Separate Share Rule for See-Through Trusts

Take-Away: The *separate account* rules were recently modified by the SECURE Act's Final Regulations, to make it easier for subtrusts to share in a decedent's retirement account that is payable to the account owner's Trust. However, additional language will have to be included in the Trust instrument to effectively divide the retirement account payable to the Trust and have each subtrust satisfy the *separate account* rules.

Background: Prior to the SECURE 2.0 Act, if an IRA was made payable to a Trust that is established for multiple beneficiaries, the IRA beneficiary designation form had to spell out each separate 'subtrust' for each trust beneficiary and the amount or percentage of the IRA that each subtrust was to receive to satisfy the *separate account* rules. Consequently, the IRA's 'division' usually occurred in the IRA beneficiary designation form, not the Trust instrument itself, even though that is where the subtrusts are created and administered.

Separate Accounts: The Final Regulations under the SECURE Act provide the following definition of *separate accounts:*

".. Are separate portions of [the IRA].. reflecting the separate interests of..the beneficiaries under the plan as of the date of the employee's death for which separate accounting is maintained. The separate accounting must allocate all post-death investment gains and losses, contributions, and forfeitures, for the period prior to the establishment of the separate accounts on a pro rata basis in a reasonable and consistent manner among the separate accounts. However, once the separate accounts are actually established, the separate accounting can provide for separate investments for each separate account under which gains and losses from the investment of the account are only allocated to that account, or investment gain or losses can continue to be allocated among the separate accounts on a pro rata basis. A separate accounting must allocate any post-death distribution to the separate account of the beneficiary receiving that distribution."

Proposed Regulations: In February of 2022, the IRS issued Proposed Regulations for the SECURE Act. Those Regulations provided the rule that *separate account* treatment would be available for subtrusts that are established under a single Trust instrument, only if one of two conditions were met: either (i) the IRA beneficiary designation form named the subtrusts directly (the existing practice for *separate accounts*); or (ii) any beneficiary of any one of the subtrusts was a disabled or chronically ill individual who qualifies as an *eligible designated beneficiary* (EDB.). In other words, if a Trust was named as the

IRA's beneficiary and there was no disabled or chronically ill individual who was a beneficiary of a subtrust under that Trust, there would be no *separate accounts* treatment for any of the subtrusts.

Final Regulations: The IRS's Final Regulations, published in July, 2024, changed the rule. The IRS announced that when a Trust is named as an IRA beneficiary and the Trust is split into subtrusts for each beneficiary at the IRA owner (settlor's) death, the subtrusts can receive *separate account* treatment regardless of whether any of the trust beneficiaries are either disabled or chronically ill, i.e., *eligible designated beneficiaries.*

Good News! This shifts the focus from the IRA beneficiary designation form to the Trust instrument itself. Accordingly, it is no longer necessary to name each of the subtrusts on the IRA beneficiary designation form for required minimum distributions (RMDs) to be determined separately for each subtrust. RMDs will be accepted if the other requirements for *separate accounts* are met, together with separate accounting as *pro rata* allocations of all gains and losses in the IRA until the subtrust accounts are physically separated by the trustee. So far, so good. Until you read a bit further in the Final Regulations.

The 'Trap:' The Final Regulations, however, go on to point out that while *separate account* treatment for subtrusts is available when the funding Trust is named as the IRA's beneficiary, the Trust instrument must specify what portion of the IRA is going into each of the subtrusts. If that allocation is not specified, the funding Trust, not the individually created subtrusts, will continue to be treated as the sole IRA beneficiary.

Modify Pick-and-Choose Provision: Therefore, if the IRA owner wants a Trust, and not its subtrusts, to be named as his/her IRA beneficiary to benefit from *separate account* treatment, the allocation of the IRA's value among the created subtrusts must be specified in the Trust instrument. While the Trust instrument might give the trustee the authority to pick-and-choose what assets are to be transferred to each of the subtrusts, that pick-and-choose authority will now have to contain an exception for any inherited IRAs that are payable to the Trust. Giving the trustee the discretion to decide how much of the IRA each subtrust will receive will not satisfy the requirement to establish *separate shares.*

Example: (Thank you, Natalie Choate.) Bud owns a traditional IRA. Bud makes his IRA payable to his Trust. Bud's Trust is established for the benefit of Bud's wife, Anne, his son, Art who is disabled, a minor child Pete, and Bud's adult daughter Cindy, who is age 22. Bud wants separate subtrusts to be created for each of Anne, Art, Pete, and Cindy. Bud's Trust instrument provides "*Any IRA payable to*

this Trust on my death shall be allocated equally to the separate trusts established for my wife and children." Therefore, each subtrust will receive *separate account* treatment.

Anne, Bud's wife, is an *eligible designated beneficiary* (EDB.) Anne's subtrust can receive *separate account* treatment. Anne's share of Bud's IRA will be payable to her subtrust. If Anne's subtrust is a *conduit* trust, its share of Bud's IRA will be distributed over Anne's life expectancy, recalculated annually.

Art, who is a disabled child, is also an EDB. Art's subtrust will qualify as an *Applicable Multi-Beneficiary Trust* (AMBT). This AMBT will not be required to immediately distribute any IRA withdrawal to Art, so those accumulated funds will not be treated as an available asset for Art's Medicaid or SSI eligibility purposes.

Pete is Bud's minor child. Pete is an EDB so long as he is a minor. Pete's subtrust share of Bud's IRA will be distributable in annual installments to him over his life expectancy, with a 100% distribution of the subtrust's share of the IRA that will be required when Pete attains the age 31.

Cindy, Bud's adult daughter will have her subtrust subject to the SECURE Act's basic10-year depletion requirement.

If Bud's Trust instrument did not specify what share of his IRA went to each subtrust, ongoing RMDs from his traditional IRA will be based on a group of four beneficiaries, not all of whom are EDBs. Because there is a minor EDB in this mix of trust beneficiaries, the RMDs from Bud's IRA will be annual installments over the oldest countable beneficiary, in this case Anne using her life expectancy, with a final payment of the IRA payable to Bud's Trust when Pete attains age 21 or dies.

Conclusion: The Final Regulations simplify the *separate share* rule, in a manner of speaking. It streamlines the IRA beneficiary designation form- simply name the IRA owner's Trust. But it adds new complications to the Trust instrument itself. A Trust that is designated as IRA beneficiary must specify that the 'pick-and-choose' discretion given to the trustee to allocate assets to each subtrust must not apply to retirement accounts payable to the Trust, and the Trust instrument must specify what portion of the decedent's retirement account will to go to each subtrust to be able to benefit from *separate account* treatment.

If you would like to read additional missives, click here.