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IRAs In Estate Planning, or Trust Me, I'm an EDB for RMDs after the RBD

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Concise Estate Planning Forms for Texas Lawyers
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Chapter Three, Naming a Trust as a Beneficiary of an IRA or Other Retirement Plan

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3.01 Introduction

This chapter has the longest title in this book. Unfortunately, when it comes to planning for tax-deferred assets, my commitment to simplicity starts to break down. Sometimes it is simply not possible to simplify the Internal Revenue Code. But here is my best effort.

The Internal Revenue Code, along with the Regulations issued by the Treasury Department, requires the beneficiaries of all qualified retirement plans (QRPs) to withdraw the funds from the plan and pay income tax on those funds within a certain period of time after the participant dies. The same rules apply to Individual Retirement Accounts (IRAs) and other tax-deferred accounts.

It can help to understand the history of retirement plan taxation. Originally, the government's goal was to encourage people to save for retirement. Over the years, that program has been hugely successful: Trillions of dollars are in 401(k) plans alone, according to the many random pages that pop up in a Google search. For example, https://www.ici.org/faqs/faq/401k/faqs_401k (last viewed 7/11/23).

All of this untaxed money amounts to a huge tax expenditure for the federal government. The potential taxes are also tempting to tap when Congress needs to increase taxes to pay for other government programs. And it's more palatable to tax retirement funds after the retiree has died and no longer needs them. So Congress will periodically take the scissors to some part of the tax deferral whenever they need to balance a spending bill. A few snips here, a tuck there, and now we have this strangely uncoordinated patchwork of tax rules to comply with.

So some beneficiaries are required to withdraw the funds sooner than other beneficiaries, which for large balances can have a huge effect on the cumulative income taxes paid by the beneficiary on this money. Leaving the money in trust instead of outright further complicates the result, and will be the primary focus of this chapter.

"I suggest you remove the word 'simply' from your vocabulary when dealing with the proposed minimum distribution regulations." Natalie Choate, Choate's Notes, May 2022 (copy on file with the author).

3.02 Governing Law

The relevant statutes on Required Minimum Distributions from IRAs and QRPs are contained in Section 401 et seq of the Internal Revenue Code, and most of the Regulations are promulgated under IRC § 401. The Treasury Department issued new proposed Regulations, which can be found here:

<https://www.federalregister.gov/documents/2022/02/24/2022-02522/required-minimum-distributions> (last viewed 7/10/23).

But few practitioners would attempt to understand this area of law without reference to Natalie B. Choate's book, *Life and Death Planning for Retirement Benefits*, 8th Edition 2019, and the updates she posts at her website, www.ataxplan.com. I also subscribe to her Choate's Notes, an email

newsletter that she sends out a few times a year, the recent issues of which do not appear to be posted anywhere. You can subscribe here: <https://ataxplan.com/contact-ataxplan-publications/for-choates-notes-mailing-list/> (last viewed 7/10/23).

Natalie Choate is the foremost authority on the taxation of QRPs and IRAs. She also has become a de facto writer of new law in this area, as the Treasury Department has adopted some of her terminology (such as accumulation trusts) and blessed her planning strategies in the 2022 Proposed Regulations. You should buy her book before you buy mine.

3.03 Scope of This Chapter

This Chapter will not cover every issue that could arise after an IRA owner dies with a poorly-planned estate. Instead I will focus on how to create trusts and designate beneficiaries in order to achieve the desired results of tax savings, beneficiary protection, and investment management. I will also assume that the client will live beyond their Required Beginning Date, because (a) we don't know when the client will die, (b) it makes sense to plan for the most likely scenario, and (c) death before the RBD typically wouldn't change the strategy.

In general, we are trying to achieve the maximum stretch-out of IRA distributions after the participant's death. We do this either by (1) naming an individual as the beneficiary of the IRA, or (2) naming a trust that will be considered a see-through trust under the tax rules.

Defined benefit plans are beyond the scope of this book, because they typically disappear when the participant and their spouse die, and therefore do not create any estate planning opportunities or conundrums.

3.04 Terms Used in This Chapter

The Code and Regs use terms like "plan" and "employee" because the rules were written for 401(k) plans long before IRAs became as big as they are today. But all the same rules apply to Individual Retirement Accounts. Since many clients are no longer employees and have rolled their retirement plans into rollover IRAs before they come to us for help with beneficiary designations, I will use the term "participant" to refer to the employee, as Natalie Choate does. I will also sometimes use "account," "plan," and "IRA" interchangeably; please assume that "IRA" includes all defined contribution retirement plans and other tax-deferred retirement accounts, unless otherwise stated.

I'm not usually a fan of excessive acronym usage, but in this area of tax law they save a meaningful amount of time and type. Plus, all the experts use acronyms regularly, so you'll be lost if you don't memorize the basic ones.

DB	Designated Beneficiary (refers to both PODBs and EDBs)
PODB	Plain Old Designated Beneficiary (Natalie Choate coined this)
EDB	Eligible Designated Beneficiary

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