Trusts As Beneficiaries Of IRAs

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Post-death RMD requirements

- IRAs follow the post-death required minimum distribution (RMD) rules applicable to all retirement accounts
  (Treas. Reg. 1.408-8, Q&A-1, 1.401(a)(9); IRC Section 408(a)(6))
- In determining post-death RMDs, there are two questions to ask:
  - Did the owner die before or after his/her required beginning date?
  - To which of the following classes does the beneficiary belong:
    - Non-designated beneficiary
    - Designated beneficiary – non-spouse
    - Designated beneficiary – spouse

Post-death RMD requirements

- Defining terms:
  - **Required Beginning Date** – April 1st of the year following the year in which the individual turned 70 ½ (Treas. Reg. 1.401(a)(9)-2, Q&A-2)
  - **Designated Beneficiary** – an *individual* who is designated as the beneficiary of a retirement plan; estates and non-individual entities (e.g., charities, corporations) do not count as designated beneficiaries (Treas. Reg. 1.401(a)(9)-4)

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Post-death RMD requirements

- Basics of required post-death distributions:
  - ***Spousal designated beneficiary*** – rollover account, or leave in original decedent's name for withdrawals (Treas. Reg. 1.401(a)(9)-5, Q&A-5(c)(2); IRC Section 401(a)(9)(B)(4))
  - ***Non-spousal designated beneficiary*** – begin distributions based on beneficiary's life expectancy, or continue decedent's RMDs if death occurred after RBD (Treas. Reg. 1.401(a)(9)-5, Q&A-5(c)(1))
  - ***No designated beneficiary*** – Entire balance distributed by Dec. 31st of 5th anniversary if decedent died before RBD; if death occurred after RBD, maintain decedent's RMD schedule (Treas. Reg. 1.401(a)(9)-5, Q&A-5(c)(3))

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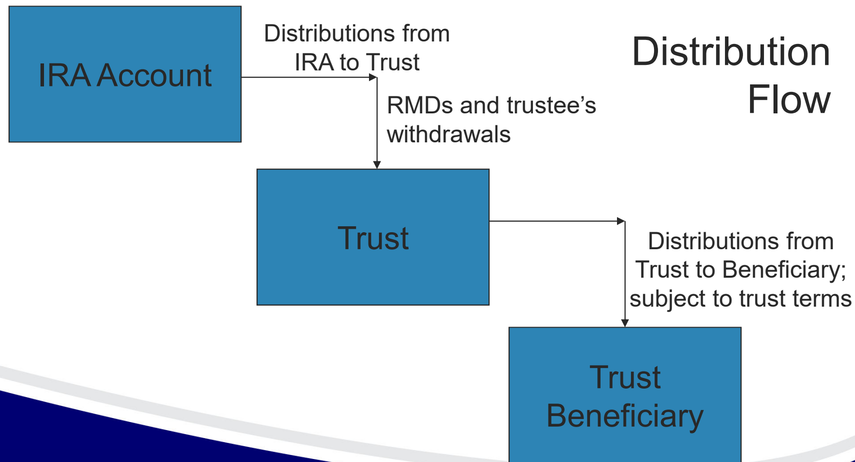
Trusts as Designated Beneficiaries

- Can trusts be considered a designated beneficiary?
  - If so, distributions would be based on trust beneficiaries' life expectancies
  - If not, distributions must occur under 5-year-rule (if death before RBD) or maintain decedent's RMDs (if death after RBD)

Trusts as Designated Beneficiaries

- Four requirements for trusts to qualify as designated beneficiaries:
  (Treas. Reg. 1.401(a)(9)-4, Q&A-5)
  - The trust must be a valid trust under state law
  - The trust must be irrevocable, or become irrevocable upon the death of the IRA owner
  - Documentation of the trust must be provided to the plan administrator by October 31st of the year following the year of death
  - The trust must have [only] identifiable individual beneficiaries that would be eligible for designated beneficiary treatment

IRA distributions and Trusts



IRA distributions and Trusts

- Tax Consequences:
  - Trust is taxable on income received, including IRA distributions
    - Compressed trust tax rates
  - Trust income allocated to beneficiary distributions from trust
    - Taxable income distributed to beneficiaries reduces taxable income for trust

Post-death RMDs

- Your trust is a designated beneficiary – now what?
  - If the decedent died after his RBD, the RMD for the year of death must be taken if it hasn't been taken already; and
  - Required minimum distributions based on beneficiaries' life expectancies must begin in the year following the year of death
    - May continue on same schedule after the death of the beneficiary to a subsequent beneficiary, if applicable

Post-death RMDs

- Anatomy of an RMD
  - Prior year's December 31st account balance

    divided by

    Applicable Distribution Period

    (Treas. Reg. 1.408-8, Q&A-6; 1.401(a)(9)-5, Q&A-4))
  - What is the correct applicable distribution period to use when a trust is a retirement plan beneficiary?

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Post-death RMDs

- Applicable Distribution Period
  - The applicable distribution period for a retirement plan's post-death RMDs is based on the oldest beneficiary's life expectancy (as of following year September 30th determination date), which produces the shortest withdrawal period…
    (Treas. Reg. 1.401(a)(9)-5, Q&A-7)
  - *Unless*, separate accounts are established for each beneficiary by December 31st of the year following the year of death
    (Treas. Reg. 1.401(a)(9)-8, Q&A-2)

Separating trust beneficiaries

- Separate account treatment for trusts
  - Multiple beneficiaries of single trust
    - IRA beneficiary is Momma Smith Trust, where Joe and Jane Smith are beneficiaries of Momma's trust
  - Multiple trusts as beneficiaries
    - IRA beneficiaries are Joe Smith Trust and Jane Smith Trust (as created under Momma's trust)

Determining the oldest trust beneficiary

- Who is the "oldest beneficiary" when evaluating beneficiaries of trusts?
  - Which beneficiaries must be included with multiple beneficiaries?
  - Current beneficiaries versus remainder beneficiaries

Determining the oldest trust beneficiary

- Conduit vs. Accumulation trusts
  (Treas. Reg. 1.401(a)(9)-5, Q&A-7(c))
  - **Conduit trusts** immediately pass through annual required minimum distributions to the trust beneficiary
    - Any subsequent beneficiary would merely possess a 'successor interest' in the IRA benefits
  - **Accumulation trusts** split the income and principal interests of the trust
    - Any subsequent beneficiary that would receive the IRA's principal and accumulated income would hold a remainder interest in the value of the IRA as a beneficiary

Accumulation vs. Conduit Trusts

Example – Accumulation or Conduit

"Upon the death of Jane Smith, trust property will be held in further trust for the benefit of John Smith. The trustee is directed to withdraw annually an amount necessary to satisfy any required minimum distributions from any IRA payable to this trust, and distribute those amounts from the trust to John Smith."

Conduit Trust

Accumulation vs. Conduit Trusts

Example – Accumulation or Conduit?

"Upon the death of Jane Smith, trust property will be held in further trust for the benefit of John Smith. The trustee may, in the trustee's sole discretion, distribute or retain trust income or principal for John's health, education, maintenance, or support."

Accumulation Trust

Accumulation vs. Conduit trusts

- **Example – Accumulation or Conduit**

"Upon the death of Jane Smith, trust property will be held in further trust for the benefit of John Smith. The trustee is directed to withdraw annually an amount necessary to satisfy any required minimum distributions from any IRA payable to this trust, and distribute those amounts from the trust to John Smith. In addition, the trustee may, in the trustee's sole discretion, distribute or retain trust principal for John's health, education, maintenance, or support."

Conduit Trust

Accumulation vs. Conduit trusts

Example – Accumulation or Conduit?

"Upon the death of Jane Smith, trust property will be held in further trust for the benefit of John Smith. The trustee is required to distribute all income annually for John's benefit, and the trustee may, in the trustee's sole discretion, further distribute or retain trust principal for John's health, education, maintenance, or support."

Accumulation Trust
(may vary in some states)

Accumulation trusts – oldest beneficiary

Example – Determining the oldest beneficiary of an accumulation trust

"The trustee may, in the trustee's sole discretion, distribute or retain trust income or principal for John's health, education, maintenance, or support. At John's death, assets will be distributed to John's children Jane and Jack."

Oldest beneficiary - John

Accumulation trusts – oldest beneficiary

Example – Determining the oldest beneficiary of an accumulation trust

"The trustee may, in the trustee's sole discretion, distribute or retain trust income or principal for John's health, education, maintenance, or support. At John's death, assets will be distributed to John's children Jane and Jack.

"In the event that Jane and Jack predecease, trust assets will be distributed to John's estate."

Oldest beneficiary – John…
unless Jane and Jack predecease!

Accumulation trusts – oldest beneficiary

Example – Determining the oldest beneficiary of an accumulation trust

"At death, the trust shall split into two trusts for the benefit of Jane and Jack, respectively. (Assume each trust is named separately as a beneficiary.)

The trustee may, in the trustee's sole discretion, distribute or retain trust income or principal for each trust beneficiary's health, education, maintenance, or support.

"In the event that Jane or Jack pass while assets are still held in trust, the remainder shall pass to the surviving sibling's trust.""

Oldest beneficiary – Oldest Sibling

Accumulation trusts – oldest beneficiary

Example – Determining the oldest beneficiary of an accumulation trust

"The trustee may, in the trustee's sole discretion, distribute or retain trust income or principal for John's health, education, maintenance, or support. At John's death, assets will be distributed evenly amongst John's daughter Jane, John's son Jack, and John's alma mater ABC College."

Oldest beneficiary –
ABC College (life expectancy of 0)

Accumulation trusts

Common problems

- Multiple potential beneficiaries
  - Trust for the benefit of John, John's mother if alive, and John's children at John's death
- Contingent cross-beneficiaries
  - Separate trusts for son and daughter; if son or daughter dies with trust assets remaining, the remainder passes to sibling's trust
- Failure to name subsequent beneficiaries
  - At John's death, trust assets are distributed to John's estate
- Charitable beneficiaries
  - At John's death, trust assets are distributed to charity, or are distributed evenly amongst individual beneficiaries and charity

Common applications – Summary

Trust	Primary Advantage(s)	Primary Disadvatage(s)
QTIP	Restrict spouse's access while preserving marital deduction	Loss of spousal rollover; Additional complexity
Marital	Planning for incapacity (consider alternative solutions?)	Loss of spousal rollover
Bypass	Use of decedent's estate tax exemption amount	Loss of spousal rollover
Revocable	Potential for post-death flexibility on IRA allocation	Substantial complexity; potential need for PLR or cooperative custodian
Beneficiary	Restrict beneficiary's access to IRA	Potentially less favorable income tax treatment

Final Tips

- Final tips when using trusts as Beneficiaries of IRAs
  - Use contingent beneficiary designations to allow for post-death disclaimers
  - Be certain trust has language to address IRA's RMDs
  - Be cautious about accumulation trusts, and whether a non-designated beneficiary will need to be included
  - Balance income tax consequences with other needs and goals
  - Be certain the estate attorney involved understands the rules!
  - Don't forget the formalities of documentation!

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Questions?

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