Naming a Trust as IRA Beneficiary: Key Considerations

Trusts & Estates Insights

Trusts are versatile estate planning vehicles that allow individuals to protect and preserve wealth and to pass assets to the next generation or others. Individual retirement accounts (IRAs) grow free from current income tax and may be used along with a trust structure to transfer significant wealth to others.

IRAs were introduced in the 1970s and have since become an increasingly popular structure for accumulating wealth. These tax-advantaged accounts now collectively hold almost $11.5 trillion of assets, which is more than a third of all retirement assets in the U.S.[1] As the significance of IRA assets has grown, it has become more common to name trusts as IRA beneficiaries, thus combining the tax-advantaged growth of an IRA with all of the advantages that trusts have to offer.

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A Reminder of IRA Basics: How an IRA Can Be Inherited

An IRA is an investment account that you own. Each year, you can contribute earned income to the account, subject to certain limits. For traditional IRAs, this contribution may be deductible for income tax purposes, depending on your income level. Later withdrawals are then typically subject to income taxation.

In contrast, with Roth IRAs, the contribution is not tax deductible, but later withdrawals are generally tax-free. Both traditional and Roth IRAs can also be funded by rolling assets from an employer sponsored plan, such as a 401(k) or 403(b), into the IRA vehicle. If you withdraw assets from either type of IRA before age 59 ½, you generally will incur an early-withdrawal penalty of 10%.

A trust can also be named as an IRA beneficiary, and in some instances a trust can be a better option than an individual beneficiary

When you reach a specified age, you must start taking required minimum distributions (RMDs) annually from your traditional IRA. The required beginning date (RBD) for RMDs is April 1 of the year following the year you reach the indicated age, and the RMD amount is calculated based on your age and a related life expectancy factor from IRS tables, applied to the prior year-end account value. Roth IRAs and other Roth accounts are not subject to RMDs during your lifetime.

Exhibit A: Required Beginning Date (RBD) Ages[2]

Date of Birth	Required Beginning Date Age
Before 7/1/1949	70 1/2
7/1/1949 through 1950	72
1951 through 1959	73
1960 or after	75

The IRS tables are structured so that some assets will remain in your IRA throughout your lifetime if you limit your withdrawals to RMDs. If the IRA has a high rate of investment return, it is possible for your IRA to have greater value at your death than when you started taking RMDs.

At your death, the assets remaining in your IRA pass as you direct in the IRA beneficiary designation form and not under the terms of your will or trust. Account owners commonly designate individuals as beneficiaries – for example, all to a spouse or in equal shares to children. Charities are also sometimes named as beneficiaries of traditional IRAs. A trust, however, can also be named as an IRA beneficiary, and in some instances a trust can be a better option than an individual beneficiary.

Reasons to Name a Trust

When a trust is named as the IRA beneficiary, the trust inherits the IRA when the IRA owner dies. The IRA is then maintained as a separate account that is an asset of the trust. Some good reasons to consider naming a trust as an IRA beneficiary include:

- **Working around beneficiary ownership limitations:** Perhaps the intended beneficiary is a minor who is legally unable to own the IRA. Or perhaps the IRA owner wants to support an individual with special needs who would lose access to government benefits if they owned assets in their own name. A solution in both cases could be to name a trust as the IRA beneficiary. On the owner's death, the trust would become the legal owner of the IRA and the trustees would administer it for the benefit of the individual who could not own the IRA outright.

- **Solving for second marriage or other family structures:** An IRA owner may wish for RMDs to benefit a second spouse during the spouse's lifetime, and then to have the remainder of the IRA pass for the benefit of children from a first marriage. If the IRA owner leaves the IRA outright to a spouse, it is certain that the spouse will benefit, but it is not guaranteed that the children will receive anything. If the owner instead leaves the IRA to a properly structured trust, the desire to benefit both sets of beneficiaries can be ensured.
- **Limiting a beneficiary's access:** It is often assumed that IRA beneficiaries will take only the RMDs, but an individual who has inherited an IRA outright has the right to take larger distributions, or even withdraw everything from the IRA. As discussed further below, even if most beneficiaries withdraw only the RMDs, under the current rules, all IRA assets may be required to be distributed from the IRA by December 31 of the 10th year following the IRA owner's death, or sooner. This can result in the IRA assets being fully under the control of the beneficiary sooner than desired. However, if a trust is named as the IRA beneficiary, then the trust terms will determine beneficiary access to the inherited IRA assets.
- **Naming successive beneficiaries:** When an individual inherits an IRA, the inheritor names their own beneficiaries who will receive the account at the inheritor's death. If the original IRA owner wishes to determine the successor beneficiary beyond the point of their death, naming a trust as the IRA beneficiary can provide certainty as to whom the subsequent beneficiaries will be.
- **Providing creditor protection:** A person's own IRA has some level of protection from creditors, but this does not always carry through to the inherited IRA. The U.S. Supreme Court ruled in Clark v. Rameker, 573 U.S. 122 (2014) that inherited IRAs do not qualify under the Federal Bankruptcy Code as exempt from the claims of creditors as "retirement funds." Having an inherited IRA owned in a properly structured trust will provide some protection from the beneficiaries' creditors.
- **Funding estate plans structured to minimize estate tax:** Most wealthy individuals' estate plans include trusts designed to minimize and postpone the payment of estate tax. For such estate plans to work as intended, the portion of the trusts that would be sheltered by an individual's federal or state estate tax exemption likely needs to be funded upon the individual's death. Often, the only asset available to do this funding is an IRA. In such situations, naming one or more trusts as the IRA beneficiary can further minimize or postpone estate tax.

The SECURE Act significantly reduced the ability to create a "stretch IRA"

Pulling Back on the Stretch IRA

Just as there are rules about RMDs during the IRA owner's life, there also are rules about distributions from an inherited IRA after the owner dies. Historically, the preferred payout for an inherited IRA has been the "stretch IRA," where the post-death RMDs are stretched out over the life expectancy of the new IRA beneficiary. This allows the IRA assets to continue to grow tax deferred, often for many years after the owner's death.

RMD payout rules are different than a trust's distribution provisions

The SECURE Act, passed in December of 2019, the SECURE Act 2.0 of 2022, and subsequent Treasury guidance[3], have significantly reduced the ability to create a "stretch IRA." For most individual beneficiaries, IRAs inherited after 2019 are subject to a 10-year rule that requires the IRA to be completely distributed by December 31 of the tenth year following the year of the IRA owner's death. The 10-year rule may or may not include RMDs during the ten years, depending on whether the deceased IRA owner had reached their RBD at their death.

Non-individual beneficiaries such as an estate, charity or certain trusts, are usually subject to either a 5-year rule, which requires distribution of the entire IRA by December 31 of the fifth year following the IRA owner's death, or the "ghost life expectancy" rule, in which RMDs are spread out over the deceased account owner's remaining single life expectancy. In such cases, the 5-year rule applies where the account owner died prior to their RBD, and the "ghost life expectancy rule" applies where the account owner died after their RBD and therefore had been subject to RMDs.

Certain beneficiaries, known as "eligible designated beneficiaries" or EDBs, are not subject to the new 10-year limitation. EDBs include: the IRA owner's surviving spouse, the owner's children while they are under age 21, certain individuals who are chronically ill or disabled as of the date of IRA owner's death, and any person who is not more than 10 years younger than the IRA owner. EDBs can generally still enjoy the benefits of a stretch IRA by taking RMDs over a period that could be as long as their lifetime.

RMD Rules for Trusts Inheriting IRAs

The post-death RMDs for a trust named as an IRA beneficiary will be calculated under either the stretch payout rule, the 10-year rule, the 5-year rule, or the ghost life-expectancy rule, depending on the attributes of the trust and the trust beneficiaries. Important factors include whether the trust qualifies as a see-through trust, whether it is a conduit trust or an accumulation trust, and whether the trust beneficiaries are non-individuals, "regular" individuals, or EDBs. Whether the IRA owner died before or after their RBD can also be a factor in determining when RMDs must begin. The application of the RMD rules to these different types of trusts and beneficiaries is outlined in Exhibit B.

Treasury Regulations issued in July 2024 clarify the analysis as to how the RMD rules apply. It is important to involve your estate planning advisor in any decision to name a trust as an IRA beneficiary to ensure that the trust is drafted in a way that will accomplish your goals. You will want to confirm that your reasons for naming a trust as your IRA beneficiary are reflected in the trust terms and will not be negated by the RMD payout provisions and the potentially higher income taxes the trust may pay on income not distributed to a beneficiary. It is also important to review beneficiary designations to be sure that beneficiaries, including trust beneficiaries, are appropriately named.

Note that the RMD payout rules are different than a trust's distribution provisions. Even if RMD rules require that assets be paid out of the IRA to a trust, that does not necessarily mean that the assets must be distributed from the trust to its beneficiaries at the same time. Instead, the terms of the trust instrument governing distributions to trust beneficiaries will apply. For example, if the trust document provides the trustee with broad discretion to make decisions regarding the distribution of IRA assets, then once the IRA assets are distributed out of the IRA to the trust itself, the after-tax proceeds of the IRA will remain invested with other trust assets until the trustee exercises its discretion to make a distribution to one or more of the beneficiaries.

Exhibit B: Required Minimum Distribution (RMD) Rules for Trusts as IRA Beneficiaries

	See-Through Trusts[4]		Other Trusts
	Conduit Trust	Accumulation Trust	
Key Trust Terms	Must distribute all IRA distributions to an individual trust beneficiary when received	Allows for the accumulation of IRA distributions within the trust, rather than immediate payout	Does not meet definition of see-through trust; likely accumulates IRA distributions; identity of beneficiaries does not matter
Require Minimum Distributions (RMDs) to the Trust	**For an "Eligible Designated Beneficiary (EDB)"** [5,6] Payout based on the life expectancy of the beneficiary (stretch IRA rules still apply) **For a beneficiary that is not an EDB:** 100% distribution to the trust by 12/31 of the 10th year following the owner's death. During that time, annual RMDs paid to trust if owner died on or after their Required Beginning Date (RBD)	10-year rule – 100% distribution to the trust by 12/31 of the 10th year following the owner's death. During that time, annual RMDs paid to trust if owner died after RBD	**If the IRA owner dies before their RBD:** 5-year rule – 100% distribution to the trust by 12/31 of the 5th year following the owner's death **If the IRA owner dies on or after their RBD:** "Ghost Life Expectancy" - Distribute to the trust based on life expectancy of the IRA owner at the time of death, or the trust can elect to use the 5-year rule
Distributions to Trust Beneficiaries	Distributed immediately to conduit beneficiary after trust receives IRA distributions Results in a non-EDB receiving 100% of the IRA proceeds by 12/31 of the 10th year following the owner's death	Trust terms govern the timing of distributions to trust beneficiaries May be different than the timing and amounts of IRA distributions to the trust IRA distributions may be taxable to the trust or a trust beneficiary depending when distributions are made from the trust	

Fiduciary Trust Company has administered IRAs from the time the IRA rules were first established in the 1970s

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What Sets Fiduciary Trust Apart: We understand IRAs and Trusts

Fiduciary Trust Company has administered IRAs from the time the IRA rules were first established in the 1970s, and we have been administering trusts for more than 135 years. We offer a range of services to support both IRA and trust administration, from providing general advice and administrative services to managing investments and serving as a corporate trustee. We also collaborate with your outside counsel to help ensure that your IRA and IRA beneficiary designations are integrated into your estate plan.

Our expertise in advising clients with trusts makes us an ideal partner for establishing IRAs that name trusts as beneficiaries. For example, we are experienced in planning for and managing the complexities of how IRA distributions to trusts are treated for income tax versus trust accounting purposes.

Due to our long history of working with high-net-worth families and serving as trustee to invest, manage, and administer trusts and IRAs, we are uniquely qualified to advise you on all aspects of naming a trust as an IRA beneficiary.

To learn more about our IRA, trust, and other services, please contact Sid Queler at 617-292-6799 or queler@fiduciary-trust.com. ■

[1] Based on Year-End 2022. Investment Company Institute.

[2] Based on anticipated legislative technical correction of scrivener's error in The SECURE 2.0 Act of 2022. See footnote 3.

[3] Setting Every Community Up for Retirement Enhancement Act (SECURE Act), effective for IRA owners who die after December 31, 2019, is known as the SECURE Act. The Treasury issued Proposed Treasury Regulations on February 23, 2022, expanding on the practical implementation of the SECURE Act. The SECURE 2.0 Act of 2022, was signed into law on December 29, 2022, impacting RMD ages and other retirement planning provisions.

[4] Generally, beneficiaries must be individuals (not an entity, such as an estate or a charity) and must be "identifiable" (generally meaning that it must be possible to identify the oldest beneficiary the trust will have).

[5] Includes IRA owner's surviving spouse, the owner's children while they are under age 21, certain individuals who are chronically ill or disabled, and any person who is not more than 10 years younger than the IRA owner.

[6] Life expectancy payout available for trust beneficiaries who are chronically ill or disabled at the time of IRA owner's death as long as the trust is properly drafted.