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LEAVING IRAs TO A TRUST

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I. INTRODUCTION

When we prepare estate plans for our clients, we plan differently for their IRAs, 401(k)s and other retirement accounts. These accounts have different tax treatment from probate assets, and we must take care in the manner in which they are left to the children.

This paper will discuss the basic rules for naming a trust for children as a beneficiary of IRAs and 401(k)s, including Designated Beneficiary and Stretch IRA rules. We'll explore the requirements and impact of various trust options, including see-through, conduit, accumulation and special needs trusts.

We will first go over the rules prior to the SECURE Act, and then go over how the new SECURE Act affects the way clients can leave retirement plans to children.

A. Terms

The concepts in this paper generally apply to IRAs and qualified retirement plans such as 401(k)s and 403(b)s. For simplicity's sake, in this paper I'll usually refer to these retirement plans as **IRAs.** IRAs are administered by custodians, and qualified plans are administered by plan administrators. I'll usually refer to them as the **plan administrator**. 401(k)s are established by an employee and IRAs are created by a plan participant. I will refer to the person establishing and contributing to the IRA or 401(k) as the **participant**.

The following acronyms are used in this paper:

IRA—Individual Retirement Account
DB—Designated Beneficiary
EDB—Eligible Designated Beneficiary
Non-DB—Non-Designated Beneficiary
RBD—Required Beginning Date
RMD—Required Minimum Distribution

The date that the plan participant must take distributions from a traditional IRA or qualified retirement plan is called the Required Beginning Date (RBD). For participants who die before

January 1, 2020, that date is April 1 of the year following the year in which the participant reached the age of 70 ½.[1] According to the SECURE Act, for participants who die after December 31, 2019, the RBD is 72. Roth IRAs have no required beginning date.

B. Basic Rules

IRAs are distributed upon the death of the participant to the beneficiary designated by the participant in the proper form. It is not distributed according to the participant's will. If the participant fails to properly name a beneficiary, the terms of the IRA contract govern who will inherit the IRA.

Typically, the participant names a primary beneficiary, and a contingent beneficiary if the primary beneficiary predeceases. If no beneficiaries are named on the form, or if all beneficiaries predecease the participant, the plan documents state who the default beneficiary is. The default may be the estate, which could result in a loss of tax benefits.

Our goal in planning has often been to stretch out the payout of IRAs to the beneficiary as long as possible, to increase the wealth transferring to the next generation. We try to minimize taxes and maximize deferral. Some of these options have been eliminated by the SECURE Act.

II. THE PROBLEM

For illustration purposes, let's assume that Marilyn Morte is married to Henry, and they have two children, Annie and Ben. Annie is 27 and, due to her disability, is receiving SSI/Medicaid and other benefits based on financial need. Ben is 21 and a college senior. Marilyn has a traditional IRA of $1 million and anticipates that upon her death it will still be worth $1M. She would like to leave the IRA to her husband Henry, but if he is deceased, then to Annie and Ben. She would like to use a large portion of it to fund Annie's special needs trust, as Annie will not be self-supporting and will require public benefits for her lifetime. Marilyn would like to maximize the tax-deferred growth that her children receive.

Henry has predeceased Marilyn, and Marilyn has designated her IRA beneficiaries as follows:

75% to Annie
25% to Ben

If Marilyn dies before 2020, and Annie inherits 75% of the IRA outright, Annie has two options. One, she can cash it out within 5 years and pay income tax on the whole amount. Two, she can transfer it into an inherited IRA. With the inherited IRA, she would receive tax-deferred growth, but must take Required Minimum Distributions ("RMDs") each year. The amount of each distribution will be calculated based on Annie's life expectancy according to the IRS single life chart. Annie can take additional distributions as well.

[1] Treas Reg. Sec. 1.401(a)(9)-5, A-1(c); 1.408-8, A-3

Title search: Leaving IRAs to a Trust

Also available as part of the eCourse
Leaving IRAs to a Trust and the Impact of the SECURES Act on Beneficiary Designations

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