GIVING THROUGH RETIREMENT PLANS

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Tax-Favored Retirement Plans

Many have taken advantage of generous tax incentives provided by Congress to encourage saving for retirement through contributions to IRAs, 401(k)s and similar plans.

These options-have traditionally featured income tax savings when contributions are made. Amounts in the plans then build tax free and are not generally subject to income tax until they are withdrawn by one or more beneficiaries.

Any funds remaining are included as part of the owner's estate for state and/or federal estate tax purposes.

Making Future Gifts

You may want to consider including charitable gifts when planning for the ultimate distribution of assets remaining in retirement accounts after you have provided for yourself and your loved ones. That is because these funds would otherwise be subject to federal and state income tax, where applicable, when received by others.

In addition, funds remaining will be included in your estate should state and/or federal estate taxes be due.

The combination of these taxes could, in some cases, amount to as much as 50 percent or more of retirement account remainders left to heirs.

Careful planning can help minimize the taxes that could be due on retirement plan assets during and after one's lifetime.

Because retirement plan assets can be subject to substantial taxation, you might instead direct that these assets be used to make charitable gifts. You can then leave other less heavily taxed assets to heirs, resulting in more being received by them.

Example: David had previously named one of his charitable interests to receive a gift through his will. He had also provided for gifts to his nieces and nephews by naming them as beneficiaries of his retirement account.

He was surprised to learn that the retirement funds will be subject to state and federal income tax when received by his nieces and nephews and could also be subject to estate tax as well, substantially reducing the amount he intended to give them.

After consulting with his advisors, David decided to provide that his charitable gift would instead be made from his retirement plan, and his nieces and nephews would receive other assets that would not be subject to income tax.

The amount he leaves to charity will be tax deductible for estate tax purposes, where applicable, whether left by will or through his retirement plan, while the nieces and nephews will not owe income tax on the amount they will now receive through his will.

Through this simple change, David was able to ensure that his charitable gifts would be made while his loved ones would receive more after tax than might otherwise have been the case.

You can change beneficiaries of your plan remainder in the future should your needs or wishes change. The consent of a spouse may be necessary. In some cases, you may want to set aside the amount for charity in a separate account. Check with your advisors for more details.

Making Charitable Gifts Today

When considering the best way to make charitable gifts today, you may also find that retirement plans may be an excellent source from which to make these gifts.

Special Opportunity for IRA Giving

If you have a traditional IRA and are aged 70.5 or older, you may wish to consider making a direct distribution of as much as $105,000 per year to eligible charities. Such gifts are not considered part of your taxable income while they still can count towards your required minimum distribution (RMD) for the year. Please note beginning in 2024, the required minimum distribution age was increased to 73. This can be an excellent tax-free way to make charitable gifts whether or not you itemize your deductions. Other tax savings may also result from giving in this way.

If you have a Roth IRA, it may be preferable to take a tax-free withdrawal and use the funds to make tax-deductible gifts.

Other Possibilities

If you are aged 59.5 or older, you may wish to make withdrawals from retirement plans in amounts sufficient to fund your charitable gifts.

You would be required to report the withdrawn funds as income on your tax return. If you itemize your deductions,

you are then allowed an offsetting charitable deduction for your gift.

For those who can deduct the full amount of the withdrawal/gift, this can result in the use of these funds without incurring unnecessary income, gift or estate taxes.

Even if higher income taxpayers are subject to partial limitations on their tax deductions, making gifts in this way can still result in the elimination of a substantial portion of taxes that would otherwise be due on the donated amounts.

Example: John and Alison have committed to making a charitable gift over a five-year period. After consulting with their tax advisors, they decide to make gifts each year in the form of stock that has increased in value, thereby benefiting from an income tax deduction for the full value of the securities while also avoiding capital gains tax on the increase in value.

They also plan to make withdrawals from their retirement accounts equal to the value of the securities they donate each year. While they will report the withdrawal amount as income each year, it will be offset by their charitable deduction for the full value of the donated securities.

They might then use the cash withdrawn to make new investments that will have a more favorable cost basis for tax purposes, and thereby restructure and diversify their portfolio in a tax-efficient manner.

Other Ways to Give

If you have reached limits on the amount you can contribute to tax-favored retirement plans, there are charitable gift planning options that can be used to help supplement those plans. These possibilities feature several benefits, including federal income, capital gains, estate and gift tax savings.

Some options allow you to set aside additional funds that can grow tax free and provide for increased income during retirement years. Or you may arrange for a fixed or variable income for a surviving spouse or other heirs for life or other period.

These options allow you to enjoy immediate tax benefits because amounts contributed in this way will ultimately be devoted to charitable purposes.

We will be pleased to provide you and your advisors with additional information regarding any of the ideas presented in this booklet.

Technical Advisory Section

Any funds withdrawn during life from an IRA or other tax-favored retirement plan (other than Roth IRAs) will normally be subject to income tax. If the funds are then donated for charitable use, there is an offsetting charitable income tax deduction and, when properly structured, the transaction can be a wash for tax purposes. Careful consideration should be given to limitations of deductions based on adjusted gross income (AGI) and any other provisions of the Internal Revenue Code (IRC) that may act to reduce the amount of deductions in certain circumstances. The impact of state tax laws should also be considered where applicable.

In years when individuals are facing requirements to withdraw funds from an IRA or other tax-favored retirement account in excess of what they currently need to fund living expenses, they may consider making special gifts to fulfill charitable commitments utilizing the withdrawal amounts.

If they have highly appreciated securities, they may wish to use the securities to fund their gifts, while using cash from the withdrawal to make new investments at a higher cost basis for tax purposes.

As part of the Pension Protection Act of 2006 (PPA), Congress enacted a number of charitable giving incentives and reforms. Insofar as gifts from retirement accounts are concerned, the PPA made an exception to the law outlined above and provided in section 408(b) (8) that individuals aged 70.5 or older could direct that a total of up to $105,000 per year be distributed from their traditional or Roth IRA directly to an organization described in section l 70(b)(1)(A) (other than an organization described in section 509(a)(3)) or a donor-advised fund (as defined in section 4966(d)(2)). This is known as a Qualified Charitable Distribution (QCD). The 2024 maximum QCD is $105,000. The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) became law on December 20, 2019. The Secure Act made major changes to the RMD rules. For those who turn 73 in 2023 through 2032, the starting age for RMDs is 73 and the first RMD must be taken no later than April 1 of the year following the year they turn 73. The beginning age for RMDs is 75 for those who turn 74 after December 31, 2032. Please note that an individual can still begin QCDs at age 70.5, even if they are not required to take an RMD.

To qualify under the provisions of the PPA, the distribution must be made by the IRA trustee to the charitable recipient and must be otherwise fully deductible. Distributions to fund charitable gift annuities, charitable remainder trusts and other split interest gifts do not qualify, nor do gifts that feature other tangible benefits that would otherwise cause a reduction in the tax-deductible amount.

Amounts transferred in this manner are not included in a taxpayer's AGI but are counted as part of a mandatory withdrawal.

This can hold special advantages for donors who otherwise exceed 50 percent of AGI limits on their gifts or experience other adverse tax consequences that would keep the gift from being a complete wash for tax purposes.

For a complete explanation of the PPA, see the Joint Committee on Taxation explanation of H.R.4 at http://www.house.gov.

Making Testamentary Gifts from Retirement Accounts

From a tax planning perspective, one of the most efficient ways to leave a gift to a charitable interest at death may be through a traditional IRA or other qualified retirement plan.

Simplified Example: Joan, a widow, 75, plans to leave her $100,000 IRA to her granddaughter, Ellen. An IRA balance as well as other qualified retirement plans may be subject to estate taxes (at an assumed rate of 40 percent) and income taxes (at an

assumed rate of 39.6 percent). State income and estate taxes may also be due on these amounts.

Under these assumptions, therefore, Ellen could eventually receive less than half of the IRA balance.

Why are these funds subject to both estate and income taxes? Because qualified retirement fund balances are considered income in respect of a decedent **(IRD)** under Internal Revenue Code section 691.(Note that section 691(c) provides for an income tax deduction for estate tax attributable to **IRD.)**

Joan, on the other hand, could leave the $100,000 in the IRA directly to one or more charitable interests free from all income and estate taxes. There would be no federal estate tax because of the estate tax charitable deduction and no income tax because of the charitable organization's exemption from income taxes.

If Joan wished to leave bequests to both Ellen and her charitable interest(s), it would thus be better for Ellen to receive assets other than the IRA balance, with the gift to charity through the IRA. This way, Ellen's inheritance would possibly be subject to estate tax, but not income tax. If no estate tax were due, Ellen would receive the entire $100,000.

Special Consideration

Providing for Charity: The term "designated beneficiary" is a technical term that primarily includes individuals. An irrevocable trust that meets certain requirements can also be a designated beneficiary. Although a charity can be a beneficiary, it cannot be a designated beneficiary. Neither can a charitable remainder trust (CRT). Nor can any of multiple beneficiaries if any one of them is a charity or a CRT.

If, however, the plan owner names both a charity (or a CRT) and an individual as beneficiaries and the distribution to the charity (or CRT) is made before the date for determining whether there is a designated beneficiary, the individual beneficiary will be considered a designated beneficiary.

Spousal Rollover: If the surviving spouse of an IRA owner receives a lump-sum distribution from the IRA, the surviving spouse generally may roll the distribution over into his or her own IRA tax free within 60 days of receipt.

Rollover IRAs: If a donor leaves IRA money in a lump sum to his or her spouse who then rolls the money over into the spouse's own **IRA,** it may make sense to provide for all or part of the money remaining in the rollover IRA at the spouse's death to go to charity.

QTIP Trust: It is possible, subject to certain requirements, to make the QTIP election with respect to both an IRA and a trust named as beneficiary of the IRA. See Rev. Rul. 2000-2 and Rev. Rul. 2006-26. In this case, it may be desirable to provide that part or all of any principal remaining in the trust at the surviving spouse's death go to charity.

Rollover to Charitable Trust: As of January 2016, federal tax law does not afford any means of rolling money out of an IRA or other tax-qualified retirement plan account during lifetime directly to a trust or other split-interest charitable gift without the account owner having to report the money as income for federal income tax purposes.

A charitably motivated individual might, however, want to withdraw money from his or her IRA today, place part of the money in a charitable remainder trust (or other charitable life income arrangement) to provide a retirement income and use the remainder of the money to pay tax on the withdrawal. In this case, the charitable deduction with respect to the trust will help reduce but not eliminate the tax owed.

Designating a Charitable Remainder Trust as Beneficiary: While tax-free transfers from IRAs to trusts and other split-interest gifts

are not possible during lifetime, it is possible to name a CRT to receive the balance of an IRA at death. In this case, the money is not subject to income tax on the transfer from the IRA to the CRT because of the CRT's tax exemption under Code section 664(c). The individual beneficiary of the CRT simply pays income tax on the distributions he or she receives from the trust.

Upon the transfer from the IRA to the CRT, an estate tax charitable deduction is allowed for the value of the remainder interest in the trust as determined under IRS regulations. When IRA assets are left at death to a CRT, a question arises: What becomes of the income tax deduction under Code section 691(c) for estate tax attributable to income in respect of a decedent (IRD)?

In Letter Ruling 199901023, the IRS said the deduction was allocated to the CRT and was used to reduce the amount of first-tier income (ordinary income) for trust income tax accounting purposes.

With increased estate tax exemptions confirmed in the Tax Cuts and Jobs Act of 2017, planning for estate tax consequences of establishing a CRT at death have been less of a consideration for many. Several legislative proposals have been made to simplify the process of making outright and deferred gifts using retirement plan assets.

Donors and advisors should always check the latest statutes and regulations prior to completing gifts in this manner.

Other Relevant Rulings: In Letter Ruling 9237020, the IRS considered a proposal to leave residual IRA money at the IRA owner's death to a charitable remainder unitrust, which would make payments to the IRA owner's son for a term of 20 years and then distribute all of its assets to charity. The IRS ruled that the IRA money would not be subject to income tax as it rolled out of the IRA into the unitrust because of the trust's exemption from income taxes under IRC section 664(c). The IRS also ruled that the IRA money rolling into the unitrust would qualify under the usual rules for the federal estate tax charitable deduction.

In Letter Ruling 9253055, the IRS took the same basic position with respect to a proposal to leave, at death, residual money in a corporate retirement plan account to a unitrust for the benefit of the donor/employee's spouse. This ruling stated that the spouse's interest in the unitrust would qualify for the federal estate tax marital deduction.

This type of plan can make sense for the charitably motivated person who (1) wants to shield residual IRA or other retirement plan money from what may seem to be punitive estate and income taxes; (2) wants to provide an income to a family member; and (3) likes the idea of outlining the use of any remaining funds at the termination of the trust.

The purpose of this publication is to provide general gift, estate, and financial planning information. It is not intended as legal, accounting, or other professional advice. For assistance in planning charitable gifts with tax and other financial implications, the services of appropriate advisors should be obtained. Consult an attorney for advice if your plans require revision of a will or other legal documents. Tax deductions vary based on applicable federal rates, which can change. Some opportunities may not be available in all states.