

[Bill Laskin](#) - Tue, 3/13/2018 - 16:07

The charitable IRA rollover has received a lot of attention from gift planners over the last few years. Since it was made permanent by the PATH Act in late 2015, gift planners across the country have re-doubled their efforts to let their supporters know about this tax efficient way to give. Many are finding success, too. Over one-third of the respondents to a recent poll of PG Calc webinar attendees said their organization had received over 20 charitable IRA rollover gifts in the past year. A couple indicated their organization had received over 100 such gifts!

In your excitement over attracting charitable IRA rollover gifts, however, don't forget a source of gifts with much greater potential: transfers of retirement plan assets at the donor's death. This source of gifts offers several big advantages over the charitable IRA rollover:

1. All qualified retirement plans, including 401(k)s and 403(b)s, can be used to make tax-efficient charitable gifts at the owner's death, not just traditional IRAs.
2. The donor doesn't have to attain 70½ years old or any other age to be eligible.
3. The retirement plan assets can be used to fund a life income plan as well as be given outright.
4. For a variety of reasons, most donors are comfortable making bequest gifts that are many times larger than the gifts they are willing to make during life.

## **Taxation of Retirement Plan Assets**

Typically, the assets in a retirement plan or individual retirement account (IRA) have never been taxed until they are distributed. Consequently, these distributions are subject to income tax at the beneficiary's income tax rate, which can be as high as 37%, more if the beneficiary resides in a state with an income tax. Other assets in an estate, such as cash, securities, tangible personal property, and real estate, are not subject to income tax when they are passed on to heirs. So, at a minimum, using retirement plan assets to make charitable gifts at death rather than other assets will avoid all income taxes.

In addition, retirement plan assets given at death are subject to estate tax. If grandchildren (or other "skip persons") receive the distribution, generation skipping tax also applies. That's potentially three separate federal taxes! For the small fraction of estates large enough to pay estate tax, retirement plan assets can be assessed a combined tax rate of over 70%. In some states, 85% or more is possible.

To the extent that a donor wishes to make charitable gifts at her death, she can reduce these taxes the most by funding these gifts first with what remains in her retirement account. If that amount is not sufficient, only then does it make tax sense to use other assets in the estate to make up the difference.

## **Outright Gifts**

The simplest way to make a gift of retirement plan assets at death is outright. The donor requests a beneficiary designation form from the plan administrator, identifies the charity or charities she wishes to designate as beneficiaries of the plan when she dies, including the percentage of the remaining balance each charity should receive, then returns the form to the administrator. Most retirement plan administrators will insist that the owner designate a percentage of the remainder, rather than a specific dollar amount, since it is uncertain what the plan balance will be when the donor dies. It is best that any restrictions on how the charity may use the funds be described in a document provided to the charity rather than on the beneficiary designation form itself. This approach assures that the charity is aware of the restrictions and gives it the opportunity to discuss with the donor any questions about them.

## **Charitable Remainder Trusts**

For donors who wish to support your charity with an estate gift and provide an income stream to one or more heirs, using retirement plan assets to fund a testamentary charitable remainder trust (TCRT) can be a good way to accomplish both goals. In a series of positive private letter rulings, starting with PLR 9237020 and PLR 9253038, the IRS has indicated that such a transfer would not trigger federal income tax on the entire balance. Rather, this income tax is applied only as this income is distributed to the income beneficiaries of the charitable remainder trust according to the usual four-tier system. Although a private letter ruling may be relied upon only by the taxpayer who requests it, many gift planners feel comfortable applying this opinion to other similar gifts. There is also general

agreement that a similar transfer made during life *will* trigger income taxation.

Since only a very few estates are large enough to owe estate tax, such a transfer typically creates no federal estate tax. For estates that *are* large enough to owe federal estate tax, a transfer of retirement plan assets into a charitable remainder trust is eligible for an estate tax deduction equal to the charitable remainder value of the trust. As a result, even with very large estates, retirement plan assets that are designated to fund a charitable remainder trust at the owner's death are typically subject to a combined tax rate of 20% or less.

The dramatic reduction in taxes makes funding a TCRT at death a very low-cost gift for the donor's heirs and charity.

## An Example

Suppose you meet with a retired doctor, age 80, who is a devoted supporter of your charity and learn that she has a \$3 million IRA and a total estate of \$15 million. She is widowed. Armed with this knowledge, you compare the benefits if she were to die today and transfer the IRA directly to her 60 year-old son or to a 5% unitrust (CRU) for the benefit of her son.

	<b>Direct to Son</b>	<b>Transfer to 5% CRUT</b>
<b>Estate</b>	\$15,000,000	\$15,000,000
<b>Transfer from IRA</b>	\$3,000,000	\$3,000,000
<b>Federal income tax on IRA assets</b>	\$666,666	\$0
<b>Federal estate tax on IRA assets</b>	\$1,200,000	\$740,856
<b>Total taxes on IRA assets</b>	\$1,866,666 (62.2%)	\$740,856 (24.7%)

<b>Total taxes on rest of estate</b>	\$328,000	\$328,000
<b>Net to heirs from estate</b>	\$12,806,000	\$10,931,144
<b>Total income payments (est.)</b>	\$0	\$5,163,971 (PV @ 4%: \$3,104,450)
<b>Total benefit to heirs (est.)</b>	\$12,806,000	\$14,035,594
<b>Total benefit to charity (est.)</b>	\$0	\$6,098,382 (PV @ 4%: \$2,397,110)

You can see that her heirs, including her son, would receive directly from her estate about \$1,875,000 more directly from her estate, net of taxes, than if the \$3 million IRA were used to fund a 5% CRUT with her son as the income beneficiary (see *Net to heirs from estate* in the table). But that's only part of the story. If we assume the unitrust will earn an annual investment return of 8%, the son will receive from the unitrust over his life expectancy income payments in excess of \$5 million. Even if you discount these payments for inflation at 4%/year, they will be worth over \$3.1 million. Add this benefit to the net to heirs and overall they will be better off if her IRA is transferred to the CRUT. And, of course, the charity will receive the remainder of the CRUT when the son dies, estimated to be over \$6 million.

## Charitable Gift Annuities

A donor can accomplish similar goals by funding a charitable gift annuity with assets left in her retirement plan. The numbers will work out somewhat differently and will depend on the age of the annuitant and the annuity rate offered. Per an IRS ruling in PLR 200230018, the assets transferred to fund the gift annuity will not be included in the donor's estate for income tax purposes and the estate will be allowed a deduction for the charity's interest in the assets. The IRS declined to rule on the taxable character of the annuity payments, so the conservative approach is to treat payments as entirely ordinary income.

Funding a gift annuity rather than a charitable remainder trust may be more attractive to donors who are already familiar with gift annuities because they have funded one during life, who like the relative simplicity of setting one up, or who are considering a gift amount that is too small to support the administrative costs of a charitable remainder trust.

## **How to Illustrate a Testamentary Retirement Plan Gift in PGM**

To illustrate in *Planned Giving Manager* the benefits of funding a testamentary charitable remainder trust or gift annuity funded with retirement plan assets:

1. Run *Life Income Projections*
2. Open Presentation Selection and select the estate plan charts or diagrams.
3. Open Type of Plan to Model, then select *Testamentary gift of retirement plan or IRD*. Click *More* at the bottom of the window to enter facts about the donor's estate, such as the *Value of estate*, *Prior taxable gifts*, and whether there's any *Deceased spousal unused exclusion*.
4. Open Gift Options and select the gifts you want to illustrate. For example, you can illustrate a testamentary outright gift by selecting *Bequest to Charity*.
5. Enter all other information as you would if you were creating illustrations for a standard life income plan.

## **One Challenge with Beneficiary Designations**

The biggest challenge with retirement plan beneficiary designations seems to be receiving them. Many charities report difficulties getting retirement plan administrators to transfer funds designated to them. The vast majority of retirement plan asset transfers that occur when the owner dies go to another individual, so administrators tend to apply their rules on these transfers – setting up a new account to receive the funds, requiring the tax ID of an individual who is the owner of the new account, etc. – to charities.

Many charities rightfully balk at these procedures. It often takes numerous phone calls and reaching someone high enough in the administrator's organization before the administrator will agree to transfer the funds without requiring the charity to jump through all of the usual hoops. Perhaps this state of affairs will improve in time, but for now you may need to be persistent and insistent for your charity to get what rightfully belongs to it without acceding to all of the administrator's usual

requirements. Attorney Jon Tidd shared at a recent Planned Giving Group of New England meeting that pointing out to legal counsel at the administrator that it is the administrator's *fiduciary duty* to transfer the funds according to the owner's wishes can be persuasive.

## **Conclusion**

The taxes applied to retirement plan assets transferred at death can be significant, even brutal. Using those same assets to fund an outright gift to charity, a charitable remainder trust, or a charitable gift annuity instead can greatly reduce those taxes, benefitting both the donor's heirs and your charity. The *Testamentary Gift of Retirement Plan or IRD* model in *Life Income Projections* gives you a powerful tool for presenting these benefits to your prospects. Retirement planning is complicated, however. As in all matters planned giving, make sure your prospect's legal and financial advisors are involved in the gift planning process.

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