IRA Wins Oscar for Best Tax Performance in a Testamentary Charitable Gift

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Traditional IRAs
During Owner's Life

Introduction

- Tax deferred growth
- Ownership issues
- SEP IRAs/SIMPLE IRAs/qualified retirement plans are different from traditional IRAs.
- Roth IRAs are *very* different.

IRA Pre-mature Distributions/ Partial Withdrawals

Taxed as ordinary income

For simplicity purposes – we'll assume no after tax contributions

IRA premature distributions - withdrawals before age 59½

IRS 10 percent penalty tax under IRC 72(t)

Exceptions to the 10% tax in IRC 72(t):

- Death
- Disability
- Qualified higher education
- First-time homebuyer
- Substantially equal periodic payments
- Etc.

IRA Lifetime Required Minimum Distributions

Must begin by the Required Beginning Date:

1. When is the Required Beginning Date (RBD)?

   April 1 following the year the participant turns age 70½.

   The second distribution is due by 12/31 of that same calendar year.
2. Distribution amount = 12/31 account balance for year before participant turns age 70½ divided by participant's life expectancy factor from IRS Uniform Lifetime Table
3. 50% penalty tax on the amount that should have been taken but wasn't

IRA Lifetime Required Minimum Distributions

4. Example:

- Beth is age 70½ on January 31, 2017
- Required Beginning Date is April 1, 2018
- First distribution from the IRA is due April 1, 2018 and is based on 12/31/2016 account balance ($100,000) divided by factor from Uniform Lifetime Table (26.5)
- RMD for 2017 = $3,773.58
- RMD for 2018 is 12/31/2017 account balance / 25.6

IRA Lifetime Required Minimum Distributions

4. Example continued:

- If Beth only takes out $2,000 instead of the full $3,773.58, the penalty tax is applied against the amount that should have been taken but wasn't:

  $3,773.58
  – $2,000.00
  $1,773.58 x .50 = $886.79 penalty owed – report and pay on IRS Form 1040

IRA Lifetime Required Minimum Distributions

5. If you have more than one IRA, how do you determine the total distribution?
6. Can you take the amount out of each account or all from just one account?
7. What if you have an IRA and 401(k)? – can you aggregate?
8. Does the IRA administrator report the amount of the RMD to the IRS?

Lifetime Gifts Using IRA Funds

Gifts to spouse during life

- Cannot be given to a spouse during the IRA owner's lifetime. Instead, the IRA must be surrendered for cash. Surrendered amount is ordinary income to IRA owner.
- If incident to a divorce, a judge may grant the transfer into name of other spouse per court order. (Note: For Section 403(b) accounts, a QDRO is needed and the receiving spouse has 60 days to Rollover to avoid a taxable event).

Lifetime Gifts Using IRA Funds

Gifts to family/heirs/noncharities

- IRAs cannot be given to another person. Need to surrender for cash….then taxed to the owner as ordinary income.
- Penalty taxes could apply if the transferor is under age 59½ without an exception applying

Lifetime IRA Gifts To Charity

- IRAs themselves cannot be given to charity.
- Must be surrendered for cash like gifts to non-charities.
- Typically, the full amount surrendered is taxed to the IRA owner as ordinary income.
- An itemized income tax deduction would be available, however, for the amount of the cash proceeds donated to charity if he/she itemizes.
- However, this may not be a pure wash.
- **Exception: Charitable IRA Rollover

Example: Lifetime Gift

- **Laura has $300,000 in her IRA.**
- **She wants to give $50,000 toward a capital campaign.**
- **She would have to withdraw $50,000 from the IRA.**
- **She would have to pay income tax on the $50,000.**

- Laura can make a gift of $50,000 (or a smaller gift since she'll have to pay income tax).
- She can deduct her gift up to 60% of her AGI.
- What if her AGI is only $80,000, including the withdrawal?
- What's her deduction?

Results:

- The best-case scenario is a tax wash.
- This is not a good result for her since she's expecting to come out ahead tax wise.
- Laura's better off giving stock or cash from a tax standpoint.

Lifetime Gifts: Charitable IRA Rollover

- Started in 2006……now permanent legislation (QCD)
- 70½ or older at time of gift
- IRAs & Roths only (not qualified retirement plans)
- Direct transfer from IRA to qualified charities
- Maximum $100,000 per taxpayer per year
- Outright gift; no CGA/CRT; no private benefits
- No federal deduction, however not taxable income (Line 15a IRS Form 1040)
- Can't go to private foundations, supporting orgs or donor advised funds
- Can satisfy RMDs

IRAs
At the Owner's Death

Leave to Family at Death

- **Pension, profit-sharing, IRAs, etc., are all 100% includible in the deceased's estate for federal estate tax purposes. But less than 1% of the population will be subject to estate tax.**
- **The heir/beneficiary must pay income taxes on the plan assets, too, from the first $1.**
- **Plans will all be taxed at least once and can even be taxed twice by the IRS—once for income tax and a second time for estate tax.**

Naming a Spouse as Sole Beneficiary of IRAs

- A spouse as beneficiary -- if the spouse cashes in the proceeds, typically the entire amount is subject to ordinary income tax.
- Can the spouse defer that tax? Yes, a spouse as sole beneficiary can roll over the death proceeds into his or her own IRA—a Spousal Rollover IRA—and defer taking any required minimum distributions until the surviving spouses reaches his or her own required beginning date (RBD).

Naming a Spouse as Sole Beneficiary of IRAs

- If the surviving spouse was **older** than the deceased spouse and the deceased spouse had not reached his or her RBD, the surviving spouse may choose to leave the IRA as is—meaning in the name of the deceased spouse – allowing the surviving spouse to wait to begin receiving distributions until the deceased spouse would have reached his or her RBD.
- Deceased is age 65; surviving spouse is age 73

Naming a Non-Spouse as Beneficiary of IRAs

The downside of leaving an IRA to family/heirs/noncharities –

- The nonspouse beneficiary will be subject to income tax on the full amount of the death proceeds because there is typically no cost basis to offset the taxable amount.
- Can the nonspouse beneficiary defer that tax in any way? Yes, the beneficiary can stretch out the receipt of his or her death benefit and defer tax.
- The income taxes are not eliminated, however—they are postponed. Called a "stretch" or "inherited' or "beneficiary" IRA. Does not have the exact same benefits as a spousal IRA.

Required Minimum Distribution Rules AFTER the IRA Owner's Death

- Must first know if death occurred before or after the Required Beginning Date.
- Must secondly know if the owner named a Designated Beneficiary (DB) or not.
- A DB is a person, only certain trusts (e.g., see through trust). A DB is **not** a charity or an estate or certain other trusts.

Required Minimum Distribution Rules AFTER the IRA Owner's Death

- If the owner died BEFORE the RBD and named a DB, the *minimum* distribution options are:
  - Over the life expectancy of the beneficiary starting in the year following the year of death using a single life expectancy table, or
  - The five year rule (can wait and take it all in the 5th year)
- Without a DB, the minimum distribution period is the five year rule.
- Can always take out more than the minimum.

Required Minimum Distribution Rules AFTER the IRA Owner's Death

- If the owner died on or AFTER the RBD and named a DB, the minimum distribution options are the longer of:
  - life expectancy of the beneficiary or
  - the deceased owner's resurrected remaining life expectancy
- Without a DB, the minimum is the deceased owner's resurrected remaining life expectancy
- The beneficiary can always take out more than the minimum

Required Minimum Distribution Rules AFTER the IRA Owner's Death

- September 30th of the year following the year of the IRA owner's death is when we determine if there is a DB or not
- Eliminate those who don't want to "stretch" their IRA distributions by paying them before September 30

After IRA Owner's Death: Beneficiary's Required *Minimum* Distributions

	IRA Owner's Death *Before* RBD	IRA Owner's Death *After* RBD
Designated Beneficiary	Over the beneficiary's life expectancy	Longer of: bene's LE or Deceased owner's resurrected LE
No Designated Beneficiary	Distribute entire account within 5 years of death	Deceased owner's resurrected LE

Charitable Gift of IRA Assets at Death:

The "Smarter Gift"

People Look for Significance

"We make a living by what we get, but we make a life by what we give."

-Sir Winston Churchill

Prospective Donor Profile

- Someone with an IRA or other qualified retirement plan account.
- Does not like the fact that estate and income taxes may consume 60% or more of the asset.
- Is not looking for a current tax deduction

Donor Profile (contd.)

- Is interested in making a gift after death more than in life
- Has other assets to provide for a spouse and loved ones.

Making the Match

"If you plan to leave something to charity in your estate plan, could I share with you a way to make sure the best assets are used for the gift to minimize the loss in taxes?"

Benefits:

1. Retirement assets remain available for life.
2. Deduction for estate for amount to charity.
3. Donor retains ability to change beneficiary.
4. Leaves more to heirs than simple bequest of same amount from other assets.

Retirement Plan Example

- Fred is 65 years old.
- He has $700,000 in an IRA.
- Fred names Charity XYZ as the beneficiary of the IRA.
- He has full ownership and access his entire life.

Contrast Bequest & IRA Gift
("Starter Gift" vs. "Smarter Gift")

Additional Assumptions for Fred:

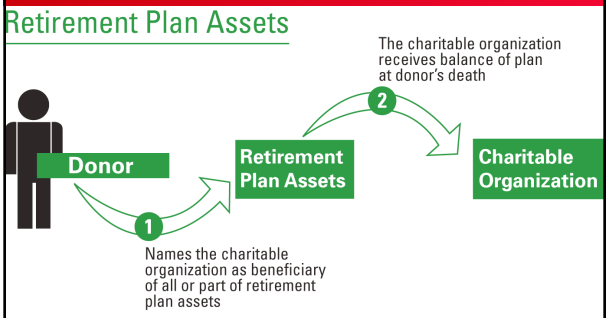
- IRA: $ 700,000
- Other Assets: $1,800,000
- Total Estate Value: $2,500,000

- Federal income tax rate: 24%
- Fred wants $700,000 to charity, rest to heirs
- Fred is a widower with children

Retirement Plan Results

- Charity XYZ receives $700,000 at Fred's death.
- The IRA escapes income taxes and any applicable estate tax
- His taxable estate value is reduced by the amount of the gift
- He leaves to heirs assets that are not taxable rather than an asset that would have been subject to income and perhaps estate taxes

Retirement Plan Assets



Shift in Paradigm

- Many charitable bequests in wills could be more efficiently made directly as a beneficiary from a qualified plan/IRA

Contrast Bequest & IRA Gift
("Starter Gift" vs. "Smarter Gift")

Death in 2019
($11.4 Million Federal Estate Tax Exemption)

BEQUEST IN WILL TO CHARITY	
Estate Value	$2,500,000
Income Tax (24%)	($ 168,000)
Estate Tax	($ 0)
TOTAL to Taxes	$ 168,000
TOTAL to Charity	$ 700,000
TOTAL to Heirs	$1,632,000

IRA BENEFICIARY TO CHARITY	
Estate Value	$2,500,000
Income Tax (24%)	($ 0)
Estate Tax	($ 0)
TOTAL to Taxes	$ 0
TOTAL to Charity	$ 700,000
TOTAL to Heirs	$1,800,000

NET GAIN TO HEIRS: $168,000

Naming a Charity as Beneficiary of Qualified Plans and IRAs

- Simple to implement in that the client only needs to change the account's beneficiary designation to charity
- Eliminates income and estate tax on amount given to charity at death.
- Best to avoid running this account through the will or trust if at all possible – complex drafting required and special language instructing all charitable gifts to be made from IRD assets

Naming a Charity as Beneficiary of Qualified Plans and IRAs

- Donor retains total access and control over the qualified plan values during his/her lifetime – can change investment allocations, etc.
- Donor can still change the plan beneficiary at any time in the future if desired
- However, the amount of the gift can vary up or down
- Gift can unwind if not careful when changing custodians

Technical Points

- The spouse, if any, needs to consent to changing the qualified plan beneficiary to someone other than the spouse or to a charity.
- Spousal consent not required for IRA accounts unless community property.

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Take it to the Next Level

IRA flowing to a Spousal T-CRUT

- IRA's primary beneficiary: a Testamentary CRUT (TCRUT). Spouse as sole income beneficiary of the CRT
- Tax exempt status of the CRT – allows IRA to avoid **immediate** taxation when in CRT
- Works when surviving spouse doesn't need access to the IRA outright. SS has less control
- Prevents surviving spouse from leaving these assets to a future spouse

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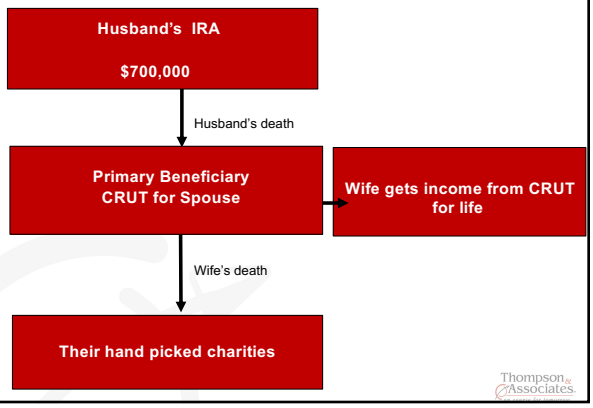
Testamentary CRUT for Spouse



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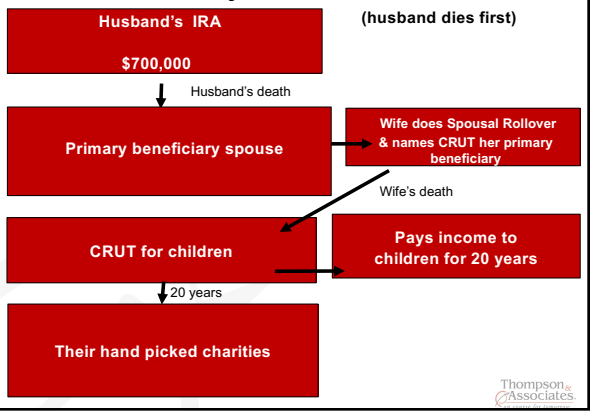
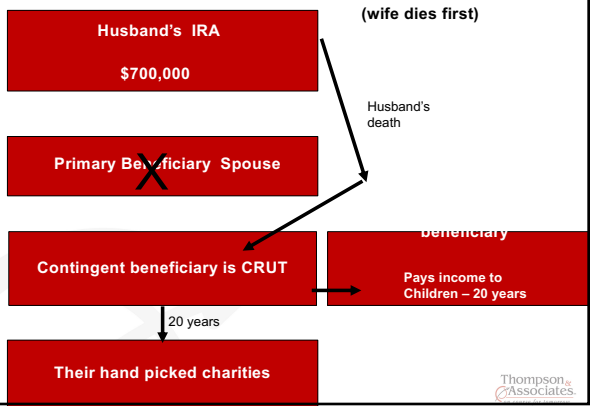
IRA Flowing to a T-CRUT

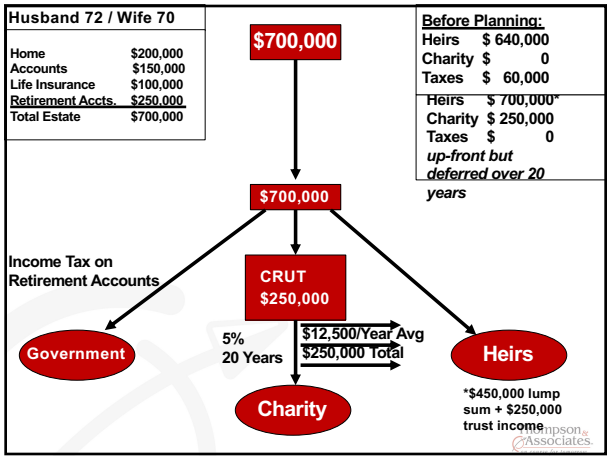
- Husband has IRA; wife is primary beneficiary
- The CRT can be a ***contingent*** beneficiary on husband's IRA.
- If wife is the SS, she does a spousal rollover first then names the CRT as her primary beneficiary.
- Then at her death IRA flows to the CRT. Or, if he dies second.
- CRT pays income to the children for perhaps 20 years (possibly life), thereafter to hand-picked charities

Testamentary CRUT for Children



Testamentary CRUT for Children





IRA Flowing to a T-CRUT

- All income paid out from this CRT funded by the IRA is taxable income (Tier 1)

IRA Flowing to a T-CRUT

Donor simply completes a change of beneficiary form with the insurance company.

Example

- Mary Ellen dies in 2019
- $700,000 IRA
- Sarah age 46 beneficiary

Example

Choices:

- 1. If lump sum, after-tax Sarah receives $532,000
- 2. Or, Sarah can do a stretch-IRA
- 3. Or, mom could have set up a charitable remainder trust as the beneficiary of her IRA

Charitable Trust Example

- Sarah would be the CRT income beneficiary (ex. 5%) for 20 years
- Remainder of CRT to Mary Ellen's charities – possibly all $700,000
- Defers income taxes owed by Sarah over 20 year period
- Charities receive the remainder after 20 years
- Plus, partial estate tax charitable deduction for the remainder interest were Mary Ellen's estate to need it

Alternative: Give to a CGA at Death

- If the IRA is to fund a CGA at death, the CGA payments are all taxable income – there is no cost basis.
- Plus, the present value of the remainder interest of the CGA qualifies for an estate tax charitable deduction.
- The IRA owner's final income tax return will deduct the estate taxes paid as an income tax deduction.
- Donor simply completes a change of beneficiary form with the insurance company.

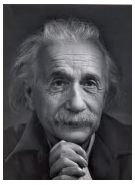
Alternative: Give to a Pooled Income Fund or Charitable Lead Trust

- Because both of these are taxable entities, naming these entities as the beneficiary of the IRA will cause taxable issues.
- Therefore, not a good tax planning result.

IRA Death Claims

- Lag time with some IRA administrators when paying death claims to charities
- Why they do it
- How to get your claim paid

People care about their legacy



"It is the responsibility of every human being to aspire to do* something worthwhile*, to make this world a better place than the one they found."

-Albert Einstein

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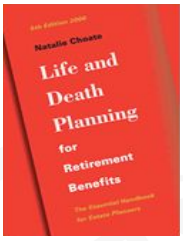

Life and Death Planning for Retirement Benefits, 7th Edition, by Natalie Choate, published by Ataxplan Publications

For more information, contact:

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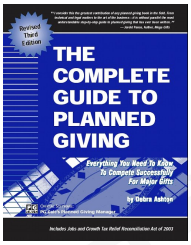
Book for Charity Staff



The Complete Guide to Planned Giving, 3rd Edition, by Debra Ashton, published by Ashton & Associates

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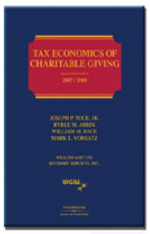

Tax Economics of Charitable Giving, 2018/2019 Edition, published by Warren Gorham and Lamont of RIA

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Related Papers & Web Sites

- 2016 Paper by Christopher Hoyt, *"FAMILY AND CHARITABLE PLANNING WITH RETIREMENT ACCOUNTS"*
- www.IRAhelp.com - Ed Slott's website
- www.charitableplanning.com - Emanuel Kallina, resource for professional advisors and gift planners: subscription required, daily e-mail available – **20% discount to NCGP members**!
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