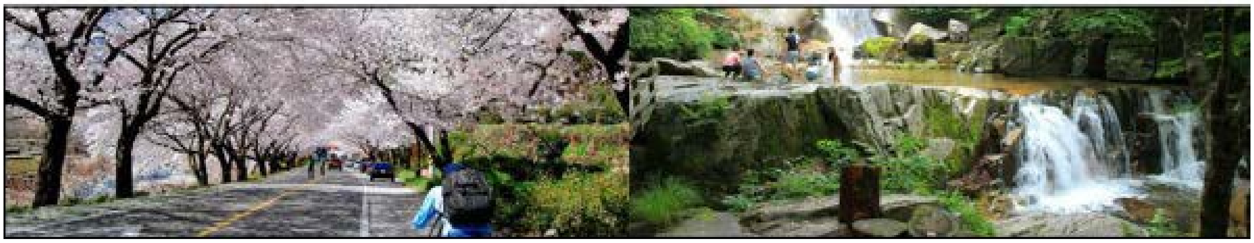

FINANCIAL PERSPECTIVES

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The Daunting Tasks of an IRA Trust Trustee
August 25, 2021

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An IRA owner should name a trust as his IRA beneficiary only when there is a legitimate and justifiable reason to do so. If an adult beneficiary is otherwise healthy and responsible, and if there is no desire to control assets after death, then naming a person directly as an IRA beneficiary may be a better option. However, in those cases when a trust is necessary, be sure the trustee – the person responsible for following the provisions of the trust and dispersing its assets — *understands the trust and IRA rules.* Otherwise, saddling an inexperienced trustee with such a daunting task can lead to egregious mistakes — *as a recent IRS private letter ruling illustrates.*

Trust Distribution Disaster

PLR 202125007, released by the IRS on June 25, 2021, is another in a long line of botched IRA trust beneficiary horror stories. In this situation, an IRA owner named a trust as IRA beneficiary. After her death, IRA assets were properly moved into a trust-owned inherited IRA. The adult children of the original IRA owner, as trustees and trust beneficiaries, had total control of the assets. The children wanted to trade stocks within the inherited IRA but were informed by the custodian that the existing account could not accommodate their request. So, the trustee children decided to transfer "substantially all" of the inherited IRA assets to a non-qualified (non-IRA) brokerage account, owned by the trust. This action resulted in a taxable distribution — *at trust tax rates!* — of most of the IRA assets.

Once inherited IRA dollars are withdrawn by a non-spouse beneficiary (and a trust is a non-spouse beneficiary), there is no putting them back. Even if the error is discovered within 60 days of the original transaction, a rollover is not allowed, and the distribution is likely taxable. Even though the trustees identified their error several months later and requested that the former IRA dollars be returned (thus avoiding the massive tax hit), this PLR was doomed. The IRS concluded that:

> *"…once the assets have been distributed from an inherited IRA, there is no permitted method of transferring them back into an IRA. In this case, the assets of IRA X were transferred to a non-IRA account. Accordingly, the assets may not now be transferred to an IRA account."*

Purpose of the Trust?

What was the point of this trust? The adult children had complete control over the funds and could pay the inherited IRA out to themselves at any time (which they erroneously did).

■ An IRA owner should name a trust as his IRA beneficiary only when there is a legitimate and justifiable reason to do so.
■ Once the assets have been distributed from a non-spouse inherited IRA, there is no permitted method of transferring them back into an IRA.
■ There is no income tax benefit that can be gained with a trust which cannot be gained without a trust.
■ When deciding whom to name as the trustee of a trust, one must carefully consider several issues, such as fiduciary obligations and potential personal liability of the trustee.

Additionally, using a trust as IRA beneficiary will not save income tax — *there is no income tax benefit that can be gained with a trust which cannot be gained without a trust.* Adding to the children's misery, high trust tax rates were likely imposed. (In 2021, trusts reach the top 37% bracket after only $13,050 in income.) While we do not know the purpose of the trust in this PLR, there can be legitimate reasons to name a trust as IRA beneficiary. For example, a trust makes sense if the beneficiary is a minor, disabled, incompetent or unsophisticated. Also, a trust is a good way to provide an income stream or, for a subsequent marriage, to provide income to a spouse and the remainder to the original IRA owner's children. A trust can ensure beneficiaries do not withdraw more than required distributions. Trusts can also provide creditor and divorce protection and can fund charitable bequests through charitable remainder trusts (CRTs).

Naming a Trustee

Assuming a trust is named as IRA beneficiary for a valid reason, great care must be given to selecting the trustee of the trust. As we saw in PLR 202125007, the inexperienced adult children trustees committed a fatal error. Such a grievous mistake could have been avoided had a proper trustee been chosen — *one who was knowledgeable of trust and IRA rules.* When deciding who to name as the trustee of an IRA trust, one must carefully consider several issues, including:

- *Does the trustee know the fiduciary obligations and whom to turn to for guidance? (Based on the outcome of PLR 202125007, it seems clear that the trustees made no such outreach.)*
- *Is the trustee aware of the potential personal liability (as trustee) to trust beneficiaries for mistakes that could either accelerate taxes or cause losses for trust beneficiaries?*

Recognize that serving as a trustee is no small task.

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