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Futures

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A no-nonsense newsletter for estate planners and financial advisors from The Dayton Foundation

Optimizing the Use of Retirement Plans and IRA Benefits for Charitable Giving Purposes

By John M. Cloud, Esq., Rogers & Greenberg, LLP

Some time ago, I wrote an article for *Futures,* in which I outlined techniques for using individual retirement accounts (IRAs) and qualified retirement plans (QRPs) to satisfy charitable giving objectives.

My main premise in that article was that individuals who wish to make charitable bequests should consider making them with their QRPs and IRAs – and other assets that generate income in respect of the decedent (IRD), such as employee stock options, installment sale notes, savings bonds, annuity contracts and deferred compensation payments. As a means of accomplishing this, you might focus on the designation of beneficiary form to name The Dayton Foundation or your favorite charity, rather than the will or trust, as the key document in making a charitable bequest.

"...individuals who wish to make charitable bequests should consider making them with their qualified retirement plan and individual retirement accounts...."

– John M. Cloud

Non-IRD assets, on the other hand, are more appropriately left to their non-charitable beneficiaries, since these assets are not subject to the income taxes that IRAs and QRPs are.

JOHN M. CLOUD, ESQ.

If the estate or trust already is designated as the beneficiary of the QRP or IRA, be prepared to obtain essentially the same result as a direct designation of the charity(ies) beneficiary by including a provision in the will or trust. The provision might read, "To the extent possible, all of my charitable bequests contained herein shall be satisfied with property that constitutes 'income in respect of the Decedent,' as that term is defined in the U.S. Income Tax Laws." Such a catch-all clause will enable the estate or trust to claim both an income tax deduction and an estate tax charitable deduction for any kind of IRD assets that it holds.

Assuming there are both charitable and non-charitable beneficiaries, in order to further insure that the executor or trustee will have sufficient flexibility to accomplish the desired tax result on a postmortem basis, give him or her the discretion to make non-pro-rata distributions of IRD assets. In several Private Letter Rulings (PLRs), the IRS has sanctioned such a catch-all provision as a means of enabling the executor or trustee to still allocate the IRD assets to the charitable beneficiary(ies) and the non-IRD assets to the individual beneficiaries without it constituting a taxable exchange among the beneficiaries.

Distribution of IRAs and QRPs to a Charitable Remainder Trust

For estates not subject to a federal estate tax liability, estate planners should consider a Charitable Remainder Trust (CRT), rather than a stretch IRA, as the beneficiary of an IRA or QRP any time a client expresses an interest in a sequence of beneficiaries, ending with a charity. That is because a CRT is tax exempt and therefore it is possible to defer income taxation of the IRA and QRP until the CRT actually makes a distribution to the income beneficiary(ies).

Another advantage of a CRT over a stretch IRA is that whereas the stretch IRA regulations adopted in 2002 require distributions to be made from an IRA over a time period that does not extend beyond the life expectancy of the oldest beneficiary, the term of a CRT can last until the final (and usually youngest) beneficiary dies.

There are two important caveats to these advantages of using a CRT over a stretch IRA in this scenario. First of all, this technique probably will not work for the very small percentage of estates that exceed \$3.5 million and that remain subject to a federal estate tax liability. That is because it still is the position of the IRS (see PLR 199901023) that a transfer of an IRA or a QRP (or any other IRD asset) to a CRT will strip away the Section 691(c) income tax deduction that the income beneficiaries of the CRT would otherwise have for any estate tax paid on the IRD item.

The second caveat is that the stretch-out CRT probably will not work if there are multiple income beneficiaries under age 40 (or a single income beneficiary under age 30). That is because the present value of the charitable deduction for a contribution to a CRT must be at least 10% of the value of the property contributed, and the longer a trust is expected to last, the lower the present value of the remainder interest.

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Land Mine Avoidance

Before the 2002 IRA regulations, if a penny was payable to a charity upon an IRA owner's death, this prevented all of the other beneficiaries who otherwise would qualify for extended payment treatment over their life expectancies from getting such treatment. (This is just another example of how a good deed never goes unpunished.) This Draconian result was corrected under the 2002 regulations, however, but only if one of two protective measures is taken.

The first is to complete the distribution to the charitable beneficiary by September 30 of the year following the year of the decedent's death. If this is done, then the charitable beneficiary does not exist on the so-called "beneficiary determination date" (September 30 of the year following the year of death) and will not affect the payout periods for beneficiaries who otherwise qualify as "designated beneficiaries." The other safeguard simply is to establish a separate rollover IRA sub-account for the charity's share, which would allow the distribution to the other beneficiaries to be computed without regard to the account for the charity.

IRA Charitable Rollovers Still Are Useful, While They Last

The Pension Protection Act of 2006 created a new exclusion from gross income for otherwise taxable IRA distributions that are made to qualified charities. Under these IRA qualified charitable distribution rules, amounts up to $100,000 *each year* may be distributed tax free as long as: (1) the distribution is made directly by the IRA trustee to a qualified charity, (which may include a donor-designated fund at The Dayton Foundation); and (2) the IRA owner has attained at least the age of 70-1/2.

This charitable rollover provision is useful as follows. Even though the IRA owner receives no charitable income tax deduction for the taxable portion of the IRA (since it never was included in his income), he would be free from the 50% adjusted gross income limitation that likely would be triggered if a large IRA distribution was taken as ordinary income and then contributed to charity.

This charitable rollover provision was adopted originally only for 2006 and 2007, but later was extended in the Economic Stimulus Act of 2008 for 2008 and 2009. This effective device therefore still can be used for at least this year. ❧

Note: Solutions will differ from case to case. The above does not constitute professional financial or tax advice.

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If you have clients who are charitably minded and also have been fortunate enough to have experienced an increased value in their stock portfolio due to the recent stock market upturn, The Dayton Foundation's Charitable Checking Account℠ (CCA) Service may be just the answer they've been looking for.

By donating appreciated shares to The Dayton Foundation for their CCAs before selling them, your clients will benefit from a charitable income tax deduction in the current tax year and gain the full value of the asset for their charitable purposes, undiminished by long-term capital gains tax.

If you have clients who are looking for a better way to manage the increase in charitable requests brought on by an unstable economy, the CCA Service can make budgeting for annual charitable gifts and accommodating unexpected requests for charitable support easier, more efficient and tax-wise. Your clients may deposit assets into their account when it's most tax advantageous for them and distribute the funds to charity at any time.

Other CCA benefits include:

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❧ simplified tax reporting and record keeping with quarterly and year-end statements; and

❧ no minimum deposit or balance required and no fees!

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