

## Considerations before naming a trust as an IRA beneficiary

Naming the beneficiary to your IRA is an important step toward meeting your legacy goals. Unfortunately, many investors take little notice of this step in their wealth planning. Consequently, they create situations that do not maximize the benefits their IRA savings might offer these beneficiaries.

Some investors have created trusts and feel they are the answer to all their estate planning concerns, including who to name as their IRA beneficiary. However, the trust is often named as the IRA beneficiary when there are no exceptional circumstances to do so. While there are certainly reasons, such as a special needs beneficiary, when it would be appropriate, in most instances a trust is a poor IRA beneficiary. This is because having your trust listed as the IRA beneficiary may have tax and other consequences that could negatively affect your heirs.

The type of qualified trust (e.g. conduit or accumulation) and who the original trust beneficiary is makes a difference in how long the Inherited IRA for the trust can remain open. It also depends on if the trust that inherited the IRA has one or more than one beneficiary. For example, a qualified trust with a spouse, or disabled or chronically ill individual, or minor child of the IRA owner who has not exceeded age 21 as the only beneficiary should fall under the Eligible Designated Beneficiary (EDB) category. A qualified trust with multiple beneficiaries who are all non-spouse adults that are not chronically ill or disabled or minor child of the IRA owner who has not exceeded age 21 should fall under the Designated Beneficiary (DB) category. What if the qualified trust has more than one beneficiary? An applicable multi-beneficiary qualified trust that establishes separate Inherited IRAs in the name of the trust for each

trust beneficiary, by December 31 following the year of the IRA owner's death, those separate qualified trusts may be able to distribute based on the category of each beneficiary. This means a qualified trust with both an Eligible Designated Beneficiary (EDB) and a Designated Beneficiary (DB) may be able to each follow the distribution rules for that beneficiary type. While we want to provide you with guidance about this complex rule the trustee must speak with their attorney to determine the trust's distribution options.

### Qualified “look-through” trust requirements

Depending on the structure of the trust, it may be considered either a qualified “look-through” trust, or a non-qualified trust. A non-qualified trust is any trust that does not meet the criteria discussed next. The trust must meet the following requirements in order for it to be considered a qualified “look-through” trust:

- The trust is a valid trust under state law.
- The trust is irrevocable or will, by its terms, become irrevocable upon the IRA owner's death.
- The beneficiaries of the trust are identifiable from the trust instrument.
- Certain documentation has been provided to the IRA trustee, custodian, or issuer.

Once these rules are satisfied, the IRA custodian, under direction of the Trustee, can usually make the payments to the trust for distribution to the individual beneficiaries.

## Categories of beneficiaries

The Setting Every Community Up for Retirement Enhancement (SECURE) Act has changed the distribution options for certain beneficiaries who inherit an IRA before or on or after January 1, 2020.

The table below summarizes the trust categories.

Non-Designated Beneficiary (NDB)	Designated Beneficiary (DB)	Eligible Designated Beneficiary (EDB)
<ul style="list-style-type: none"> <li>Non-qualified trust</li> </ul>	<ul style="list-style-type: none"> <li>Primary beneficiary of qualified “look-through” trust who is <b>not</b> the surviving spouse, or disabled or chronically ill individual or minor child of the IRA owner who has not exceeded age 21</li> </ul>	<ul style="list-style-type: none"> <li>Primary beneficiary of qualified “look-through” trust who is the surviving spouse, or disabled or chronically ill individual or minor child of the IRA owner who has not exceeded age 21</li> </ul>

## Trust distribution options

The table below summarizes the options for a trust named as an IRA beneficiary, and if the owner died before or on or after their Required Beginning Date (RBD). RBD is generally April 1 following the year you turn age 72.

Beneficiary category	Life expectancy	5-year rule	10-year rule	10-year rule with RMDs <sup>1</sup>
<b>Non-Designated beneficiary:</b>				
<i>Non-Qualified Trust</i>				
- original IRA owner dies <b>before</b> RBD		X		
- original IRA owner dies <b>on or after</b> RBD	X <sup>2</sup>			
<b>Designated beneficiary:</b>				
<i>Primary beneficiary of qualified trust<sup>3</sup> is an DB</i>				
- original IRA owner dies <b>before</b> RBD			X	
- original IRA owner dies <b>on or after</b> RBD				X
<b>Eligible Designated beneficiary:</b>				
<i>Primary beneficiary of qualified trust<sup>3</sup> is an EDB</i>				
- original IRA owner dies <b>before</b> RBD	X		X	
- original IRA owner dies <b>on or after</b> RBD	X			X

<sup>1</sup>These regulations are proposed, IRS notice 2022-53 states if these regulations are finalized, they won't be effective until 2023. Clients should also consult their tax professional for further guidance. Review the full IRS proposal via the Federal Register if you'd like to learn more.

<sup>2</sup>RMDs based on owner's age in year of death, divisor reduced by one each subsequent year.

<sup>3</sup>The type of qualified trust (e.g. conduit or accumulation) and who the original trust beneficiary is makes a difference in how long the Inherited IRA for the trust can remain open. It also depends on if the trust that inherited the IRA has one or more than one beneficiary. Please note WFA does not interpret the trust and the trustee should seek competent advice to determine their exact distribution options based on their situation.

## Distribution options

- Open an Inherited IRA** — An Inherited IRA is a way to keep the funds growing tax-advantaged, while taking distributions. The account titling will always refer to you as the deceased IRA owner with the trust listed as the beneficiary. Since a trust isn't the owner, the trustee may not make contributions or 60-day IRA-to-IRA rollover deposits to this account.

Inherited IRA distribution options are:

- Ten-year rule** — This option is available for Inherited Roth and Inherited Traditional IRAs. Primary beneficiary of a qualified trust<sup>3</sup> who is **not** the surviving spouse, or

disabled or chronically ill individual will follow this rule. The Inherited IRA must be emptied by the 10th year following the year of the IRA owner's death. If the IRA owner died on or after their RBD, under the proposed IRS regulations<sup>1</sup> the DB must take required minimum distributions (RMDs) based on their life expectancy during the 10-year period. If the IRA owner died before their RBD or the IRA is a Roth, then no distributions are required before the 10th year. Depending on the size of the account the trustee may want to spread distributions over the 10-year period.

- Life expectancy** — This option is available if the trust is not a qualified “look-through” trust and you die after

your RBD. The distributions are based on your single-life expectancy (term-certain) in the year of your death. These RMDs will begin the year following your death.

Primary beneficiary of a qualified trust<sup>3</sup> who is the surviving spouse, or disabled or chronically ill individual, can take distributions from the Inherited IRA in the name of the trust based on the trust beneficiary's life expectancy. The life expectancy option is often referred to as the stretch IRA strategy<sup>4</sup>.

- **Five-year rule** — This option is used if the trust is not a qualified “look-through” trust and you die before your RBD. Empty the Inherited IRA by December 31 of the year containing the fifth anniversary of the owner’s death. No distributions are required before the fifth year.
- **Disclaimer** — In some instances a trust may be able to disclaim (refuse) IRA assets within nine (9) months after your death.
- **Lump-sum** — This strategy will exhaust the entire account in one distribution, with retirement assets losing their tax-advantaged status. Once the trustee chooses to take a lump-sum distribution of the IRA assets the trust inherited, it cannot be undone.

## Key considerations

There are a few things to consider when naming a trust as an IRA beneficiary.

- The IRS has indicated that a trust that allows for the payment of debts and/or administration expenses of the estate may not be a qualified “look-through” trust. If those estate debts and expenses are paid off from the time of the death of the IRA owner up to September 30 of the year following death, the trust may be a qualified “look-through” trust.
- You may want to have the trust document examined to see if it would be a qualified “look-through” trust. Please seek legal advice to determine what course of action is most appropriate to your individual needs when naming IRA beneficiaries.
- There may be family estate planning issues where it is appropriate that there be limitations for the beneficiaries for reasons such as age, health or mental health issues,

or spend-thrift concerns. However, the use of multiple IRAs may be something to consider. A prudent strategy you could implement is to have one Wells Fargo Advisor (WFA) IRA with individual beneficiaries named, and a second WFA IRA naming a trust as a beneficiary for the special needs heir.

- While this piece is educational and provided to help you understand the complexities of naming a trust as your IRA beneficiary the ultimate responsibility will fall to the trustee of your trust. Your trustee should understand your wishes and have knowledge of how to administrate your trust upon your death.
- While we have provided this information to you it is extremely important that you have retain your own tax and legal counsel to discuss your estate planning needs and how a trust may or may not meet those desires.

## Managing for taxes

When a trust becomes an IRA beneficiary, taxation is an issue that needs to be discussed with your tax advisor. Trusts are subject to a separate tax-rate schedule that applies only to trusts and estates, for income that is not paid out to the trust’s beneficiaries. This can happen in certain complex trusts or in any cases where not all of the income received by the trust is paid out to beneficiaries in the current year. These trust income tax brackets on any undistributed income rise rapidly, reaching the highest tax rate of 37% for taxable income over \$13,450. By contrast, when an individual is named as the IRA beneficiary, the top income-tax bracket of 37% applies only to taxable income over \$647,850 for joint filers or \$539,900 for single filers based on 2022 tax rates.

## Talk to Wells Fargo Advisors

We suggest that IRA investors become educated on the various beneficiary planning methods that are now available to determine whether a trust is necessary to meet their legacy goals. At Wells Fargo Advisors, we welcome the opportunity to work with you and your tax and legal advisors to help create an IRA strategy designed to help you achieve your desired result.

<sup>4</sup> Stretching an IRA refers to the ability to take RMDs over the beneficiary's single life expectancy (using the term-certain calculation method) rather than over the life expectancy of the original IRA owner.

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