

Conduit Trusts and the Spouse's Election

Quick-Take: Conduit trusts are important when a spouse is a beneficiary of a trust that is named as the beneficiary of a spouse's trust.

Background: We have covered in several missives in the past the role of *see-through trusts*. In general, distributions from inherited IRAs are subject to the SECURE Act's 10-year distribution rule, or alternatively a life expectancy distribution rule for eligible designated beneficiaries, e.g., surviving spouse, disabled or chronically ill individuals, a minor child of the IRA owner, and someone who is less than 10-years younger than the IRA owner. As such, a trust is not a designated beneficiary, and if a trust is named as the beneficiary of the decedent's IRA, it faces a 5-year distribution rule. But we then have the *see-through trust* rules, where a trust will be treated as a designated beneficiary of the IRA.

See-Through Trust Rules: To be treated as a *see-through trust* the following conditions must be met: (i) The trust must be valid under state law; (ii) the trust must be irrevocable at the IRA owner's death; (iii) the trust must have identifiable beneficiaries; and (iv) information regarding the trust beneficiaries must be provided to the plan administrator, or IRA custodian, by October 31 of the year following the year of the IRA owner's death.

Example: Assume that you have a basic trust that becomes irrevocable on the death of the husband. Ward, the deceased husband, created a trust that provides for his wife, June for her lifetime, with the remainder of the trust passing to the couple's two sons, Wally and Beaver, on June's death. Ward's trust authorizes the trustee to pay June income in the trustee's discretion. The trust also gives the trustee the discretion to distribute trust principal to June. This trust might be a conventional credit shelter trust. Ward's IRA names this trust as its beneficiary. The countable beneficiaries of Ward's trust for *see-through trust* purposes, are June, Wally and Beaver, and also for purposes of determining required minimum distributions (RMDs) from Ward's IRA.

Trust Not an EDB: Ward's trust will NOT be an eligible designated beneficiary (EDB), so it will be subject to the 10-year distribution rule under the SECURE Act. Consequently, despite June being the lifetime beneficiary of Ward's trust, her presence as a beneficiary will not allow for a life expectancy distribution regarding the IRA payable to Ward's trust.

Conduit Trust: If Ward's Trust provides that every distribution that the trustee receives from Ward's IRA must be forwarded to June, or paid for her benefit, then Ward's trust will qualify as a *conduit* trust. Other, non-IRA income, can continue to be distributed to June in the trustee's discretion. If Ward's trust is intended to be a marital deduction trust, the IRS will treat Ward's IRA as a separate QTIP trust, which will require that all income from Ward's trust be paid directly to, or for the benefit, of June. The IRS will permit, however, that trust expenses to be paid from the required minimum distribution (RMD) amounts paid to Ward's trust.

RMDs: As a *conduit* trust, the trust's remainder beneficiaries, i.e., Wally and Beaver, are ignored. As a *conduit* trust, Ward's trust is treated pretty much the same as if Ward had named June directly as the designated beneficiary of his IRA, other than June's inability to rollover Ward's IRA and make it her own IRA. [SECURE 2.0 Act.] Accordingly, June's life expectancy can be used to determine each year's RMD from Ward's IRA; each IRA distribution to Ward's trust is recalculated annually. [In contrast, other beneficiaries are faced with a fixed distribution period, reduced by one each year. However, that rule will not apply to distributions to Ward's *conduit* trust.]

Surviving Spouse Election: June, as a surviving spouse, does not have to take any distribution from Ward's IRA until Ward would have attained Ward's required beginning date (RBD) which is age 73. June can use the Uniform Life Expectancy Table (based on someone 10 years younger than her spouse), which is the same Table that Ward would have used to calculate his own RMDs. However, this is when things get a bit confusing.

Deemed Election: The Uniform Lifetime Table is available to June instead of the Single Year Life Expectancy Table that is used with a trust, but June must formally *elect* this option to use the Uniform Lifetime Table. This election can be hard-wired into Ward's trust instrument for June. Fortunately, too, the Final Regulations provide that June will be deemed to have made this life expectancy distribution election.

Opt-Out? Note, though, the June can elect the 10-year distribution rule instead of the life expectancy payment period. If Ward does not want June to 'burn through' his inherited IRA

in that ten years, Ward will have to change the terms of his trust to expressly opt out of the deemed election.

Successor Beneficiaries: Assume that Ward's trust holds his IRA and June dies before Ward would have reached his Required Beginning Date (RBD) of age 73. June is treated as the owner of Ward's IRA, and she will have to have named a successor beneficiary to Ward's IRA. If June has failed to name a successor beneficiary to Ward's IRA, the trust will be forced into a 5-year payout of the IRA. With the *conduit* trust, the IRA funds must go to another individual, e.g., Wally and Beaver on June's death, otherwise, the 5-year distribution rule is in effect.

After Ward's Death: Suppose Ward's trust is not set up as a *conduit* trust. It might still be converted to a *conduit* trust after his death. This would require a trust reformation, or trust modification before what is called the *beneficiary finalization date* (BFD.) That is the September 30 date of the year after Ward's death. I am not sure if a nonjudicial settlement agreement would work in this instance, since a *conduit* provision would not just be an administrative provision, but would affect beneficial interests in the trust. [MCL 700.7111.] Alternatively, if Ward's sons were also discretionary beneficiaries along with June, Wally or Beaver could disclaim their interests as discretionary income beneficiaries and those disclaimers (to be qualified, within 9 months of Ward's death), would also enable Ward's trust to be converted to a *conduit* trust.

Conclusion: A *conduit see-through* trust works almost as well as naming a surviving spouse directly as a designated beneficiary of an IRA. What is important is to make sure that the trust provisions satisfy the *see-through trust* rules, and that the deemed election announced in the SECURE Act Final Regulations is consistent with the IRA owner's testamentary wishes.

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