

Trust Beneficiaries and Your Retirement Accounts



One often overlooked aspect of estate planning involves beneficiary designations. Keeping beneficiary designations up to date is one of the most important aspects of legacy planning when you have accumulated assets in tax-deferred retirement accounts, such as Traditional IRAs, Roth IRAs, 401(k) or 403(b) plans, SEP IRAs, SIMPLE IRAs, and a host of other employer-sponsored retirement plans.

Naming a beneficiary is straightforward enough. You complete a beneficiary designation form. Updating a beneficiary designation is just as easy. But sometimes life is not straightforward. Sometimes, special needs and circumstances arise. Trust planning is one way to address distribution of assets, including retirement account assets, when life gets a little more complicated. Maybe you have a child who is a spendthrift or has special needs that need to be accommodated after you are gone. Maybe you want to protect your assets and keep them in the family should your son or daughter go through a divorce. Maybe you don't want to leave your assets to your

children, but instead want to skip a generation and have it go directly to your grandchildren. Or maybe you are concerned your spouse will be unable to handle all of life's financial responsibilities after you are gone and want to provide help in the way of a corporate trustee to handle your financial affairs.

A trust can be named the beneficiary of your IRAs, 401(k) plans or other retirement accounts. Naming a trust gives you the ability to exercise control over how your retirement account is distributed after you die, by way of the trust document's provisions. Naming a trust can be more costly and add more complexity to your estate plan. In the end, the benefits of the post-death control that is gained must be carefully weighed against some of the drawbacks.

First, if you name a trust as your primary beneficiary, instead of your spouse or other individuals, it is the trust that becomes the owner of the IRA after your death, not the individual beneficiaries that were named in the trust document. The trustee or trustees of the trust authorize the distribution of the retirement account assets according to the provisions of the trust document, not the trust beneficiaries themselves. The trust then becomes a middleman or gatekeeper between the retirement account and the trust beneficiaries.

If you want those individuals named in your trust document to have direct control over the investing and distribution of your retirement accounts after your death, it is usually better to name them as direct beneficiaries.

Retirement Planning

Second, after your death, IRS rules require distributions from your retirement accounts. These required minimum distributions, or “RMDs”, are calculated differently when a trust is the beneficiary. RMD calculations are pretty straightforward. You typically divide the prior year-end account balance by a life expectancy factor. Knowing whose life you are using or alternately if the 10-year rule applies is where a trust beneficiary can get tricky. A “qualified” trust allows you to look into the trust to identify beneficiaries to determine if they are eligible or non-eligible designated beneficiaries. If the trust is not a “qualified” trust, the retirement account will either be forced to distribute over five years or over the deceased account owner’s statistical life expectancy.

For a trust to be qualified, it must be irrevocable upon the retirement account owner’s death, it must identify specific individual beneficiaries (as opposed to classes of beneficiaries), documentation regarding the trust beneficiaries must be provided to the retirement account trustee or custodian by October 31st of the year following the account owner’s death, and the trust must be valid under state law.

Once it is determined over how many years the retirement account can be distributed, the RMD can be calculated. Like it says in its name, an RMD represents the minimum amount that must be paid from the retirement account to the trust. The trust document itself may require the retirement account to be withdrawn faster than the number of years determined by the RMD.

The trustee ultimately must authorize the appropriate distribution to be paid from the retirement account to the trust and depending on the provisions of the trust, the amount distributed may stay in the trust or be distributed to the trust beneficiaries.

Third, when distributed, retirement account assets generally add to the beneficiary’s taxable income. But who pays the income taxes when a trust is named as a beneficiary of an IRA or 401(k) is also determined by the trust document. If the trust document requires the retirement account distribution to be held or accumulated in the trust, the trust must report the income on the trust’s tax return. If the trust treats the distribution from the retirement account as income that is distributed to the trust beneficiaries, then the trust beneficiaries will pay any income tax that is due.

It’s true. Life can get complicated. Yours may require special planning for your retirement accounts. As you plan for the legacy you wish to leave, make sure you work with your legal and tax professionals to develop a plan for the unique nature of retirement accounts in your estate.

Your financial advisor can help ensure that the beneficiary designations you made reflect the estate planning goals that you have developed with your tax and legal advisors. Make sure you sit down with your financial advisor every year or two, or when life happens and things change, to review what you have on file and update your beneficiary designations should your goals change. ■

IMPORTANT DISCLOSURES This piece is intended to provide accurate information regarding the subject matter discussed. It is made available with the understanding that Benjamin F. Edwards is not engaged in rendering legal, accounting or tax preparation services. Specific questions on taxes or legal matters as they relate to your individual situation should be directed to your tax or legal professional.