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# New Regulations Provide Flexibility for Using Trust Beneficiaries as IRA Measuring Lives

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The explosion in the stock market left many individuals with large account balances in qualified retirement plans and individual retirements accounts (IRAs). Careful planning can preserve a stream of income from these tax-favored retirement vehicles not only for the plan participants and IRA owners themselves but also for their beneficiaries.

Some beneficiaries, however, will need the protections afforded by a trust. There is good news on this front. The IRS has issued new proposed regulations that liberalize the rules for using trust beneficiaries as measuring lives for distributions from IRAs.

The new rules also apply for qualified retirement plans. In fact, the new proposed regs are issued under Section 401(a)(9) of the Internal Revenue Code, which deals with required distributions from qualified plans. The new regs take the form of changes to some of the questions and answers under Proposed Regulations Section 1.401(a)(9)-1, which was issued several years ago. The regs apply to IRAs by virtue of Proposed Regulations Section 1.408-8. Our focus is on using trusts for IRAs because many participants in qualified plans ultimately end up having their plan account balances transferred to IRAs.

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### The Five-Year Rule

If an IRA beneficiary is not an individual (such as the estate of the decedent or a trust created by the decedent), the IRA owner is generally treated as having no designated beneficiary when determining the distribution period. (Prop. Reg. § 1.401(a)(9)-1, Q&A D-2A.) In such situations, distributions commencing before death must be made over the IRA owner's single life or life expectancy, and distributions commencing after death must be made within five years of death.

The advantage of designating an individual as an IRA beneficiary is to start a new measuring life for distributions. Typically, the new measuring life will be considerably longer than the five-year period or the balance of the IRA owner's life expectancy. This means that the fund will con-tinue to grow on a tax-deferred basis for a longer period.

Naming a trust as the IRA beneficiary has several advantages:

- In second marriages the trust is often used to protect the children from a first marriage. The usual structure is to designate the trust as the IRA beneficiary and structure the trust to qualify for the marital deduction under Revenue Ruling 89-89 (1989-2 C.B. 231). The surviving (second) spouse is the lifetime beneficiary and on his or her death, the children from the first marriage are the remainder beneficiaries. If the second spouse is designated as primary beneficiary, rather than a trust, he or she could roll over the IRA proceeds into his or her own account and the children from the first marriage would have no rights to the balance of the IRA at the time of the spouse's death. Naming a trust as beneficiary, provided the surviving spouse is not allowed to invade principal, ensures that the children from the first marriage will not lose their inheritance.
- The trust structure is important when IRA beneficiaries are minors, young adults who may not have the maturity to handle large sums of money or spendthrifts. Designating the trust as IRA beneficiary provides the same protections as do similar type trusts provided for in wills, revocable and irrevocable trusts.

### Irrevocable Trust Exception under Old Regs

Under the old proposed regulations, it was possible to use trust beneficiaries as measuring lives if four conditions were satisfied as of the required beginning date (the date on which distributions must commence, usually April 1 of the year after the IRA owner reaches age 70½):

1. The trust must be irrevocable (changed by new regs).
2. A copy of the trust is provided to the plan (changed by new regs).
3. The trust must be valid under state law (no change).
4. The beneficiaries must be identifiable (no change).

### Trust Need Not Be Irrevocable When Created

The new regs eliminate the need for an irrevocable trust, provided the trust becomes irrevocable at death. (Prop. Reg. § 1.401(a)(9)-1, Q&A D-5A(b).) Therefore, a testamentary trust may be named as an IRA beneficiary. Under the old regulations, because the trust had to be irrevocable, a testamentary trust satisfied the exception only if the IRA owner died before age 70½. Therefore, to satisfy the old regs it was necessary to create an irrevocable standby trust to receive the IRA distributions after the IRA owner's death.

### Providing Copy of Trust to Plan

The other requirement of the old regs that often caused problems was the need to deliver a copy of the trust to the plan administrator. The new regs provide this only as an option. Rather than deliver a copy, the IRA owner may provide a list of all the trust beneficiaries, including contingent and remainder beneficiaries with a description of the conditions of their entitlement. The list must be certified as true and correct and the IRA owner must agree to provide corrected certifications and a copy of the trust upon demand. (Prop. Reg. § 1.401(a)(9)-1, Q&A D-7A(a).)

Within nine months after death, the trustee must furnish to the plan administrator either a final list of trust beneficiaries or a copy of the trust. If after death, there are any discrepancies between the list and the IRA, which caused improper distributions to be made, the IRA is not disqualified and will be treated as having changed beneficiaries during the calendar year when the discrepancy is discovered. (Prop. Reg. § 1.401(a)(9)-1, Q&A D-7A(b).)

Although the new rule may seem complicated, it is preferable to furnishing the entire will if a testamentary trust is to be designated as IRA beneficiary. Clients still have the option of creating an irrevocable standby trust if there is concern about furnishing a copy of the will.

### Form of Certification

Under the old regs, it was common practice not only to deliver a copy of the trust to the plan administrator but also to provide a new beneficiary designation form. That form usually recited that the IRA owner elects not to recalculate life expectancy (to avoid the possibility that the entire IRA account would have to be distributed one year after death) in addition to designating the trust as IRA beneficiary and listing the names, relationships, and social security numbers of the trust beneficiaries. Practitioners may want to consider including in the new certification the election not to recalculate life expectancy.

### Trust Provisions

The will should include provisions usually included in a standby trust, such as provisions empowering the trustee to demand the minimum distribution each year, to convert non–income-producing property to income-producing property, and to invade the IRA in the trustee's discretion, as well as others. If the trust is intended to qualify as a qualified terminable interest property trust, then it is also necessary to comply with Revenue Ruling 89-89.

**COMMENT: Practitioners may want to consider including IRA provisions in the will even though the client may not have a present intention to designate a trust as IRA beneficiary. The advantage of this type of planning is that if the future circumstances change (i.e., a second marriage or a spendthrift) the client need only file a certification without the need to prepare a new will or a codicil.**

### Conclusion

The new rules should result in greater use of trusts as IRA beneficiaries. This will mean that the IRA assets will be preserved for family members and will continue building up on a tax-deferred basis for the longest possible period as younger IRA beneficiaries will be the measuring lives. ■

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