

# Using Trusts as IRA Beneficiaries

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## Overview of Beneficiary Rules

- IRAs pass by way of beneficiary form
  - Avoid time and expense of probate
  - Overrides a beneficiary named in the will (for that IRA only)
- In absence of a named beneficiary, the IRA will pass according to the custodial document
  - Often the owner's estate
  - May be owner's spouse and/or children

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## Two Types of IRA Beneficiaries


- Non-Designated Beneficiary
- Designated Beneficiary

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## Two Types of IRA Beneficiaries (Cont.)


- Non-Designated Beneficiary
  - Estate
  - Charity
  - Non-See-through Trusts
  - No stretch IRA
    - 5 Year Rule or
    - IRA owner's remaining life expectancy

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## 'Death' of the Stretch

- New rules only apply to Designated Beneficiaries
  - No direct change to rules for Non-Designated Beneficiaries
- General rule is a new 10-Year Rule (for Non-Eligible Designated Beneficiaries)
  - Similar to 5-Year Rule for NDBs when death occurs prior to RBD
  - All funds must be distributed by the end of the 10th year after death
  - RMDs during years 1-9??
  - Applies to some trusts



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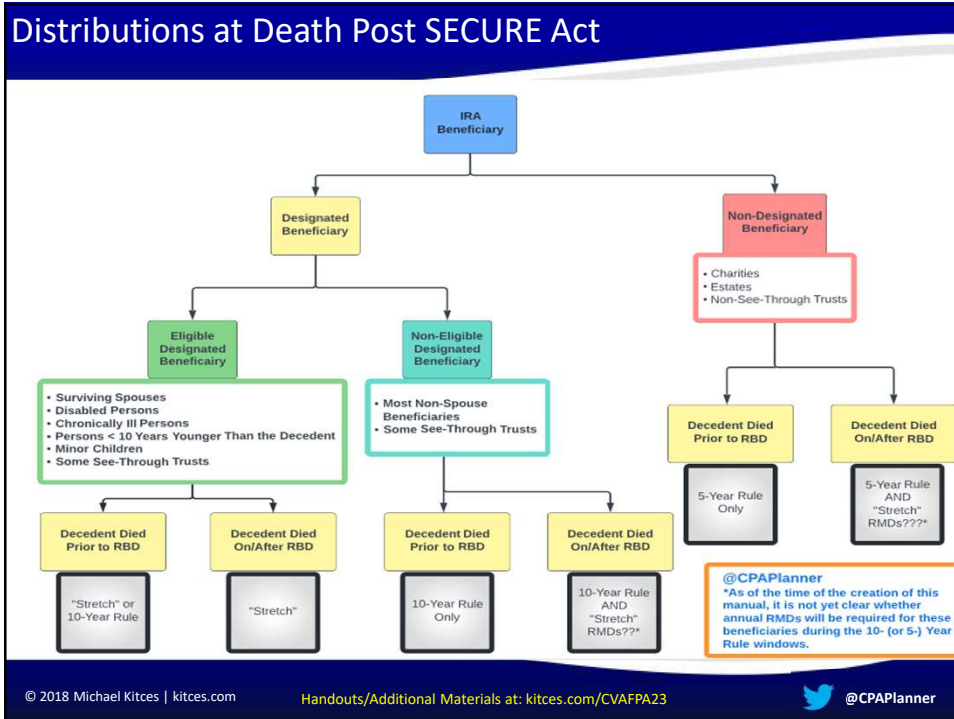
## 'Death' of the Stretch

- Eligible Designated Beneficiaries (EDBs) are also exempt from the SECURE Act's changes.
- The 5 types of EDBs are:
  - Surviving spouses
  - Disabled persons
  - Chronically ill persons
  - A beneficiary not more than 10 years younger than the decedent
  - The decedent's minor child\*
- Applies to some trusts benefiting EDBs

\*Only applies until age of majority

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## What Happens if There Is More Than One Beneficiary?

- General Rule
  - All beneficiaries must take RMDs based on the *least* favorable distribution schedule
  - If one (or more) of the beneficiaries is not a designated beneficiary, then all beneficiaries must use the post-death distribution rules for Non-Designated Beneficiaries
  - If all beneficiaries are Designated Beneficiaries, but one (or more) of the Designated Beneficiaries is not an Eligible Designated Beneficiary, then all beneficiaries must use the 10-Year Rule
    - Exception for Applicable Multi-Beneficiary Trusts

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## What Happens if There Is More Than One Beneficiary?

- Allowing each beneficiary to use the most favorable post-death distribution option
  - September 30th “cash out” date can be used
  - “Separate accounts” may be established by December 31st of year following year of death
- Rules above do ***not*** allow trusts to use separate distribution schedules for different trust beneficiaries

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## Reasons to Name a Trust as an IRA Beneficiary

- The primary reason to name a trust as the beneficiary of an IRA should be some form of control
- Common scenarios where a trust might be considered include:
  - Situations involving beneficiaries who are
    - Minors
    - Disabled
    - Incompetent
    - Unsophisticated
  - Concerns when there is a second marriage

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## Reasons to Name a Trust as an IRA Beneficiary

- Other common scenarios where a trust might be considered include:
  - Cases where the owner wants to guarantee the stretch IRA is used
  - Planning to help avoid estate taxes
    - Can also be done without a trust
  - Situations where creditor protection may be an issue
  - Clients who are concerned about beneficiaries' spouses
  - Plans that involve the use of charitable trusts

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## Reasons *NOT* to Name a Trust as an IRA Beneficiary

- To save money on income taxes
  - For 2023, the top federal income tax rates begin at:
    - \$578,125 for single filers
    - \$693,750 for joint filers
    - \$14,451 for trusts and estates
- To save money on estate taxes
- "Because my attorney told me so"

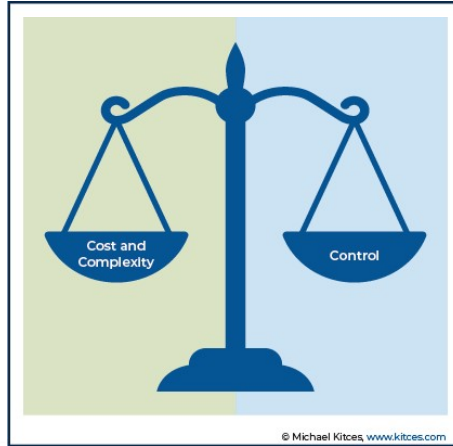
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## Should A Trust Be Named As The Beneficiary?



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## See-Through Trusts

- Also known as look-through trusts
- Allow trust beneficiaries to use oldest applicable trust beneficiary's life expectancy to determine post-death distribution schedule
- There is no separate account treatment for trust beneficiaries
- Must meet certain requirements

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## See-Through Trust Requirements

- Regulation 1.401(a)(9)-4, A-5
  1. Valid under state law
  2. Irrevocable at death
  3. Trust beneficiaries are identifiable
  4. Proper documentation is provided to the custodian by October 31st of the year following the year of death

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## Life Cycle of an IRA Trust

1. Owner determines there is a post-death control issue that requires the use of a trust
2. Trust is drafted by a qualified estate planning attorney (can be a testamentary trust)
3. The trust is named as the beneficiary on the beneficiary form
  1. John Doe IRA trust
  2. John Doe IRA trust established under Article X Section X of John Doe Last Will and Testament

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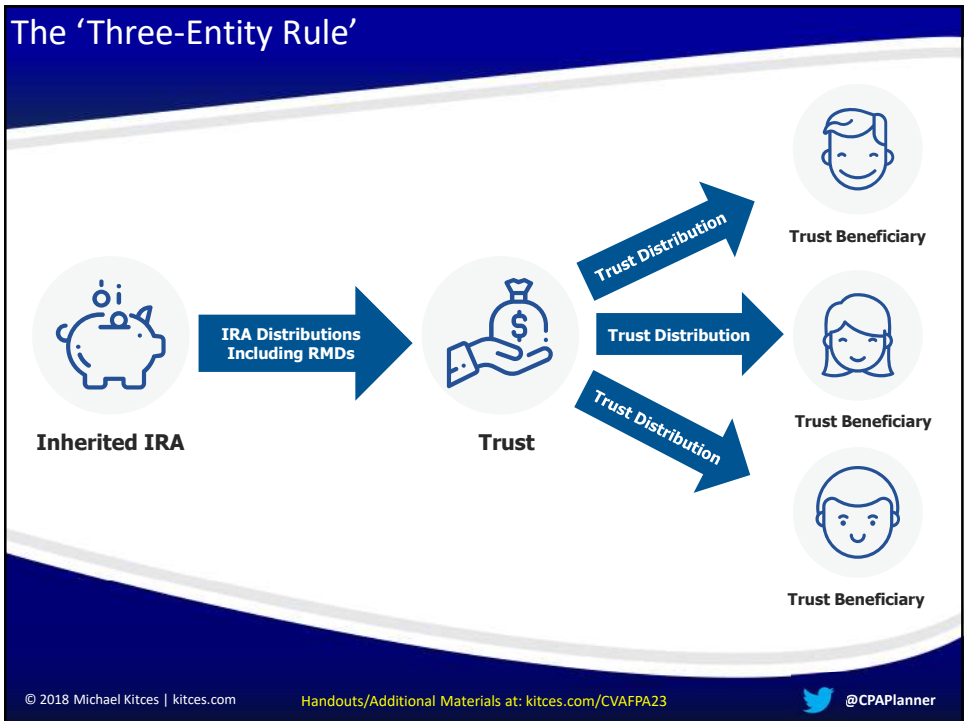


## Life Cycle of an IRA Trust

4. IRA Owner Dies
5. Properly titled inherited IRA is established FBO the trust
  1. John Smith (deceased January 3, 2022) IRA fbo John Smith Trust
6. Distributions go from the inherited IRA to the trust
7. Distributions go from the trust to the trust beneficiaries per the terms of the trust

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## Two Types of IRA Trusts


- Conduit Trusts
- Discretionary Trusts
  - Also known as accumulation trusts

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## Conduit Trusts

- Whatever is distributed from the inherited IRA to the trust must be passed out to the trust beneficiaries
- Trust beneficiaries pay income tax on distributions at their own personal rates
- Only income beneficiaries of the trust are looked at to consider oldest age for RMDs

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## Conduit Trusts

- Advantages of conduit trusts include:
  - Potentially more tax efficient than discretionary trusts
  - A remainder beneficiary will have no impact on the post-death distribution schedule
- Disadvantages of conduit trusts include:
  - Less post-death control

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## Conduit Trusts After The SECURE Act

- Conduit Trusts benefiting a single EDBs *should* be able to receive EDB treatment
- Unclear what the treatment of Conduit Trusts with only multiple EDBs is
  - Update trusts to have only one EDB?

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## Conduit Trusts After The SECURE Act

- Many Conduit Trusts will be subject to the 10-Year Rule
  - Best-case scenario = Trust is useless after 10 years
  - Worst-case scenario = Trust is useless after 10 years, no distributions are allowed until the 10<sup>th</sup> year after death, and in that year, everything must be distributed to both the trust and to the trust beneficiaries

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## Discretionary Trusts

- Distributions from the inherited IRA may be accumulated in the trust
  - Funds may also be distributed out of the trust, depending on the language of the trust
- Distributions from an inherited IRA to a trust, not passed along to trust beneficiaries within the same year, are generally taxed at trust tax rates
  - Funds distributed from a trust to a beneficiary during the first 65 days of the year can be treated as distributed in the prior year if the trustee elects
  - Power of withdrawal option to try and push income onto trust beneficiaries' returns?
- All current and potential beneficiaries of the trust are looked at to consider least favorable distribution schedule
  - Current beneficiaries
  - Remaindermen

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## Discretionary Trusts

- Advantages of discretionary trusts include:
  - Greater control over trust assets
  - Easier to keep assets away from:
    - Creditors
    - Ex-spouses
  
- Disadvantages of discretionary trusts include:
  - Greater possibility for conflict between trustee and trust beneficiaries
  - Distributions may be taxed at compressed trust tax brackets
  - Remaindermen impact the post-death distribution schedule

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## Discretionary Trusts After The SECURE Act

- Discretionary Trusts will generally not qualify for EDB treatment
  
- Exception: Applicable Multi-Beneficiary Trusts
  - All trust beneficiaries must be designated beneficiaries
  - At least one trust beneficiary must be an EDB because they are either:
    - Disabled
    - Chronically ill

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## Discretionary Trusts After The SECURE Act

- Applicable Multi-Beneficiary Trust divided into separate trusts for each beneficiary immediately upon the death of the owner
  - The separate trust FBO the disabled/chronically ill beneficiary will be treated as an EDB
  
- Applicable Multi-Beneficiary Trust in which no individual other than a disabled person and/or a chronically ill person will receive any benefit until the death of all disabled and/or chronically ill persons
  - The trust will be treated as an EDB

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## Charity as Special Needs Trust Beneficiary

- Impacts Applicable Multi-Beneficiary Trusts (AMBTs), which must:
  - Have more than one beneficiary;
  - All trust beneficiaries must be people; and
  - At least one beneficiary must be disabled or chronically ill (as defined by the SECURE Act).
  
- Effective upon enactment of SECURE 2.0, qualified charities can now count as people!
- Allows Special Needs Trusts to include qualified charities as a beneficiary while maintaining Stretch RMDs.

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## Discretionary Trust Idea

- Consider Roth conversions during owner's lifetime
  - Inherited IRAs cannot be converted to inherited Roth IRAs
  - Inherited plans (e.g. inherited 401(k)) can be converted to inherited Roth IRAs
  - Reduces value of estate for Federal/state estate tax purposes
  
- Inherited Roth IRAs can generally avoid the tax issues that are present with traditional IRAs

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## Proposed Regs' Impact on Trusts as Beneficiaries

- Proposed regulations would provide for additional flexibility in post-death planning
  - Powers of Appointment
    - Previously general power of appointments were often fatal errors
    - Regs would allow POAs to be exercised by 9/30 of year after death in favor of an identifiable beneficiary
  - Post-death reformation of trusts
    - Would allow for removal of identifiable beneficiaries by 9/30 of year after death

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## Proposed Regs' Impact on Trusts as Beneficiaries

- Would allow certain beneficiaries to be excluded when determining post-death distribution rules:
  - Remaindermen of a Conduit Trust (carryover from existing rules)
  - A beneficiary of a discretionary/accumulation trust who is conditioned on the death of a secondary beneficiary
  - If the trust is set up to pay out everything to a minor beneficiary by the end of the year they turn 31
    - i.e., 10 years after the age of majority

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## When Does it All End?

- When there is no money left in the inherited IRA
- When the trust terminates
  - When there is \$X or less in the trust
  - After X years
  - When the beneficiary is X years old
  - When X dies
  - Check with the custodian to see if the trust assets can be assigned out to the trust beneficiaries if the trust terminates, but there are still funds in the inherited IRA

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## 5 Costly IRA Trust Mistakes

1. Moving an IRA "into" the trust
2. Trust language that calls for debts and expenses of the estate to be paid from trust assets
3. Not understanding what constitutes trust income
4. Naming a trust as an IRA beneficiary without first considering alternatives
5. Failing to add flexibility to the overall plan

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## Mistake #1- Moving an IRA "Into" the Trust

- IRAs/Inherited IRAs cannot be moved into trusts
- Causes the IRA/inherited IRA to be taxable
- IRAs cannot be owned by trusts during an owner's lifetime
- A common mistake occurs when clients try to fund revocable living trusts with IRA assets
- For owners, the mistake can only be fixed if caught within 60 days

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## Mistake #2- “Debts and Expenses of the Estate” Language

- Estate is treated as a beneficiary of IRA
  - An estate is not a designated beneficiary
    - Stretch IRA can be blown
  - Creditor protection of the inherited IRA may be compromised
- To remove an estate as a trust beneficiary, cash out the estate (pay off estate obligations) by September 30th of the year following the year of death
  - PLRs 200432027, 200432028, 200432029
- “Shall” vs. “may” vs. staying silent
- Trust expenses vs. estate expenses

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## Mistake #3 - Not Understanding Trust Income

- Inherited IRA distributions; What’s income? What’s principal?
- Uniform Principal and Income Act (UPAIA)
  - Adopted by over 40 states
  - Defines 10% of RMD as income, 90% principal
- Income using the Unitrust concept
  - Must be allowed by state law
  - Federal regulations allow for unitrust rate to be set between 3% and 5%

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### Mistake #3 - Not Understanding Trust Income

- Check to see if trust uses the term “income” or “RMDs”
- An attorney can use specific language to draft around income issues
- Uniform Fiduciary Income and Principal Act
  - Approved and recommended for enactment in July 2018
  - Enacted so far in:
    - Arkansas, Kansas, Colorado, Washington, Utah, and Virginia
  - Introduced so far in:
    - Missouri and California

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### Mistake #3 - Not Understanding Trust Income

- QTIP trusts as IRA beneficiaries
  - Revenue Ruling 2006-26
- Surviving spouse is entitled to trust income during their lifetime
- After surviving spouse’s death, the trust’s principal passes to beneficiaries named by original IRA owner
- Allows marital deduction to be used

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### Mistake #3 - Not Understanding Trust Income

- QTIP trusts create unique problems for IRAs
  - QTIP trusts must use the word “income”
  - Remainder beneficiaries may not inherit any assets for many years
    - Inherited IRA might be completely exhausted prior to remainder beneficiaries inheriting assets

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### Mistake #4 – Failing to Consider Alternatives

- Is an UGMA/UTMA account sufficient for minor beneficiaries
  - Beneficiary will have access to funds at 18 or 21
  - “Jim Smith as custodian for John Doe, under the State X Uniform Transfers to Minors Act”
- Can disclaimer planning be used to avoid estate taxes?
- QTIP trusts
  - Can the IRA be split between the surviving spouse and the children?
  - Can life insurance be used to provide a benefit to the surviving spouse and/or other beneficiaries?

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## Mistake #5 – Failing to Add Flexibility To The Plan

- Can a trust protector be used to allow for certain changes?
  - Add a trustee?
  - Replace a trustee?
- Can the trust be terminated if the need for the trust is no longer present?
  - Is the beneficiary still a minor?
  - Is creditor protection still an issue?
  - Does the trust have enough assets to warrant the added expenses?
  - Does the trust authorize the trustee to distribute the inherited IRA in-kind?
- Have trust beneficiaries predeceased the owner?
  - Can you condition the trust as beneficiary upon the survival of the key trust beneficiary?

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## Mistake #5 – Failing to Add Flexibility To The Plan

- Does the trust allow for a change in situs?
- Does the trust explicitly allow for decanting?
- Does the trust give beneficiaries a special power of appointment to select future beneficiaries (that don't ruin the stretch)?
- Does the trust allow the trustee the option of creating a "duplicate trust" for ease in managing?
- Does the trust have a "no bad beneficiaries" clause?


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# Important Rulings and Updates




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## Name Subtrusts Directly To Use More Than 1 Life Expectancy\*

- **PLRs 200317041, 200317043 and 200317044**
  - No separate account treatment for trust that splits into subtrusts
- **PLR 200537044**
  - Separate account treatment when subtrusts are named as the beneficiaries
    - "Subtrust X established under Article X, Section X of the John Doe IRA Trust"
- **PLRs 200634068, 200634069, 200634070**
  - No separate account treatment when primary trust is named beneficiary

\*Does not apply equally to an Applicable Multi-Beneficiary Trust

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## Post-Death Creation Of A Trust As The IRA Beneficiary

- **PLR 201116005**
  - IRS allowed a disabled beneficiary to transfer an inherited IRA to special needs trust (of which they were the beneficiary)
  - Inherited IRA still not moved into trust
    - Properly titled inherited IRA FBO special needs trust established
    - Distributions from inherited IRA payable to special needs trust
  - Considered a 1st party trust
    - Entitlement programs reimbursed after death of beneficiary before any remaining assets can pass to remaindermen
  - IRS reiterated that such a transfer cannot occur during an IRA owner's lifetime
- Followed previous IRS decisions in:
  - **PLR 200620025**
  - **PLR 200826008 (minor beneficiary)**

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## Spousal Rollover 'Through' The Trust Denied

- **PLR 200944059**
  - IRS denied spousal rollover of IRA left to trust
  - Spouse was sole trustee and was able to take distributions from the trust for her health, maintenance and support
  - Remaining principal was to pass to couple's son
  - Ruling was denied because spouse did not have complete and total control over inherited IRA
    - Distributions were subject to "ascertainable standards"

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## IRS Allows Swapping of Community Property

- **PLR 201125047**
  - Landmark ruling allowing community property to be rolled over by surviving spouse even though trust was partial IRA beneficiary
  - Trust divided into several subtrusts, with spouse having total access to assets in “Marital Share One”
  - Trustee had full discretion to divide trust property using non-pro-rata allocation
  - Trustee exchanged decedent’s IRA with spouse’s property of equal value such that Marital Share One held entire IRA

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## State-Granted Posthumous Reformation Ignored By IRS

- **PLR 201021038**
  - Discretionary trust was beneficiary of decedent’s IRA
  - Trust left assets to children and let children decide who future trust beneficiaries were, via their will
  - State Court allowed reformation of trust post-death to preserve stretch
  - IRS denied the PLR request submitted to verify the Service would honor the reformation
    - “In this instance, the efforts undertaken to modify the terms of the Restated Trust will not be given retroactive effect for federal tax purposes and the designated beneficiary”

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## New Accumulation Trust PLR vs. Old PLR

- PLR **200228025** v. **201320021**
  - Both PLRs involve discretionary trusts'
  - Both PLRs address the issue of contingent beneficiaries
  - PLR 200228025 left assets to 2 grandchildren, but if both died prior to 30, older contingent beneficiaries would receive funds
  - PLR 201320021 left assets to trust for children's benefit, did not name contingent beneficiaries
    - Is staying silent the better option? Perhaps...

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## Trust Can Distribute Inherited IRA In-Kind

- PLR **201430022**
  - Trust was named as the IRA beneficiary
  - Trust had 18(!) beneficiaries
  - IRS allowed the trust to distribute the inherited IRAs (in-kind) to each of the trust beneficiaries
  - Trust beneficiaries were allowed to "stretch" over the decedent's remaining life expectancy

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## Pecuniary Bequests Create Accelerated Taxation

- **PLR 201438014**
  - Trust was named as the beneficiary of an IRA
  - Trust had two pecuniary bequests
  - Trustee had trust posthumously reformed by State court to make the charitable gifts direct bequests
  - The IRS disregarded the State court order and determined the charitable gifts were pecuniary bequests
    - No charitable deduction was allowed

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## States Post-Death Beneficiary Correction Disregarded

- **PLRs 201628004, 201628005 201628006**
  - 3 trusts were named as the beneficiaries of a decedent's IRAs
  - Prior to death, the IRAs were moved to a new custodian, but the estate was incorrectly named as the beneficiary
  - Trustees asked State court to posthumously change the IRA beneficiaries to the trusts... they did, but...
  - The IRS said that they could not be designated beneficiaries

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## Post-Death Limited Release Saves “Stretch” for Trust

- [PLR 201840007](#)
  - Discretionary trusts gave testamentary, general power of appointment to trust beneficiaries upon attainment of age 30
  - Beneficiaries executed a limited release on September 30th of the year after death, which limited their power of appointment to someone younger than oldest (current) trust beneficiary
  - IRS allowed IRA to be stretched over oldest trust beneficiary’s life expectancy

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## Your Immediate Action Plan

- 1) Make a list of clients who have named trusts as their IRA beneficiary
  - Review their situation and see if a trust should, in fact, be named as the beneficiary
- 2) Make a list of clients who may want to consider naming a trust as an IRA beneficiary
- 3) Check to see if clients’ trusts will qualify as see-through trusts and whether they will be conduit or discretionary trusts
  - Will they be able to ‘stretch,’ or will the 10-Year Rule apply?

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## Your Immediate Action Plan (Cont.)

- 4) Learn the specific rules that apply in your state
  - Age of majority
  - Definition(s) of income
  - IRA creditor protections
- 5) Find a qualified estate planning attorney, who also has knowledge about IRA rules, that you can feel confident in recommending to clients

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## Questions?

**Handouts & additional materials:  
[www.kitces.com/CVAFPA23](http://www.kitces.com/CVAFPA23)**

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