Chapter 6: Irrevocable Trusts

An irrevocable trust account is a deposit account held in the name of a trust established by statute or written trust agreement that cannot be terminated or revoked by the grantors. In order for a trust deposit to qualify for FDIC insurance coverage as an irrevocable trust account, the trust must be a valid trust under state law.

An irrevocable trust may come into existence upon the death of an owner of a formal revocable trust (or if a trust has multiple owners, the portion of the trust attributed to the revocable trust owner who has died). The reason is that the owner no longer can revoke or change the terms of the trust.

Even though an irrevocable trust may arise from a formal revocable trust, the FDIC's rules for the two types of trusts are different. The FDIC's rules for irrevocable trust accounts are explained in detail below.

FDIC Rules for Insurance Coverage of Irrevocable Trust Deposits

The applicable section of the FDIC's insurance regulations is 12 C.F.R. § 330.13. That section provides, in part, as follows:

> Funds representing the "non-contingent trust interest(s)" . . . of a beneficiary deposited into one or more deposit accounts established pursuant to one or more irrevocable trust agreements created by the same settlor(s) (grantor(s)) shall be added together and insured up to [$100,000] in the aggregate. Such insurance coverage shall be separate from the coverage provided for other accounts maintained by the settlor(s), trustee(s) or beneficiaries of the irrevocable trust(s) at the same insured depository institution. Each "trust interest" . . . in any irrevocable trust established by two or more settlors shall be deemed to be derived from each settlor pro rata to his or her contribution to the trust.
> 12 C.F.R. § 330.13(a).

Under this section of the FDIC's regulations, the interests of a beneficiary in all deposit accounts established by the same grantor and held at a bank under an irrevocable trust are added together and insured up to $100,000. If an irrevocable trust has two or more grantors, then coverage is provided separately for the beneficiaries named by each grantor.

FDIC Recordkeeping Requirements for Irrevocable Trusts

Under the FDIC's regulations, a bank deposit cannot be insured as an irrevocable trust account unless the account records of the insured bank disclose the existence of a trust relationship. This requirement can be satisfied by titling the account in the name of the trust (for example, The Smith Family Trust).

No Kinship Requirement for Irrevocable Trusts

Per beneficiary coverage does not depend upon the kinship between the grantor and the beneficiaries of the irrevocable trust. In other words, in the irrevocable trust ownership category, the FDIC does not draw a distinction between qualifying and non-qualifying beneficiaries. Even if the beneficiaries are not the grantor's spouse, children, grandchildren, parents or siblings, per beneficiary coverage is possible. Indeed, per beneficiary coverage is possible even if the beneficiaries are not people but organizations such as charitable organizations.

Per beneficiary Coverage Available for Non-contingent Interests Only

Per beneficiary coverage is only available when the beneficiary's interest is a non-contingent trust interest. This term is defined as follows:

> *Non-contingent trust interest* means a trust interest capable of determination without evaluation of contingencies except for those covered by the present worth tables and rules of calculation for their use set forth in § 20.2031-7 of the Federal Estate Tax Regulations (26 CFR 20.2031-7) or any similar present worth or life expectancy tables which may be adopted by the Internal Revenue Service. 12 C.F.R. § 330.1(l).

In the case of any irrevocable trust in which the interests of some or all of the beneficiaries do not satisfy this definition of non-contingent trust interest, the deposits representing the contingent interests are added together and insured up to $100,000 in the aggregate. 12 C.F.R. § 330.13(b).

The following are examples of situations in which the FDIC would *not* provide per beneficiary coverage because the beneficiaries' interests are contingent interests under the FDIC's regulations:

- The trust agreement does not name the beneficiaries or provide any means of identifying the beneficiaries. In this situation, per beneficiary would not be possible because the trust includes no beneficiaries.

- The trust agreement provides that the trustee may divert funds from some beneficiaries to other beneficiaries (for example, for the medical needs of the second group of beneficiaries). In this situation, the interests of the first group of beneficiaries would be contingent upon the discretion of the trustee.

- The trust agreement provides that the beneficiaries shall receive no funds unless some condition is satisfied (for example, the beneficiaries must graduate from college). In this situation, the interests of the beneficiaries would be contingent upon the satisfaction of the condition.

It is important to note that FDIC regulations require the use of IRS actuarial tables to compute the value of a life estate interest under an irrevocable trust. The computation is based on the life estate beneficiary's estimated remaining life expectancy and the balance of the trust account. This requirement is significantly different from the FDIC's rule for valuation of life estate interests in revocable trust deposits.

Single Account Coverage for Interests Retained by Grantor

Under the FDIC's regulations, an irrevocable trust account cannot be insured on a per beneficiary basis to the extent that the grantor retains an interest in the deposit funds. See 12 C.F.R. § 330.1(q), which provides that the term "trust interest" does not include any interest retained by the settlor. If the grantor retains an interest, then the funds are insured to the grantor in the single ownership category.

Summary

Under FDIC regulations, the deposits contributed by a grantor to an irrevocable trust account are insured as follows:

- To the extent that the grantor retains an interest in the trust assets, the funds are insured to the grantor in the single ownership category. In the case of most irrevocable trust accounts, the grantor does not retain an interest because the grantor is deceased (that is, the irrevocable trust sprung from a revocable trust when the grantor died). Consequently, in most cases, the funds are not insured to the grantor in the single ownership category. Rather, the funds are insured as described below.

- To the extent that the interests of some or all of the beneficiaries are subject to contingencies, the deposits are added together and insured up to $100,000 for the entire trust. Per beneficiary coverage is not available for contingent trust interests.

- To the extent that the interests of a beneficiary are non-contingent, the funds for each beneficiary are separately insured up to $100,000.

Important Note: The FDIC's experience indicates that, in many cases, the interests of beneficiaries of an irrevocable trust are subject to contingencies that negate eligibility for per beneficiary coverage. When irrevocable trust deposits do not represent the non-contingent interests of identifiable beneficiaries, the FDIC cannot provide insurance coverage up to $100,000 on a per beneficiary basis. Rather, coverage is limited to $100,000 for the entire trust account.

In light of the prevalence of contingencies in irrevocable trust agreements, the trustee of an irrevocable trust may wish to place no more than $100,000 of an irrevocable trust's funds at any insured bank. A grantor or trustee of an irrevocable trust account should consult with a legal or financial advisor if there are questions about conditions or contingencies in the trust.

Calculating Coverage for Irrevocable Trust Accounts

While the FDIC's irrevocable trust regulations (12 C.F.R. § 330.13) do not prescribe a specific methodology for calculating FDIC insurance coverage for deposits based on irrevocable trust agreements, answers to the following questions are required to determine coverage for irrevocable trust deposits. Answers to these questions should be analyzed together to accurately calculate the FDIC deposit insurance coverage for a specific trust agreement.

The six questions that must be answered to determine FDIC insurance coverage for an irrevocable trust account are:

1. *Who are the grantors of the trust?*

2. *Who are identified as the primary beneficiaries?*

3. *What is dollar amount or percentage interest allocated by each grantor to each primary beneficiary? (This includes any specific lump sum amounts to be distributed to any beneficiary prior to the allocation by percentages.)*

4. *Are there any contingencies or conditions associated with the beneficiaries receiving their beneficiary interests?*

5. *Is everyone named in the trust deposit living – both grantors and beneficiaries? If the grantor is living, does the grantor retain an interest in the trust?*

6. *Is the trust properly identified in the bank's records?*

Note that these six questions for irrevocable trusts are different from the questions used to calculate coverage for formal revocable trusts. The differences between the two sets of questions – that is, the questions used for formal revocable trusts vs. irrevocable trusts – are:

- There is no kinship requirement for irrevocable trusts, so there is no need to determine whether a beneficiary is a qualifying beneficiary for an irrevocable trust.

- For irrevocable trusts, we need to determine whether there are any contingent interests or conditions that affect the distribution to one or more of the primary beneficiaries.

The other questions used for formal revocable trusts are also relevant for irrevocable trusts. For irrevocable trusts, you still will need to identify the grantors and all of the beneficiaries, and determine whether the grantors and beneficiaries are living. You will also need to determine whether there is a life estate beneficiary, which would require calculation of the life estate beneficiary's interest using IRS actuarial tables. The analysis of primary and alternative beneficiaries is still relevant in performing the calculation (provided none of the beneficiaries' interests is contingent). Finally, you will need to verify whether the FDIC's account titling requirements have been met.

Example 31
Formal Revocable Trust Converts to Irrevocable Trust Upon Grantor's Death
(After the Expiration of the Six-Month Grace Period)

Facts: Martha Green, who was the sole owner of a family trust, died last year. Before her death, Martha opened a certificate of deposit in the name of her trust, which identifies her five children as equal beneficiaries upon her death. Under the trust agreement, each beneficiary must reach the age of 21 to receive an equal share of the trust assets. In addition, under the trust, the trustee can reallocate 100% of the funds to any beneficiary for medical needs as deemed necessary. Now that Martha has died and the trust is irrevocable, the trustee is wondering what is the maximum amount of trust assets he can keep on deposit at the bank and ensure the funds are fully insured.

Analysis:

1. *Who are the grantors of the trust?* There is one grantor named in the trust agreement, Martha Green.

2. *Who are the primary beneficiaries?* There are five primary beneficiaries named in the trust agreement, Martha's children.

3. *What is the dollar amount or percentage interest allocated by each grantor to each primary beneficiary?* Each child is to receive an equal share.

4. *Are there any contingencies or conditions associated with the beneficiaries receiving their beneficiary interests?* The fact that the trustee can reallocate 100% of the funds to any beneficiary for medical needs as deemed necessary indicates that the beneficiaries' interests are contingent.

5. *Is everyone named on the trust deposit living – both grantors and beneficiaries?* The beneficiaries are living. The grantor, Martha Green, has died and therefore cannot retain an interest in the trust.

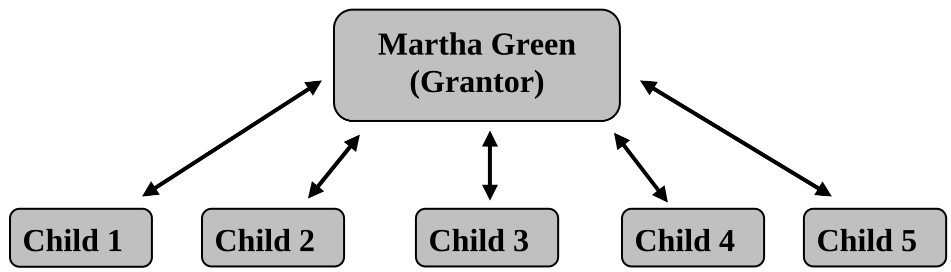
6. *Is the trust properly identified in the bank's records?* The account title "The Martha Green Family Trust" would meet the FDIC requirement.

With the answers to the above questions, you can determine the maximum amount of FDIC insurance coverage available at one bank under this trust agreement. In this example, the maximum fully insured amount at one bank for this trust agreement is $100,000. This coverage limit is $100,000 in total because the interests of all the beneficiaries are contingent upon specific conditions identified in the trust.

Note that when Martha Green was living, her trust deposits would have been insured as revocable trust deposits up to $500,000 ($100,000 per qualifying beneficiary). FDIC rules for revocable trusts specifically state that the FDIC will ignore any contingencies when determining coverage for revocable trust deposits. Therefore, contingencies are only a factor in determining FDIC coverage for irrevocable trusts. This example illustrates how the death of the owner of a revocable trust can result in a significant reduction in FDIC coverage for the trust's deposits, and the importance of reviewing FDIC insurance coverage after the owner of a revocable trust dies.

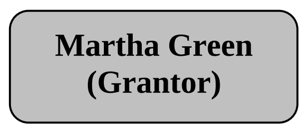
The following diagrams illustrate the impact of the trust owner's death on FDIC insurance coverage of bank deposits held in the name of the Martha Green Family Trust.

Deposit Insurance Coverage – When the Owner is Living



- **Maximum coverage for revocable trust = $500,000**

Deposit Insurance Coverage – After the Owner Dies
(after expiration of six-month grace period)



- **Trust is now irrevocable**
- **Beneficiaries' interests are contingent**
- **Maximum coverage for irrevocable trust = $100,000**

Example 32
Death of a Formal Revocable Trust Owner – Trust Splits into A/B Trust
(After Expiration of Six-Month Grace Period)

<u>Facts</u>: Thomas and Laura Mitchell (husband and wife) established a joint revocable trust five years ago. Thomas died one year ago and, at that time, the joint trust split into A and B trusts. Following Thomas's death, two deposit accounts were opened: (1) an account in the name of the A trust and (2) an account in the name of the B trust. These are the only deposit accounts held by the A and B trusts at the same bank. The terms applicable to the A and B trusts are described below:

- The A trust is revocable and Laura is the sole owner. The terms are similar to the A trust (that is, the couple's four children – Alex, Bonny, Carl and Donna – are entitled to receive equal shares of the trust assets after Laura's death).

- The B trust is irrevocable and contains Thomas's interest in the original trust. Laura has a life estate interest in the B trust and is entitled to receive the net income from the trust at least quarterly. Eric Mitchell (not a grantor or beneficiary) is named as the trustee. The B trust provides that the trustee can invade the trust assets to provide for care if Laura incurs a catastrophic medical illness or condition. Upon Laura's death, Thomas and Laura's four children – Alex, Bonny, Carl and Donna – are to receive equal shares of the remaining trust assets.

Analysis of Coverage for the A Trust:

1. *Who are the owners of the trust?* Laura Mitchell is the sole owner of this revocable trust. (Reminder: Since Eric Mitchell is a trustee and not an owner, his designation as trustee is irrelevant in calculating FDIC deposit insurance coverage for this deposit.)

2. *Who are identified as the primary beneficiaries upon the death of the owner?* Four beneficiaries are identified in the trust: Alex Mitchell, Bonny Mitchell, Carl Mitchell and Donna Mitchell

3. *Are the primary beneficiaries qualifying or non-qualifying beneficiaries?* All four of the beneficiaries are the owner's children and, thus, are qualifying beneficiaries.

4. *What is the dollar amount or percentage interest the owner has allocated to each primary beneficiary?* The four beneficiaries share equally in the trust assets. Therefore, each of the beneficiaries has a 25% interest in the trust assets.

5. *Is everyone named on the trust deposit living – both owners and beneficiaries?* Yes.

6. *Is the trust properly identified in the bank's records?* An account titled "The Laura Mitchell Survivor's (A) Trust" would meet the FDIC requirement.

With the answers to the above questions, you can determine the maximum fully insured amount at one FDIC-insured bank under this trust agreement. The total A trust is insured for $400,000 ($100,000 for the trust interests of each of Laura Mitchell's four children). The dollar amount attributable to each beneficiary is $100,000 since each beneficiary is entitled to an equal share of the trust assets.

Coverage for Example 32 – The Laura Mitchell Survivor's (A) Trust – can be stated as:		
Owner to Beneficiary	**Beneficiary % Interest**	**Maximum Fully Insured Amount**
Laura to Child 1	25%	$100,000
Laura to Child 2	25%	100,000
Laura to Child 3	25%	100,000
Laura to Child 4	25%	100,000
Total Insured	**100%**	**$400,000**

<u>Analysis of Coverage for B Trust:</u>

1. *Who are the grantors of the trust?* Thomas Mitchell is the sole grantor and is deceased. Since six months have passed since Thomas' death, the FDIC's grace period does not apply. (Reminder: Since Eric Mitchell is a trustee and not a grantor, his designation as trustee is irrelevant in calculating FDIC deposit insurance coverage for this deposit.)

2. *Who are identified as the primary beneficiaries?* Five beneficiaries are named: Laura Mitchell has a life estate interest in the trust; Alex Mitchell, Bonny Mitchell, Carl Mitchell and Donna Mitchell are remainder beneficiaries.

3. *What dollar amount or percentage interest has each grantor allocated to each primary beneficiary?* There is a life estate beneficiary interest requiring an actuarial computation, and four remainder beneficiaries who share equally in the remainder assets. FDIC regulations require computation of the value of a life estate interest in an irrevocable trust using IRS actuarial tables, which is significantly different from the FDIC's rules for coverage of revocable trust deposits. The computation is based on Laura's estimated remaining life expectancy and the balance of the trust funds. For this example, we have assumed that Laura's life estate interest in the trust deposits is valued at $30,000.

4. *Are there any contingencies or conditions associated with the beneficiaries receiving their beneficiary interest?* The trust provides for equal shares of the trust assets for the four children after Laura's death. However, since the trust states that the trustee can invade the trust to provide for Laura's care if she incurs a catastrophic medical illness or condition, this contingency results in all four of the children's interests being insured by the FDIC as contingent interests. All four of the children's interests in the trust are added together and insured up to $100,000.

5. *Is everyone named in the trust living – both grantors and beneficiaries?* Thomas Mitchell is deceased, which resulted in the establishment of the B trust as an irrevocable trust.

6. *Is the trust properly identified in the bank's records*? A deposit account titled "The Thomas and Laura Mitchell Marital ('B') Trust" would satisfy the FDIC titling requirement. The trustee's records must contain the list of all named beneficiaries in the trust. The identities and interests of the beneficiaries' interests must be ascertainable from the records of the trustee or the institution.

With the answers to the above questions, you can determine the maximum amount of deposit insurance coverage available at a single FDIC-insured institution under this trust agreement. As explained above, Laura's life estate interest in the trust deposits is assumed to be $30,000. The four children's contingent interests are added together and insured up to $100,000. The maximum fully insured amount for the B trust is $130,000.

Coverage for Example 32 – The Thomas Mitchell Decedent's (B) Trust – can be stated as:		
Beneficiary Interests	**Beneficiary % Interest or $ Allocation**	**Maximum Fully Insured Amount**
Thomas to Four Children	100%	$100,000
Laura's Life Estate Interest	Computed to be $30,000	30,000
Total Insured		**$130,000**

Summary of the deposit insurance coverage for the A and B trusts: Deposits opened at one FDIC-insured bank using the B trust are insured up to $130,000. Deposits at one bank using the A trust can be insured up to $400,000.

When both of the original co-owners were alive, naming their four children as beneficiaries, the trust deposits could have been insured up to $800,000. The death of one owner, and the split of the revocable trust into the A and B trusts, resulted in the reduction of deposit insurance coverage for the combined trust funds.

If the trust had not split into AB trusts and instead became a revocable trust with one owner under the same terms and conditions of the B trust, then the reduction in the deposit insurance coverage would have been $400,000. That is, the revocable trust owned solely by Laura Mitchell would be eligible for up to $400,000 in deposit insurance coverage at one FDIC-insured bank.