Naming a Special Needs Trust as Beneficiary of Your IRA or Retirement Plan

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If you're reading this article and have a child or family member with special needs, you've probably already set up a third-party special needs trust (sometimes called a supplemental needs trust) and named it a beneficiary of your will or living trust. If not, you might first read some other *Voice®* articles, including Developing an Estate Plan for Parents of Children with Disabilities: A 15-Step Approach and Your Special Needs Trust ("SNT") Defined. Your goal will typically be to leave assets that can benefit your family member with a disability without causing their loss of needs-based government benefits. Further, you will likely want to protect those assets at your family member's death (or sometimes during their lifetime) from claims for Medicaid or other public benefits received. Finally, you do not want the trust's assets to be wiped out by taxes.

The most important first steps are setting up the special needs trust (SNT) and preparing a will or trust that names the SNT as a beneficiary. But then you must decide which assets are to go into the SNT. What about your retirement plan or IRA? IRAs and retirement accounts may represent a significant portion of your total assets and appear to be a natural source of funding for your SNT. This article explains considerations when naming an SNT as the beneficiary of your IRAs and other retirement accounts.

Coordinate the will, trust, and beneficiary designations

The first thing to understand is that your will controls only assets in your name, not those with a beneficiary designation. For example, if you've named a beneficiary of your life insurance, the proceeds of your life insurance will pass to the beneficiary and won't be controlled by the terms of your will. The same applies to joint tenancy accounts where the named joint tenant wholly owns the account after your death under a right of survivorship. The same is generally true of your IRAs and other retirement accounts if you name a specific beneficiary to receive the accounts upon your death. So, if your will leaves a share of your assets to an SNT intended for your child with special needs, but you have named your child with special needs as the beneficiary on your IRA beneficiary form (perhaps by naming all your children as equal beneficiaries), rather than specifying the child's trust, the IRA will pass *directly* to the child when you die, not to the SNT. Therefore, for optimal results, your beneficiary designations, will, and trusts must be coordinated.

Problems naming trusts and estates as beneficiaries of retirement accounts

When it comes to life insurance, you might choose to name your estate or revocable trust as the beneficiary, particularly if you have several children or other beneficiaries. That way, the proceeds can be divided into as many portions as the document specifies, with the share for your child with special needs passing to their SNT. However, unlike life insurance, IRAs and other retirement accounts are more complicated because they contain tax-deferred assets.

Because IRAs and retirement accounts (other than Roth accounts) are made up of pre-tax dollars, the recipient of distributions from these accounts must pay income tax on every dollar received. If the account is large and distributed all at once or over a short period, each distribution will be large, and the tax bill will be correspondingly large. This is especially problematic due to the steep tax brackets paid by estates and trusts on income retained in the trust. For example, retained net income over $15,650 (for 2025) is taxed at the 37% bracket. Plus, any state income taxes may result in another 5-10% in tax. By contrast, the longer the payments can be stretched out, the smaller each year's payment, and the smaller the tax bill, not to mention leaving more in the account to grow tax deferred.

Generally speaking, estates and ordinary revocable trusts won't be able to stretch payments out very far. While a trust or estate can reduce taxes by paying IRA distributions out to a beneficiary, who then pays tax at the beneficiary's much lower tax rate, this isn't likely the best approach for a beneficiary with special needs. Unfortunately, naming an estate or ordinary revocable trust as the beneficiary of an IRA can result in a quick required payout of the IRA and a high tax bill.

Retirement account distribution rules: A Primer

With a tax-deferred retirement account, the tax eventually comes due when the funds are withdrawn. There are two basic concepts used to determine how and when retirement accounts pay out: the required beginning date (RBD), which is the date when the owner has to take distributions and start paying taxes on them; and the required minimum distributions (RMDs), which are the required amounts that have to be taken each year.

First, the RBD starts the distributions. Historically, the RBD for employer plans was when the person retired, or April 1st after turning age 70½; and for IRAs, the RBD was April 1st following the year the owner turned 70½. The RBD was changed to age 72 starting in 2020, and in 2023, it changed again to age 73, with an increase to age 75 for those born in 1960 or later.

Second, the RMD is the amount to be distributed each year beginning with that RBD. To compute the annual amounts, the IRS in 2001 set up a “Uniform Lifetime Table” for account owners. (For boring historical reasons, this is based on the joint life expectancy of the owner and a hypothetical spouse ten years younger. Those who have even younger spouses have slightly more complex rules.)

Required minimum distributions after the owner's death

The distribution requirements change when the account owner or plan participant dies. Before 2020, it was possible to "stretch" the required minimum distributions over the beneficiary's life expectancy. However, in 2020, that all changed with the SECURE Act, along with additional changes in 2023 with SECURE 2.0. Until the IRS issued its final regulations in July 2024, there was some confusion about how the withdrawal rules applied, but most of those questions have been resolved. However, with all these changes, you may have heard different things from different people and seen different things online.

With the SECURE Act, in general, for most (but not all) beneficiaries, the longest "stretch" payout allowed is now ten years (or for a minor, until age thirty-one). The exceptions do include beneficiaries who are disabled, which is why you are reading this article. Whether or not a trust can get the same treatment as a person with a disability depends on various factors.

Here is how payout from a retirement account works. First, payout after death depends upon whether the death was before or after the RBD. Second, payout after death depends on whether there is a designated beneficiary. Third, payout after death now depends upon who that designated beneficiary is.

Let's start where the owner dies **before the RBD**. The default rule in this situation is a five-year payout; nothing has to be paid out immediately, but all has to be paid out by Dec. 31 of the year, which is the fifth anniversary of death. This applies when there is no designated beneficiary, for example, if no beneficiary was named or the beneficiary was "my estate" or "my revocable trust." In contrast, if there is a designated beneficiary, the payout is ordinarily ten years. Even ten years isn't very long, but there are exceptions for an eligible designated beneficiary (EDB). We'll get to these later.

If the owner dies on or **after the RBD,** distributions are based on whether there is a designated beneficiary and who that is. Where there is no designated beneficiary, the default rule is that the remainder of the owner’s life expectancy (computed using the Single Life table) will determine RMDs. This is sometimes called the "ghost" life expectancy since it's based on the dead person's age. Sometimes, that's not so bad -- someone age 75 has a life expectancy of 13.4 years, but it may still be shorter than an EDB’s life expectancy. However, if someone who dies on or after the RBD has a designated beneficiary, there are two rules. First, annual distributions are still required because the deceased owner was already taking distributions, and the law says that the distribution method after death has to be "at least as rapidly" as the existing distribution method. (Between 2020 and 2022, a lot of people thought they were not required, so there are special penalty waivers for people who didn't take them at that time.) These annual distributions won't be based on the dead person's "ghost" life expectancy but on the designated beneficiary's life expectancy based on the Single Life Table, which has shorter life expectancies than were used to compute the owner's distributions. Second, the maximum payout is ten years

unless the designated beneficiary is an EDB. For an adult designated beneficiary who takes the required distribution for each of the first nine years, there will be a balloon payment in year ten—a big payout and big taxes, usually. However, there are different rules if the designated beneficiary is an EDB.

Eligible designated beneficiaries

These beneficiaries are known as EDBs:

- Spouse (the rules for spouses are beyond the scope of this article);
- Person not more than ten years younger than account owner/participant (think sibling or friend);
- Minor child of the owner (instead of ten years, substitute "age thirty-one"); and
- Person who is "disabled" or "chronically ill."

We are most interested in EDB #4 -- the disabled or chronically ill beneficiary. For that EDB, the distribution can be over the beneficiary's life expectancy, although this is computed according to the Single Life Table, which differs from the Uniform Lifetime Table used for account owners. The term "disabled" has the same meaning that Social Security uses: unable to engage in substantial gainful activity (SGA) for at least twelve years or, if ending sooner, in death. For 2025, SGA is $1620, more if the person is blind. The term "chronically ill" means unable (for an indefinite, lengthy period) to perform unassisted two or more activities of daily living.

This preferential treatment for beneficiaries who are disabled or chronically ill may extend to SNTs, provided the trusts meet certain criteria.

See-through trusts

Before we look at distributions to an SNT, here are some basics about distributions to certain trusts. To get even the ten-year payout available for the average designated beneficiary, a trust has to be a "see-through trust," where (1) all the first- and second-line beneficiaries can be identified and (2) (with one exception) all are individuals. This has to be the case by September 30th of the year after death, or if the trust doesn't qualify, the Trustee can try to fix it by the due date if the law allows.

These see-through trust rules apply to most trusts considered "accumulation" trusts. With an accumulation trust, the trustee has the discretion either to pay out or to retain in trust any IRA distributions the trustee receives. Most SNTs are accumulation trusts. A different type of trust called a "conduit" trust requires that all distributions from retirement accounts be paid out immediately to the beneficiary. For a conduit trust, only the conduit payee, the beneficiary receiving those distributions, is counted, even if a charity is the remainder beneficiary for whatever is left of the IRA at the conduit payee's death. The second-line beneficiaries don't count. But this is unusual; most people do not create trusts

to just pass the IRA money right out to the beneficiary, certainly not for their child with a disability.

Even the ten-year rule for a "see-through" trust is not great for a large IRA. For example, if the account owner has a $1 million IRA, that would mean that $100,000 per year would have to be paid to the trust and subject to income tax if retained rather than spent on the beneficiary in the year of receipt. Most people who set up lifetime trusts for their beneficiaries do not intend for the beneficiaries to receive the trust funds over ten years. In this scenario, if $20,000 were paid out each year for the beneficiary's needs and $80,000 retained, the trust would likely pay over $27,500 in federal income taxes.

How to ensure that a special needs trust gets better treatment

Thanks to advocacy from the Special Needs Alliance and other disability groups, much better rules apply when it comes to trusts for individuals who are disabled or chronically ill. You can read this linked *Voice®* article for a discussion of this issue and the related advocacy by the Special Needs Alliance.

First, the SECURE Act allows beneficiaries who are disabled or chronically ill to "stretch" payments from inherited retirement accounts over their actuarial life expectancies (not the ten-year rule, the five-year rule, or the ghost life expectancy). Someone age thirty has a fifty-five-year life expectancy!

Second, the SECURE Act allows a trust for the "sole benefit" of a person who is disabled or chronically ill to stretch the distribution in the same way over that person's life expectancy.

But the devil is in the details, and there was initial concern about whether certain SNTs would qualify. One concern was whether naming a charity as remainder beneficiary would cause the trust to fail, because a charity was not an individual, so it seemed the trust would fail the "see-through trust" rules. Another concern was about the many trusts that have "poison pill" provisions allowing the trustee to distribute trust funds to another, non-disabled person if the state threatens the disabled person’s benefits on account of the trust's existence. A third concern was about how to prove that the beneficiary was, in fact, an EDB in the first place, that is, whether a Social Security determination of disability was required.

SECURE 2.0 and regulations issued in 2024 resolved these concerns. But, as is often the case, there is good and bad news. The first good news is that with SECURE 2.0, enacted in December 2023, Congress clarified that when it comes to the "see-through" trust rules, a charity that is a first-line remainder beneficiary of a trust for the sole benefit of a disabled or chronically ill person will be treated as if it did qualify as a designated beneficiary. The trust won't flunk the "see-through trust" rules.

The second good news is that the July 2024 regulations clarify (indirectly) that a doctor's certification of disability may suffice when claiming disability. That was already the case for a "chronically ill" person, but the example in the regulations uses the definition of disability, not a chronic illness, when it describes getting a doctor's certification.

The bad news is that the July 2024 IRS regulations did confirm the fear that the "poison pill" provision will prevent the SNT's ability to take distribution over the beneficiary's lifetime, at least unless it can be fixed. If the trust can, under any circumstances, make distributions during the disabled or chronically ill person's lifetime for the benefit of anyone who is not disabled or chronically ill, it won't qualify for this SNT treatment but will be stuck with the regular rules applicable to other types of trusts. That means the ten-year rule at best, but a charitable remainder beneficiary will also disqualify it from it (unless the trust can get fixed by September 30th of the year after the owner's death).

The "Tweens" remain left out

Unfortunately, if your child does not qualify as disabled or chronically ill, for example, if you have a child on the autism spectrum who is so-called "high functioning" and able to work to some degree but not enough to be self-supporting, your child won't be an EDB, and the SNT exception won't work. Calling it a "special needs trust" won't do the trick. The trust will be stuck with the ten-year rule at best. For parents with children on the margin who may or may not qualify as disabled, the estate plan may require a lot of careful thought. You may even decide to convert your large IRA to a Roth IRA and pay the tax yourself rather than risk 37% or more in income tax on IRA distributions to your child's trust after your death. Clever tax lawyers may develop workarounds for this problem, but it won't be risk-free, easy, or simple.

Some Examples

Let's review. Go back to your child's SNT. Remember that a trust for the benefit of a person who is disabled or chronically ill and who is the only beneficiary during that beneficiary's lifetime should get the "stretch" payout over that beneficiary's actuarial life expectancy. Assume that you have named your child's SNT as a beneficiary of your retirement account or IRA. When it was drafted, you wanted to name the National Alliance on Mental Illness (NAMI) as the remainder beneficiary but were told this would defeat the "stretch" payout. With the new rules, you can name a charity if you want, and you also don't have to worry if you gave your child the power to decide who gets the money after their death -- the regulations don't care. You may want to go back and re-do the trust the way you wanted to originally.

But what if when you die, the trust is examined, and it contains that "poison pill" language, saying that if the trust causes ineligibility for benefits, it can be paid out to the child's brother? Is the trust doomed? Possibly. State laws may allow the trustee to modify the trust, and if this can be accomplished by September 30th of the year following death, it

should solve the problem. The trustee will have to move fast because modification may require court approval.

And what if you drew up an SNT some years ago as a beneficiary of your IRA because you believed your child would eventually qualify for government benefits, but in fact, your child has been able to earn $1800 per month at a low-wage job off and on? So, has there been no application for benefits from Social Security? The trust may no longer be a good option. You may consider naming your child as a beneficiary or encouraging the trustee to pay out RMDs directly to your child over the anticipated ten years.

Finally, what if your documents satisfy the rules perfectly, but you realize your trustee does not understand taxes very well? Might the trustee, ignorant of these rules, cash out the IRA and get a check? You may want to provide detailed instructions to your trustee or select one who understands complex tax issues.

Considerations in planning

There are many fine points and individual issues that your attorney should consider when drafting your trust and helping with the beneficiary forms. In general, though, if you need to name your child's SNT as a beneficiary of a retirement account, you should consider these issues carefully:

- The likely amount that will be in the account at your death. In other words, how important is it for this particular account to stretch distributions over your child's lifetime? Would the taxes be so high if paid over ten years? Is it small enough that you anticipate the trustee might decide to spend the money in five or ten years anyway? Of course, if you are young now, your account may be small, but it will likely grow over time, so you will have to monitor the situation.
- Your child's disability. Do you know for sure that your child will qualify as disabled or chronically ill? Has any determination of disability been made? If your child is not certain to be determined to be disabled, you have to consider seriously the problem of income retained in the trust. Discuss with your attorney ways to manage that tax component of the retirement accounts. Some options may include converting the accounts to Roth IRAs, designating your child as the beneficiary, or providing further instructions to the trustee.
- The trust document itself. If you've had a trust set up for your child years ago, re-examine it. Does it include the dreaded "poison pill" language or other language allowing distributions to those other than the child with a disability? If your child isn't disabled in the technical sense, did you name a charity as a beneficiary on the child's death?
- The trustee and instructions you can provide. Even if the documents seem perfect, will your trustee or account manager get the right advice when you die and arrange the distributions correctly? While having a trustee who can pay attention to details and bureaucratic requirements like filing tax returns is essential, it is essential when

an IRA will pay to the trust. The trustee must understand the legal and tax requirements or know how to engage well-qualified advisors who understand the goal.

There are also procedural requirements that must be met. For the IRS to look through a trust, it must be irrevocable as of the date of your death. In addition, the IRA custodian or retirement plan administrator must receive from the trustee either a copy of the trust document or a final list of all beneficiaries determined as of September 30 of the year following the year of death (certified by the trustee as correct and complete). Your trustee must ensure the I's are dotted and Ts crossed.

Traps for the unwary

There's one more "gotcha" trap that you ought to know about. The stretch is only available to the beneficiary with a disability (or other EDBs under the SECURE Act) or a trust for such a beneficiary while the beneficiary who is disabled is alive. The stretch is unavailable to successor beneficiaries who receive the retirement account after the initial beneficiary's death. At that point, the trust switches to the ten-year rule.

There are also a couple of traps for the unwary widow or widower. Suppose that John's IRA names his wife Helen as the primary beneficiary and their child's special needs trust as a contingent beneficiary. John then dies. Under IRS rules, Helen could "roll over" John's IRA funds into her own IRA and name her beneficiaries. This presents trap number one -- Helen must remember to name the trust, not the child. However, trap number two is if Helen dies without naming new beneficiaries. Because John's beneficiary was Helen, who survived him, even if she didn't roll over the account, it belonged to her. This means that if she dies, it goes to her estate. On her death, John's contingent beneficiary—the special needs trust—won't have the option to stretch the IRA over their child's lifetime but will be stuck with Helen's remaining life expectancy (which is likely to be a lot shorter than the child's). In other words, the typical married couple, who leaves everything to each other and only on death to the trust, should ensure that the surviving spouse remembers to name the trust as the new primary beneficiary. If there are concerns about the survivor's ability to carry out these steps, it's wise to include in the survivor's durable power of attorney document a power authorizing the agent to take these actions to roll over the account and designate the special needs trust as the new primary beneficiary.

As is often the case, what seems like a simple process that anyone can do without legal advice is not at all simple. Indeed, the naïve belief that you can go online and fill out a form to designate your trust as beneficiary of your retirement accounts can easily result in an income tax or public benefits eligibility disaster. If your estate plan makes your trust a beneficiary of your retirement plans, you should seek advice from a competent special needs attorney.

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