Avoid These 4 Common IRA Trust Mistakes

Naming a trust as your IRA beneficiary can help you meet important estate planning goals. However, if you are considering this, you should proceed with caution. Here are four common mistakes with IRA trusts you will want to avoid.

1. Naming an Unnecessary or Unwanted Trust as Your IRA Beneficiary

If you plan to leave your IRA funds to a vulnerable beneficiary such as a minor or an individual, a trust can be a good strategy to protect the beneficiary or preserve government benefits. However, naming a trust when it is not needed or wanted is a mistake.

When an unnecessary trust is named as IRA beneficiary, the trust beneficiaries will often look to the IRS for a private letter ruling (PLR) allowing a spouse beneficiary to do a spousal rollover or nonspouse beneficiaries to set up inherited IRAs.

While these PLR requests do have a track record of success, they are expensive and time consuming, not to mention the money and effort required for drafting an unnecessary IRA trust. A better approach is to proactively determine whether a trust is really needed from the onset. If the desired outcome is a spousal rollover or nonspouse beneficiaries having their own inherited IRAs, avoid the mistake of naming a trust and just name the living, breathing beneficiaries directly.

2. Paying Out the Entire Inherited IRA to the Trust

Imagine spending a lifetime building a retirement account only to have beneficiaries lose the tax-deferred status in one fell swoop by taking a total distribution from the inherited IRA. Avoid this outcome by correctly establishing an inherited IRA for the trust and only distributing RMDs or other desired distributions out of the inherited IRA to the non-qualified trust account.

3. Failing to Name the Trust as Your IRA Beneficiary

It is hard to believe, but one critical step that can get missed is remembering to name the trust on the beneficiary form. Don’t go through the trouble of having a perfect trust drafted and then overlook updating the beneficiary form.

4. Not Updating Your Trust for the Secure Act

It has been several years since the SECURE Act became a reality, and there are still many outdated IRA trusts that do not take the new rules into account. It is not too late. If you named a trust as your IRA beneficiary, you should act to review and potentially revise the trust. Conduit trusts may have to be changed to discretionary-type trusts to either allow distributions within the 10-year payout period to smooth out the tax bill, or to be held within the trust beyond the 10 years for long-term protection.

If you are considering a trust as an IRA beneficiary after the SECURE Act, one strategy worth pursuing is to convert your traditional IRAs to Roth IRAs. Leaving Roth IRA funds to a discretionary trust can provide post-death control while also eliminating trust or individual taxes.

As always, your Fairhaven Financial Advisors are here to answer any questions you may have about trusts and beneficiaries. Please feel free to reach out at 517.332.2900 to schedule a review appointment at any time.

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