

TRUST AS IRA BENEFICIARY – A POTENTIALLY CATASTROPHIC PROBLEM

Wednesday, July 19, 2023

By Andy Ives, CFP®, AIF®
IRA Analyst

We say in our training manuals that “the SECURE Act obliterates IRA trust planning.” That’s an aggressive word – “obliterates” – but it is accurate. We also shout from the mountain top that every trust created prior to the SECURE Act and named as an IRA beneficiary must be reviewed, potentially rewritten, or scrapped altogether. What was a perfectly effective planning strategy a couple of years ago could be totally useless now. Here’s how and why...

Example: The year is 2018, two years prior to the SECURE Act, and all living IRA beneficiaries are still allowed to stretch annual required minimum distribution (RMD) payments.

John, age 60, has a \$2 million dollar IRA. His wife pre-deceased him, and his only heir is his son, Billy, age 25. Billy is a terror and has an extreme gambling addiction. John wants to leave his IRA to Billy, but he cannot trust that Billy will be anywhere near responsible with the money. So, John decides to name a trust as his IRA beneficiary, with Billy as the sole trust beneficiary. The trust language dictates that only RMDs are to be paid to Billy (based on Billy’s single life expectancy). With a trust as beneficiary, Billy is precluded from invading the account. Robert rests easy knowing he will provide Billy annual income for life, while still protecting the \$2 million from getting burned down at a casino over a long weekend.

Fast forward to 2020. The SECURE Act has been passed and stretch RMD payments

are eliminated for most beneficiaries. The 10-year rule is created. John does not update his trust or review any of his estate planning goals. The original trust with its original language remains the beneficiary of John's \$2 million IRA...and Billy is still a terror.

It is late 2020, and John dies.

Upon reviewing the IRA beneficiary form, it is determined the trust is the beneficiary. As such, a trust-owned inherited IRA is created (with Billy as the beneficiary of the trust). The custodian properly identifies Billy as a non-eligible designated beneficiary and correctly determines the 10-year rule applies. John was only 62 when he died and was not yet taking RMDs. Consequently, the trust-owned inherited IRA will not have RMDs in years 1 – 9 of the 10-year rule.

The now-antiquated language of the trust – created just 2 years previous – dictates that only RMDs are to be paid out of the inherited IRA. The custodian and trustee of the trust follow the legal language of the trust precisely. There are no RMDs in years 1 – 9, so for nine years the inherited IRA just sits there, untouched. But at the end of year 10, the SECURE Act dictates that whatever remains in the account must be distributed. This is essentially the final RMD.

Since the trust language says to only pay out RMDs, and since the final payment in year 10 is considered the final RMD, the trust has no choice but to pay a full lump sum distribution of the entire inherited IRA to the trust, and then distribute those dollars to the trust beneficiary.

Had John reviewed the trust post-SECURE, he could have avoided this catastrophic scenario and designed an alternative beneficiary plan. Instead, 10 years after his death, John spins in his grave while multi-millionaire Billy the Kid hoots and hollers all the way to Vegas.

Copyright © 2023, Ed Slott and Company, LLC Reprinted from The Slott Report, July 19, 2023, with permission. <https://www.ira-help.com/slottreport/inherited-ira-rmdrequirements-and-roth-401k-rules-today%E2%80%99s-slott-report-mailbag> Ed Slott and Company, LLC takes no responsibility for the current accuracy of this article.