

Interrelated Calculations for Gifts of Retirement Plan Assets

Overview

Gifts of retirement plan assets -- assets from IRAs, 401Ks, etc. -- are subject to a number of taxes. If only specific assets are available to fund a gift and pay any resulting taxes, it can be difficult to determine how much to give and how much to keep to pay these taxes. Set out below are equations that will help you determine how much can be given in these situations, whether the gift is made while the donor is alive or through the donor's will.

Gift made during the donor's lifetime

When retirement plan assets are used to fund a life income plan during a donor's lifetime, there may be up to three taxes to consider.

1. There is always income tax on the amount withdrawn from the retirement plan to fund the trust.
2. If the income recipient is not the donor or the donor's spouse, and the recipient's income interest exceeds the annual gift tax exclusion (\$20,000 if the gift is given jointly) there will be a taxable gift. However, if the donor(s) have enough gift tax credit available, they will be able to offset any gift tax owed.
3. If the income beneficiaries are grandchildren of the donor (or other "skip persons"), generation skipping tax (GST) will apply.

Assume a donor wants to use \$1,500,000 to fund a 5.75% charitable remainder annuity trust (CRAT) and pay any net taxes that result. The donor's blended income tax rate is 44.6% and the charitable remainder factor for the CRAT is .46729 (the contribution is 46.729% of the funding amount). Gift tax is covered by the donor's gift tax credit and GST does not apply.

How much of the \$1,500,000 can the donor use to fund the CRAT?

The answer

$P = (T - (T \times I)) / (1 - (C \times I))$ where: P = principal used to fund gift plan T = total amount to fund gift plan and pay taxes I = income tax rate C = charitable remainder factor of gift plan

So, in our example

$$P = (1,500,000 - (1,500,000 \times .446)) / (1 - (.46729 \times .446)) = \$1,049,788$$

Proof

Total assets \$1,500,000

Income taxes @ 44.6% - \$669,000 (1,500,000 x .446)

Income tax savings @ 44.6% + \$218,788 (1,049,788 x .46729 x .446)

\$1,049,788 = amount to fund trust

Gift made at donor's death through his/her will

When retirement plan assets are used to fund a life income plan through a donor's will, there may be up to two taxes to consider, rather than three, as above.

Estate tax will be due on the value of the income interest retained by the income beneficiary. Of course, if the only income beneficiary is the deceased donor's spouse, then the unlimited marital deduction would eliminate the estate tax.

If the income beneficiaries are grandchildren of the donor (or other "skip persons"), generation skipping tax (GST) will apply. There are no income tax consequences because the recipient of the plan assets, the life income plan, is tax-exempt.

Assume a donor indicates in her will that she wants the \$1,500,000 in her retirement plan used to fund a 5.75% charitable remainder annuity trust (CRAT) and pay any net taxes that result. The donor's blended income tax rate is 44.6% and the charitable remainder factor for the CRAT is .46729 (the contribution is 46.729% of the funding amount). Her two sisters are the income beneficiaries so GST does not apply.

How much of the \$1,500,000 can the donor's executor use to fund the CRAT?

The answer

$P = T - (T \times Es) / (1 - (C \times Es))$ where: P = principal used to fund gift plan T = total amount to fund gift plan and pay taxes Es = estate tax rate C = charitable remainder factor of gift plan

So, in our example

$$P = 1,500,000 - (1,500,000 \times .55) / (1 - (.46729 \times .55)) = \$908,491$$

Proof

Total assets \$1,500,000

Estate tax - \$591,509 $((1,500,000 - (908,491 \times .46729)) \times .55)$

\$908,491 = amount to fund trust

[Print](#)