,000</b>	<b>\$400,000</b>

All four beneficiaries – the wife and the three children – have a 25% interest for calculation of deposit insurance coverage. Therefore, the maximum amount of deposit insurance coverage available for deposits held by the Mark Carter Living Trust at one bank is \$400,000.

## Determining Beneficiaries' Interests When Remainder Beneficiaries Have Unequal Interests (Different Shares or Dollar Amounts)

Calculation of the interests of life estate beneficiaries and remainder beneficiaries becomes more complicated when the remainder beneficiaries have different interests in the trust assets:

- The first step is to calculate the life estate beneficiary's interest in the trust prior to calculating the interests of other named beneficiaries. This is done by adding up the total number of all beneficiaries (including the life estate beneficiary) named in the trust and dividing that number into 100%, which will equal the life estate beneficiary's interest under the trust agreement. The life estate beneficiary's interest is then subtracted from 100% to obtain the residual amount. The residual amount is the percentage of the deposit allocated to the remainder beneficiaries to calculate deposit insurance coverage.
- Since the remainder beneficiaries receive different percentages or different dollar amounts, each remainder beneficiary's interest must be calculated pursuant to the terms of the trust agreement.

<b>Example 29</b> <b>Formal Revocable Trust</b> <b>Multiple Beneficiaries Including a Life Estate Beneficiary and Remainder Beneficiaries</b> <b>Beneficiaries Have Unequal Beneficiary Interests</b>	
Account Title	Balance
Teresa Short Revocable Trust	\$400,000

**Facts:** A deposit account has been opened at an FDIC-insured bank in the name of the Teresa Short Revocable Trust. The balance of the account is \$400,000. Under the terms of the trust agreement, following the death of the owner (Teresa Short), the owner's spouse (Bill Short) shall receive payments of interest during his lifetime. In addition, the spouse may receive payments of principal at the discretion of the trustee. Following Bill's death, any remaining funds shall be distributed as follows: (1) 20% to daughter Ann, (2) 30% to son Barry, and (3) 50% to daughter Catherine. All of the primary beneficiaries meet the FDIC's kinship requirement for qualifying beneficiaries.

Since we have a trust description that answers the requisite six questions, we can proceed to determine insurance coverage of the beneficiaries' interest:

- i. Place the beneficiaries in the proper order.
- ii. After placing the beneficiaries in the proper order, allocate funds to the initial beneficiary (the life estate beneficiary). In calculating the life estate interest, divide the account balance by the total number of beneficiaries to produce an average beneficiary interest.
- iii. After allocating this amount to the life estate beneficiary, subtract this amount from the balance of the account. Then allocate the remaining amount to the remainder beneficiaries in accordance with the terms of the trust agreement.
- iv. Apply the \$100,000 limit for each qualifying beneficiary.

In the above example, the initial beneficiary is Bill Short. There are four beneficiaries in total: Bill and the three children. Under the procedure described above, Bill's life estate interest is one-fourth or 25% of \$400,000. This means that Bill's life estate interest is \$100,000.



The subtraction of \$100,000 (Bill's life estate interest) from \$400,000 (the balance of the account) leaves \$300,000. This is the amount available for allocation to the remainder beneficiaries. Under the terms of the trust agreement, these funds (\$300,000) must be allocated as follows: (1) 20% to Ann, (2) 30% to Barry and (3) 50% to Catherine. This allocation produces the following results: (1) Ann's interest is \$60,000, (2) Barry's interest is \$90,000 and (3) Catherine's interest is \$150,000.

All of the beneficiaries are qualifying beneficiaries. This means that each beneficiary's interest is separately insurable up to \$100,000. Application of the \$100,000 limit produces the following results:

<b>Coverage for Example 29 can be stated as:</b>				
<b>Owner to Beneficiary</b>	<b>Beneficiary's % Interest</b>	<b>Ownership Share</b>	<b>Insured Amount</b>	<b>Uninsured Amount</b>
Teresa to Bill (spouse)	<b>25.0%</b>	\$100,000	\$100,000	\$0
Teresa to Ann (daughter)	20% of 75% = <b>15.0%</b>	60,000	60,000	0
Teresa to Barry (son)	30% of 75% = <b>22.5%</b>	90,000	90,000	0
Teresa to Catherine (daughter)	50% of 75% = <b>37.5%</b>	150,000	100,000	50,000
<b>Total</b>	<b>100.0%</b>	<b>\$400,000</b>	<b>\$350,000</b>	<b>\$50,000</b>

## Determining the Maximum Deposit Amount With Full FDIC Insurance Coverage

When an owner wants to determine the maximum amount his formal revocable trust can deposit at one bank and have all of the funds fully insured, the owner could use the following formula:

***Divide \$100,000 (FDIC insurance limit for the trust interests of a qualifying beneficiary) by the largest percentage interest of any beneficiary in the trust deposits***

In Example 29 above, under the FDIC's special rule for calculating a life estate interest, Bill Short's interest in the account balance is 25%. This means that 75% of the account is available for allocation to Ann, Barry and Catherine. Catherine is the beneficiary with the largest interest; Catherine's interest in the remaining assets is 50%. Catherine's interest in the entire account balance is 37.5% (50% of 75%). Therefore, the maximum amount that the Teresa Short Revocable Trust can deposit at one bank and have all the funds fully insured = \$100,000 divided by 37.5% (.375) = \$266,667. This is the maximum amount that the Teresa Short Revocable Trust should place in this account if the owner wants the funds to be fully insured. With this balance, Catherine's 37.5% beneficiary interest would be \$100,000 exactly (37.5% of \$266,667 = \$100,000).

A deposit by the Teresa Short Revocable Trust at one bank in excess of \$266,667 would push Catherine's interest in the deposit account beyond the \$100,000 insurance limit.

<b>Coverage for Example 29 can be stated as:</b>				
<b>The Teresa Short Revocable Trust – Maximum Fully Insured Amount = \$266,666</b>				
<b>Owner to Beneficiary</b>	<b>Beneficiary's % Interest</b>	<b>Ownership Share</b>	<b>Insured Amount</b>	<b>Uninsured Amount</b>
Teresa to Bill (spouse)	<b>25.0%</b>	\$66,666	\$66,666	\$0
Teresa to Ann (daughter)	20% of 75% = <b>15.0%</b>	40,000	40,000	0
Teresa to Barry (son)	30% of 75% = <b>22.5%</b>	60,000	60,000	0
Teresa to Catherine (daughter)	50% of 75% = <b>37.5%</b>	100,000	100,000	0
<b>Total</b>	<b>100.0%</b>	<b>\$266,666</b>	<b>\$266,666</b>	<b>\$0</b>



Note that all of the calculations above are based on the assumption that the owner and all beneficiaries are living. The calculation of coverage would be different if a beneficiary is deceased.

## When a Life Estate Beneficiary Dies

When a beneficiary with a life estate interest in a formal revocable trust dies, the residual assets (if any) will pass to one or more remainder beneficiaries as provided in the trust agreement. Example 30 (below) shows the impact on FDIC insurance coverage of revocable trust deposits when the life estate beneficiary of a revocable trust dies and the trust assets pass to the remainder beneficiaries.

<b>Example 30 Formal Revocable Trust Multiple Beneficiaries Including a Life Estate Beneficiary and Remainder Beneficiaries Beneficiaries Have Unequal Beneficiary Interests</b>	
<b>Account Title</b>	<b>Balance</b>
Teresa Short Revocable Trust	\$400,000

**Facts:** Using the Teresa Short Revocable Trust example above, assume that Bill (the owner's spouse with the life estate interest) is deceased. In this scenario, daughter Catherine's interest in the deposit account (the largest beneficial interest) would be larger since the funds available for distribution to the three children would not be reduced by Bill's life estate interest. Catherine's interest in the trust account would be 50% instead of 37.5%. Thus, the maximum amount that could be fully insured at one bank is \$200,000 instead of \$266,666.66. The \$200,000 amount is determined as follows: \$100,000 (the insurance limit) divided by 50% (representing the largest beneficiary interest) = \$200,000.

With a deposit balance of \$200,000, the Teresa Short Revocable Trust's funds would be allocated to the beneficiaries as follows:

<b>Coverage for Example 30 can be stated as: Teresa Short's Revocable Trust – After the Life Estate Beneficiary Has Died Maximum Fully Insured Amount = \$200,000</b>				
<b>Owner to Beneficiary</b>	<b>Beneficiary % Interest</b>	<b>Ownership Share</b>	<b>Insured Amount</b>	<b>Uninsured Amount</b>
Teresa to Ann	20%	\$ 40,000	\$ 40,000	\$0
Teresa to Barry	30%	60,000	60,000	0
Teresa to Catherine	50%	100,000	100,000	0
<b>Total</b>	<b>100%</b>	<b>\$200,000</b>	<b>\$200,000</b>	<b>\$0</b>

If the Teresa Short Revocable Trust were to deposit more than \$200,000 at one FDIC-insured bank after the life estate beneficiary (Bill) has died, some portion of the trust's deposits would be uninsured. If the trust deposits at one bank exceed \$200,000, then Catherine's beneficiary interest (50%) in the trust deposits would exceed the \$100,000 insurance limit.