The Do's and (a few) Don'ts of Gifts from IRAs

PG Calc Webinar

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I. INTRODUCTION

There are 9.5 *trillion* reasons why charities should be paying attention to IRA accounts. That is the number of dollars estimated to have been in IRA accounts as of the Third Quarter of 2018.* With the IRA charitable rollover (technically known as a qualified charitable distribution or QCD) now being a permanent part of tax law, gift officers should be targeting IRA accounts for major outright, planned, and blended gift commitments. This paper will focus on the many uses of IRA accounts for charitable giving. And while there are many "do's" for gifts from IRA accounts, there are some "don'ts" that require an awareness by the knowledgeable gift officer. [*Investment Company Institute's "The U.S. Retirement Market, Third Quarter 2018]

II. DON'T BE THE DONOR'S TAX ADVISOR

There is a fine line between providing the donor charitable giving information – sometimes tax and even legal – and staying in the role of a gift officer and not becoming the donor's financial advisor. As tax laws change and the rules become more nuanced and dependent on the personal financial and tax situation of the donor, the gift officer must be ever vigilant not to cross the red line of assuming the information being given applies to the donor's financial situation. Example: "You will receive an income tax charitable deduction of $xxxx for this gift." While that may be true, it may have no relevance for a donor who will be taking the standard deduction rather than itemizing. As we explore giving opportunities with IRA accounts, it becomes increasingly important for the gift officer to provide general rules and to encourage (and even implore) the donor to consult their professional advisors to ensure the information provided is relevant for their personal financial situation. Document your advice in writing and keep a copy in the donor's record.

III. WHAT IS AN IRA AND WHERE DOES THAT MONEY COME FROM?

Most Americans participate in workplace retirement savings plans such as a 401(b) or the 403(b). These are the most popular workplace savings accounts. Employee and employer contributions to these accounts are excluded from the employee's income and not subject to income or capital gain tax while in the plan. After separation from employment or upon retirement, typically employees transfer their workplace retirement account into a self-directed plan known as an IRA.

Those not eligible to participate in a workplace retirement savings can establish an IRA during their working years. Even those eligible to participate in workplace savings plans can contribute to an IRA. Depending on the employee's filing status and income, the employee can make contributions to an IRA in addition to their savings plan at work subject to certain limits.

Most of the money in IRAs comes from rollovers from workplace savings accounts. In addition, many donors will have also contributed to IRAs established outside of their 401(k), 403(b) or other employer sponsored plan.

IV. CONTRIBUTING TO IRA ACCOUNTS

A. Contributions to traditional IRA accounts

Contributions to traditional IRA accounts (distinct from employer sponsored retirement accounts) are tax deductible provided IRS regulations are met for deductibility. If the IRA contributor is covered by another retirement plan at work, then deductible contributions to the IRA may be limited or not deductible at all, depending on the contributor's modified adjusted gross income. There are also income limits for the IRA contributions to be completely tax deductible. The contribution amounts annually are limited, and are adjusted periodically by IRS (for 2019, the deductible contribution limit is up to $6,000, or $7,000 if the contributor is 50 or older.) If the IRA contributor does not meet the requirements to make tax-deductible contributions, she can make post-tax contributions (i.e. not tax-deductible). This can create possible issues for the donor if the IRA account is being used to make qualified charitable distributions as the account has both pre-tax and post-tax contributions. Let the donor's advisor handle this situation.

B. Contributions to Roth IRA accounts

Contributions can be made to a Roth IRA account at any age, provided the taxpayer has earned income. There are limits on the amount that can be contributed to a Roth IRA each year, and income limits that may reduce or even prohibit any Roth IRA contributions in a given year. Contributions to Roth IRA accounts are made after tax. Withdrawals of contributions can be made at any time tax-free. If the Roth IRA is in existence for at least five years, withdrawals of growth can be made tax-free provided the account owner is at least 59 ½. There are no required minimum distributions for a Roth IRA, regardless of age.

V. Opportunities (and Challenges) of Lifetime IRA Gifts

A. Withdrawals subject to income taxes *and* penalties

Withdrawals from a traditional IRA account prior to age 59 ½ are subject to income taxes and to a 10% penalty of the amount withdrawn. If the account owner itemizes deductions, in most cases she will be able to avoid income taxes on the amount withdrawn and contributed to charity but will still have to pay the 10% penalty. If she does not itemize deductions, then there will be no corresponding income tax charitable deduction to offset the taxes due on the amount withdrawn. A transfer of IRA assets directly from the IRA account to a charity is a taxable withdrawal from the account. It is difficult to conceive of a situation where it would be advisable for a donor under age 59 ½ to use IRA assets to make a gift to charity.

Example: Elaine, age 55, withdraws $20,000 from her IRA account to make a class gift to her alma mater in a campaign. The $20,000 is added to Elaine's gross income. Elaine, who itemizes her deductions, can deduct her $20,000 gift but will owe the IRS $2,000 as an early withdrawal penalty, for which there is no tax advantage.

Example: Elaine, rather than withdrawing $20,000 from her IRA account, has $20,000 transferred directly to her alma mater. The result will be the same as above. IRS will consider Elaine as having withdrawn $20,000 from her IRA and then she made a gift to her alma mater.

B. Withdrawals subject to income taxes only

The tax treatment of withdrawals between ages 59 ½ and 70 ½ are much like withdrawals prior to age 59 ½, except there is no penalty for an early withdrawal. There is no IRS requirement for any withdrawals from an IRA account during this age period. Withdrawals during this period will be added to gross income and subject to income tax. If the donor elects to itemize deductions, charitable gifts of IRA withdrawals can be deducted. The *Tax Cuts and Jobs Act of 2017* doubled the standard deduction and commentators estimate millions of taxpayers who previously itemized their deductions will now take the standard deduction.

Example: Anne and Bill, spouses who are ages 65 and 68, respectively, have recently downsized and moved into a rental community. They wish to make a significant contribution to a favorite charity supporting historic preservation. Anne withdraws $18,000 from her IRA account. The $18,000 is added to their gross income and will be taxed. Since Anne and Bill no longer itemize their deductions (in 2019 the standard deduction for those married filing jointly is $24,400), Anne and Bill will not be able to offset their $18,000 gift to charity with a corresponding income tax charitable deduction. Also, Anne is not yet old enough to qualify for the qualified charitable distribution.

C. Age 70 ½ and older

Once an IRA account owner reaches age 70 ½, they must start taking withdrawals from their IRA account (and from other tax qualified retirement plans, but not from a Roth IRA) for what are known as required minimum distributions (RMD). The amount is determined by an IRS Uniform Lifetime Table. The first distribution must take place in the year the account owner turns 70 ½, or by April 1 of the year thereafter. RMDs must be taken annually in all subsequent years. The amount distributed from the IRA account is added to gross income and taxable to the account owner. If the account owner fails to withdrawal the required amount of the RMD in any year, the penalty imposed by IRS is 50% of the shortfall. Not all donors need their RMD to supplement living expenses, but they must still withdraw their entire RMD. For these donors, the IRA charitable rollover, also known as a qualified charitable distribution, presents an opportunity to make a tax-free gift to charity.

D. Potential financial issues faced by IRA account owners 70 ½ and older

When an individual reaches age 70 ½, they are required to start taking required minimum distributions from their IRA and other tax qualified retirement accounts. Withdrawals from IRA accounts are added to the account owner's gross income and become subject to income taxes. Once all sources of income are determined the adjusted gross income (AGI) is calculated. The AGI factors into calculations that may have a financial impact on the donor, such as eligibility for, and imposition of taxes on, some federal benefits. The AGI is also a key component in calculating how much of a donor's charitable contributions can be deducted in a year. Examples of how the AGI impacts the taxpayer follow.

(1) *Social Security* – The greater the AGI the more of the individual's Social Security income becomes subject to tax.

(2) *Medical expenses* – The taxpayer's AGI is the basis for computing the deductibility of medical expenses.

(3) *Roth IRA contributions* - Eligibility for contributions to a Roth IRA are determined by a modified AGI calculation.

(4) *Medicare premiums* - Part B premiums can rise significantly as AGI increases.

(5) *Charitable contribution deductions* – For donors who itemize, charitable contributions of cash can be deducted up to 60% of AGI (30% of AGI for gifts of long-term appreciated assets), with the ability to carry forward any unused deduction for up to five additional years. A donor who wishes to make a large charitable gift may not be able to deduct the entire amount of the gift in one tax year

VI. THE IRA CHARITABLE ROLLOVER (QUALIFIED CHARITABLE DISTRIBUTION or QCD)

The IRA charitable rollover, or qualified charitable distribution (QCD) as it is also known, may provide substantial tax savings to the donor. The *Protecting Americans from Tax Hikes Act of 2015* made the QCD provision permanent law. The charitable giving community has increasingly recognized the advantages to qualifying donors for making gifts using the QCD.

A. Requirements for the QCD

Internal Revenue Code Section 408(d)(8) sets forth the requirements for making a valid QCD.

(1) *Account owner*. The IRA account owner must be 70 ½ or older at the time of the QCD transfer. It is not enough if the IRA account owner turns 70 ½ in the year of the gift. The donor must be 70 ½ *when making the gift*.

(2) *Amount of QCD*. The maximum amount of QCD gifts that can be excluded from gross income in a year is $100,000. Spouses can each make QCD gifts from their respective IRA accounts of up to $100,000 per spouse per year.

(3) *IRA account only*. A QCD must be made from an IRA account only. Ongoing Simplified Employee Plans (SEPs) and Savings Incentive Match Plans for Employees (SIMPLE plans), 401(k), and 403(b) plans do not qualify. A QCD can be made from a Roth IRA, but Roth IRA distributions in most cases are tax-free and there is no required minimum distribution, making it difficult to see why a Roth IRA would be used for a QCD. A rollover IRA or inherited IRA both qualify for QCD gifts provided IRS rules are followed.

(4) *Charity recipients*. The QCD must be made to 501(c)(3) charities – public charities. Supporting organizations, private foundations, and donor advised funds do not qualify.

(5) *Distribution directly to charity*. The QCD must be made directly from the IRA administrator to the charity. It is permissible for the IRA administrator to issue a check payable to the charity and mail the check to the IRA account owner, for transmittal to the charity. A QCD from an IRA checkbook where the account owner writes a check to the charity and mails or delivers the check qualifies if all other IRS requirements have been met.

(6) *No quid pro quo*. To meet the requirement for a QCD the entire contribution must qualify for a charitable deduction – i.e. no quid pro quo. The entire QCD is disqualified if there are any quid pro quo benefits. QCDs may not fund a split interest gift such as a charitable gift annuity or a charitable remainder trust, as the donor would be receiving a benefit in exchange for the gift.

(7) *Income tax charitable deduction*. The donor *cannot* take an income tax charitable deduction for a QCD gift.

(8) *Substantiation*. The IRS substantiation requirement must be met for QCDs. The charity must send a contemporaneous written acknowledgment for the QCD gift for $250 or more which must state that no goods or services were provided in return for the contribution. The written acknowledgment for a QCD would necessarily differ from the gift receipt sent for a non-QCD gift as the gift is not coming from the donor, but from an IRA account. (See Appendix #1 for a sample contemporaneous written acknowledgment for a QCD gift).

(9) *Legally binding pledge*. A QCD can satisfy a legally binding pledge.

B. Prospects best suited for QCD gifts

Assuming the age requirement is met, the QCD is ideally suited for donors who don't need their required minimum distribution for living expenses, and who will no longer be itemizing their deductions. With the doubling of the standard deduction, it is estimated that millions more taxpayers will be using the standard deduction thus eliminating the benefit of the charitable deduction. Donors who are renting, living in a continuing care community, or who own their home but no longer have a mortgage may find that they are no longer itemizing their deductions, including their charitable deductions. A QCD can also benefit a donor who wants to make a charitable gift that exceeds the adjusted gross income limitation for taking the entire charitable deduction in the year of the gift. QCD gifts are not subject to the AGI limitation for deducting charitable gifts.

C. Special issues

1. Gala and Special Event tickets

Issue: Can a donor receive any quid pro quo benefits such as gala tickets in exchange for a QCD?

As stated in the Section VI(A)(6) on quid pro quo, the entire QCD must be allowable as a charitable deduction and neither the donor nor any other party is able to receive any benefit in exchange for the gift. In short, there can be no quid pro quo. If any quid pro quo is provided such as gala or charity auction tickets, the entire QCD fails to qualify for QCD tax treatment. There can be no allocation between the charitable portion and the value of the quid pro quo.

2. QCDs from Roth IRA accounts

Issue: Does it ever make sense to do a QCD from a Roth IRA?

The statute permits a QCD from a traditional IRA and Roth IRA. Questions are often asked why a donor would do a QCD from a Roth IRA when distributions from a Roth IRA in existence for at least five years are not subject to income tax. Perhaps the only time a QCD from a Roth IRA would be advantageous from a tax perspective is if the Roth IRA was in existence for less than five years and there has been growth in the Roth IRA assets. In such a case, any withdrawals attributed to the appreciation would be taxable.

3. IRA accounts with both pre-tax and post-tax contributions.

Issue: What if the IRA account has both pre and post-tax dollars?

This is a situation best left to the donor's tax advisor. Distributions from an IRA account to charity funded with both pre-tax and post-tax dollars are deemed to come first from the taxable portion of the IRA account, thus allowing the distribution to qualify as a QCD. The gift officer should not be making this determination.

4. **Required minimum distribution (RMD)**
Issue: How does the QCD affect the required minimum distribution?
One of the tax benefits of a QCD is that it counts toward the donor’s required minimum distribution. Once an IRA account owner turns 70 ½, the account owner is required to start taking RMDs as determined by the Uniform Lifetime Table. The amount withdrawn from the IRA account is added to the account owner’s gross income. If the IRA account holder neglects to take the full required RMD, the penalty is a steep 50% of the shortfall. Also, if the donor no longer itemizes deductions, the donor will not be able to offset the additional income from RMDs with charitable deductions.

5. **AGI limitation for charitable deduction not applicable to QCDs**
Issue: Might a donor be able to make larger tax-free gifts to charity by using the QCD?
Whereas the charitable deduction for gifts of cash is limited up to 60% of the donor’s adjusted gross income (AGI) (30% of AGI for appreciated assets owned for at least one year), this limitation does not apply to QCD gifts. Provided the QCD gift does not exceed $100,000 in any tax year, and that the other requirements for making a QCD gift are met, the QCD gift is not limited by the donor’s AGI.

6. Year-end QCD – a tax trap
Issue: When is the QCD gift considered complete?
The QCD must go directly from the IRA administrator to the charity. There are several ways that can happen. The IRA administrator can make a check payable to the charity and mail it directly to the charity. The IRA administrator can make a check payable to the charity and mail it to the account owner, who can then either forward the check to the charity or hand deliver it. Some IRA administrators have issued check books to the IRA account owner allowing the account owner to write checks on her IRA account. It is permissible for the account owner to write a check payable to the charity and mail the check to the charity. That will meet the requirements for a QCD.

For QCD gifts made at year-end, there can be an issue with the year in which the gift was made. The gift date becomes critically important in these situations, especially in determining whether the donor has taken her required minimum distribution.

The mailbox rule does *not* apply to QCD gifts. The postmark date on the envelope is not the gift date insofar as the IRA administrator is concerned. The critical date is when the IRA administrator makes the distribution from the IRA account, as that is what the administrator will report on the Form 1099-R. If the administrator is issuing the check and sending it to the charity, in most cases the administrator removes the funds from the IRA account when issuing the check and that is what will be reported on Form 1099-R.

The bigger issue with the gift date is when the donor has her own IRA checkbook and mails a check to the charity in late December. Even though the check may arrive at the charity at the end of December, if charity staff is on vacation and doesn’t deposit the check until January, the IRA administrator will remove the funds from the IRA account in January. If the donor had anticipated that the QCD was to count toward her RMD in the previous tax year, that is not going to happen, and the donor may find herself subject to a 50% penalty of the shortfall of her RMD. Oops.

(Appreciation goes to Russell James, J.D., Ph.D., CFP®, Professor at Texas Tech for alerting fundraising professionals to this issue.)

D. How to initiate a QCD

Most of the larger IRA administrators will allow for a QCD to be made on-line by accessing the IRA owner's account. Other administrators have forms on-line that can be downloaded and mailed to the administrator. Donors should contact their IRA administrator for their procedure to initiate a QCD.

E. Case studies

(1) *RMD & QCD working together*.

Mary turned age 75 this year and has $500,000 in an IRA account. She no longer itemizes her deductions, so Mary does not get a direct tax benefit from her charitable gifts. According to the Uniform Lifetime Table, Mary's RMD for this year is $21,834. Mary doesn't need all her RMD for living expenses and does a QCD to her church for $10,000 and another for $2,000 to a local food bank. Her $12,000 of QCDs are deducted from her RMD requirement, and Mary withdraws from her IRA the $9,834 balance of her RMD, which will be added to her income and subject to tax. Her $12,000 of QCD gifts are not included in her income and are thus tax-free.

(2) (a) *RMD then QCD*.

Tim is age 80 with $750,000 in an IRA. His RMD for this year is $40,107. In January Tim takes his entire RMD for a luxury trip he and his wife have long planned. In the summer, Tim learns that his alma mater is looking to hit a campaign goal and requests Tim's help. Tim makes an $80,000 QCD gift to his alma mater. Since Tim already withdrew his RMD, the $41,107 RMD will be added to his taxable income. The QCD gift is still permissible and Tim will not pay income taxes on the QCD gift, but it can not count toward his RMD.

(b) *Charitable deduction limitations*.

Tim and his wife's adjusted gross income is $100,000. The limitation to deduct gifts of cash is 60% of AGI, which in Tim's case is $60,000. However, the QCD is not subject to the AGI limitation for charitable deductions. Had Tim made the gift not using the QCD but from his own funds, he would have been limited to a $60,000 charitable deduction ($100,000 x 60%) in the year of the gift, with a carry forward up to the next five years for the unused deduction. By using a QCD, the entire $80,000 gift is tax-free in the year of the gift.

(3) *A disqualified QCD*.

Elaine lives for the opera. She makes a gift each year of $3,000 to her local opera company. In exchange for her gift Elaine receives a ticket to the opera company gala that has a value of $250. This year Elaine waited to make her gift until she turned 70 ½, having learned about the QCD. Elaine does a QCD to the opera company for $3,000 and the opera company sends Elaine her ticket for the gala. Elaine's QCD violates the IRS rule that the entire QCD gift must be tax deductible to qualify as a QCD. Since that is not the case here, Elaine's entire QCD of $3,000 is disqualified.

(4) (a) *Year-end QCD.*
Rick, age 78, realizes on December 15 that he has not taken his full RMD for the current year. He obtains the form from his IRA administrator to initiate a QCD to support his local animal shelter. Rick mails the QCD form to his IRA administrator on December 19. The administrator processes Rick's QCD request on December 23 and mails the check to the animal shelter on December 26. The animal shelter receives the check on January 2 and deposits the check on January 5. If the IRA administrator removed the funds from Rick's IRA account on December 23 when it processed Rick's QCD request, then the gift counts toward Rick's RMD for the year the gift was processed. The gift meets the requirement for a charitable contribution as it was placed in the mail on December 26 which constitutes delivery to the animal shelter. The fact that the hospital deposited the check in the following year does not matter.

(b) *Year-end QCD from IRA checkbook*. Rick has been issued a checkbook to write checks on his IRA account. On December 26 Rick writes a check to his local animal shelter and promptly deposits the check in the mail, intending the check to qualify as a QCD gift and to count toward his RMD, which he has not completely taken this year. The check is received by the animal shelter on December 28 and is deposited on December 30. Rick's IRA custodian does not withdraw the funds from Rick's IRA account until January 3, which is when the distribution is deemed made to the animal shelter. The gift will not count as a QCD in the year Rick intended but will count in the year in which the IRA administrator removed the funds from Rick's IRA account. Since Rick had not taken his full required minimum distribution for the year he intended for the QCD, Rick will pay a penalty to IRS for 50% of the shortfall.

VII. Lifetime Gift Annuity funded with IRA Assets

It is possible to fund a gift annuity during a donor's lifetime with IRA assets. However, despite what some donors believe, incorrectly, there is no direct tax advantage to the donor of using IRA funds for a CGA. It is not permissible for donors of any age to avoid taxes by rolling over funds from an IRA account to the charity as a funding source for a CGA. It is expressly prohibited for QCD gifts. The charitable deduction from funding the CGA will, however, help to offset some of the taxes due as a result of withdrawing funds from the IRA account.

Case Study
Cindy, age 75, wants to make a gift to her local art museum. A gift officer has presented Cindy with an illustration for a $100,000 charitable gift annuity. Cindy's assets are mostly invested in her IRA account, but the volatility in the stock market has been making Cindy uneasy. She decides to withdraw $100,000 from her IRA account to fund a CGA. Cindy will pay income taxes on the $100,000 she withdraws from her IRA, which taxes will be partially offset by the charitable deduction she will get from funding the CGA. With the IRA withdrawal Cindy will be in a marginal tax bracket of 24%.

Withdrawal from IRA	$100,000
Funding for CGA	$100,000
CGA annuity rate	6.2%
Charitable deduction	$45,047 (3.2% discount rate)
Income taxes on IRA withdrawal	$24,000 ($100,000 x 24% tax bracket)
Tax savings	$10,811 ($45,047 x 24% tax bracket)
Net taxes Cindy must pay	$13,189 ($24,000 - $10,811)

VIII. Testamentary gifts of IRA Assets

A. Non-probate assets

IRA assets are not subject to probate, as the assets are distributed to the beneficiaries named by the IRA account owner on a form provided by the IRA account administrator. The account owner's will does not control the distribution of IRA assets. If no beneficiary has been named by the IRA account owner, then the IRA assets will become part of the deceased owner's probate estate and will be distributed under the terms of the will or intestacy laws, if the decedent died without a will. Since it is often the case for retirement accounts to be a substantial portion of a donor's estate, a provision for a charitable gift in a will or trust may not be fulfilled if the donor's probate estate is insufficient to fulfill the gift. A testamentary gift plan must take into consideration how the donor's assets are held.

B. Income in respect of a decedent (IRD)

Income that is owed to a decedent that has never been taxed is considered income in respect of a decedent (IRD). Assets in tax qualified retirement accounts such as an IRA are IRD assets. While individuals named as a beneficiary can roll over the decedent's IRA account into an inherited IRA, when the funds are ultimately withdrawn from the inherited IRA account, they are subject to income taxes at the beneficiary's tax rate. Often beneficiaries of an IRA will withdraw all the funds from the account at one time, pushing the beneficiary into a higher tax bracket subjecting the IRA assets to substantial income taxes. If a public charity is named as the beneficiary of an IRA account, since public charities are not ordinarily subject to income taxes, the amount distributed to charity from the IRA will not trigger an income tax liability.

C. Beneficiary Designations

(1) Making a charity the beneficiary of an IRA account.

Most IRA custodians make beneficiary designation forms available on their websites. In some cases, the account owner will need to log into their account to download the form. It is becoming increasingly more common to be able to designate IRA beneficiaries using the administrator's website without the need to complete a paper form. There are a variety of pitfalls, depending on the beneficiary form used by the administrator. The form may not have a space to designate the name of a charity as a beneficiary but may have a space for "other entity." Some forms do not allow more than just the name of the charity. With many charities having similar names, such as with health care organizations, it can create confusion as to exactly which charity the account owner wanted to benefit. Some websites do not allow for a specific program designation for the gift. It is advisable for the charity to get written confirmation from the donor as to where the IRA account is held and how the charity name is shown in the beneficiary designation.

(2) Designating a percentage to charity vs. A specific dollar amount

Most IRA beneficiary forms allow the account owner to designate percentages to go to the various beneficiaries, as opposed to a pecuniary (specific) dollar amount. This can be justified as it will be unknown how much the account will have at the death of the owner. Using percentages makes it possible for the administrator to make distributions to all beneficiaries, regardless of the amount left in the account.

(3) Situations where the account owner's estate becomes the beneficiary
The donor's estate will be the beneficiary of an IRA account if the owner fails to complete a beneficiary designation form or the owner completes the form and designates her estate the beneficiary. There are potentially adverse tax consequences in naming the donor's estate as the beneficiary of an IRA or other retirement account. Such a designation has been considered in some cases to be a liquidation of the IRA equal to the dollar amount distributed, causing the donor's estate to pay income taxes on the IRA account. A carefully drafted estate plan can avoid these tax consequences, but it requires a skilled estate planning attorney. It is preferable for the donor to have completed an IRA beneficiary form stating the names and percentages that each beneficiary is to receive from the account.

(4) Spousal consent
Under federal law, spousal consent is not necessary to name a non-spouse an IRA beneficiary. Such is not the case with workplace retirement accounts, such as a 401(k) or 403(b) account. Unless a plan owner's spouse consents to naming a non-spouse beneficiary of a workplace retirement account, the spouse is entitled to receive 50% of the account on the death of the plan owner. However, spouses may have rights to an IRA account under state law. If the account owner lives in a community or marital property state, spousal consent is generally required to name someone other than the spouse as a beneficiary of an IRA account. Those states are Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. The donor should consult their financial advisors when naming a charity as a beneficiary of an IRA (or any other) retirement account.

D. Collecting IRA Beneficiary Gifts

There have been many articles in the charitable giving community about the challenges of collecting IRA and other qualified plan gifts after the death of the account owner. The issues revolve around the charity being required to open an inherited IRA and provide personal information such as Social Security numbers for leadership at the charity. Charities have had varying success to avoid the unnecessary bureaucratic paperwork with certain IRA administrators, but it appears that who one talks with at the administrator's office can determine the barriers facing the beneficiary charity. This paper will give a brief summary of the issues and the options available to the charity to respond.

(1) Notification to the charity.
Notification to the charity of the death of the donor and being a beneficiary of an IRA account is not assured. Two of the largest IRA administrators state in writing to the effect that they assume no obligation to notify the beneficiaries of the account owner's death and that they have been named as beneficiaries of the IRA. Advise donors of this so that they can let the charity know that it has been named as a beneficiary of an IRA or other retirement account.

(2) Collecting IRA distributions after the death of the donor.
There are challenges to a charity receiving the assets in an IRA account after the death of the account owner where the charity is a beneficiary. What should be a fairly simple process has become a major headache for many charities. These challenges have been shared at planned giving conferences and on email digests. There are several issues.

(a) IRA administrator demands. If a charity has been named the beneficiary of an IRA account, or for that matter any tax-qualified retirement account, the process of receiving the funds should be straight-forward, but they are anything but. Certainly, the IRA administrator will want a tax identification number for the charity and possibly a certificate from the Board Secretary that the person signing the IRA beneficiary claim form is authorized to act on behalf of the charity. Unfortunately, many IRA custodians are demanding that charity leadership provide personal information such as Social Security numbers, dates of birth, residence addresses, and drivers' license numbers. The IRA administrators claim, wrongly, that the Patriot Act and other anti-terrorism legislation requires them to obtain such information. If the charity refuses to provide this information, IRA custodians refuse to release the funds. There are stories of charity planned giving staff working their way up the ladder in the hierarchy of IRA administration institutions pleading their case, with limited or no success. Either the charity acquiesces, or it doesn't get the funds.

(b) Open an Inherited IRA as the charitable beneficiary. Many IRA administrators will require the charity to open an Inherited IRA. This requirement anticipates that the IRA beneficiary is an individual. There is no reason for a charity to open an Inherited IRA, but it may be the only way the charity can ultimately obtain the IRA funds to which it is entitled. The forms provided by the IRA administrator will require personal information of a charity leader, as described in Section VIII(D)(2)(a) above. The forms will inquire as to investment experience and desired funds into which the Inherited IRA assets are to be invested. If the charity acquiesces, the Inherited IRA will be opened and then the charity can submit documentation to liquidate the account and have the proceeds sent. So long as individual Social Security numbers are provided, the possibility exists that distributions from the Inherited IRA are provided to the IRS using the Social Security number of charity staff.

(c) "Just say no" One option is for the charity to "just say no," we are not going to provide personal information for any staff members. The charity may move up the chain of the bureaucracy of the IRA administrator with questionable success. Many charities "throw in the towel" and provide the information required by the administrator. It takes staff time, energy, and sometimes expense to do battle with the IRA administrator. The path of least resistance is not always the best path, but that is the path often followed when claiming IRA assets left by a generous donor.

E. Testamentary IRA funding of life income gifts

There are situations when it is preferable to leave an heir a dependable income stream rather than giving the assets directly to the heir. This could be due to any number of reasons such as inability to manage finances, concern about marriage instability, addictions, or mental challenges. It is possible to arrange as part of an estate plan a testamentary life income gift, which will be attractive for the philanthropically inclined donor who wants to make a generous testamentary gift to charity but who also wants to provide an income stream to a loved one. The funding assets may come from the probate estate, but an even more tax-wise funding asset would be a retirement plan such as an IRA account. As discussed in Section VIII(B), IRA assets for tax purposes are considered income in respect of a decedent (IRD). However, if the IRD assets in an IRA or other tax qualified retirement plan are distributed directly to charity to fund a charitable gift annuity or a charitable remainder trust, the income taxes due on the assets if distributed to an individual are deferred.

(1) Testamentary charitable gift annuity funded with IRA assets.

(a) *Private Letter Ruling*. Private Letter Ruling 200230018 (the "PLR") provided guidance for funding a testamentary gift annuity with IRA assets. The PLR ruled that the taxpayer could provide in her IRA beneficiary designation to transfer upon the taxpayer's death all her remaining IRA assets to charity in exchange for the charity's promise to pay the annuitant (the taxpayer's sister) an annuity for the remainder of the annuitant's life, assuming the sister survived the taxpayer. The IRS ruled:

(1) The charity's tax-exempt status under IRC Sec. 501(c)(3) is not at risk by receipt of the IRA proceeds;

(2) The value of the IRA at the death of the taxpayer will be included in the taxpayer's estate;

(3) An estate tax charitable deduction will be allowed for the value of the IRA assets less the present value of the annuity payable to the sister;

(4) If the charity is the designated beneficiary of the IRA, then the proceeds will be income in respect of a decedent to the charity (and not subject to tax in the charity's hands) and will not be income in respect of a decedent to the taxpayer's estate.

The key part of the ruling is that the donor's estate will not have to pay income tax on any part of the IRA at the time the gift annuity is funded. IRS did not rule on the "investment in the contract" (i.e. tax-free income to the annuitant), so it is advisable to be conservative and presume that all the annuity payments will be taxed as ordinary income. However, if taxpayer's sister withdraws the IRA assets from the account, all the withdrawals would be taxed as ordinary income anyhow.

A private letter ruling applies only to the applicant's situation and cannot be relied upon by others as legal precedent. However, it does show the IRS thinking and likely, if presented with a similar situation, the ruling would be the same. *The critical point of this ruling is that the donor's estate will not have to pay income tax on any part of the IRA at the time the gift annuity is funded*. Prior to the ruling, it was considered possible that the present value of the annuity payments would be immediately taxable to the taxpayer's estate as income in respect of a decedent.

(b) *Procedure*. First, after consulting with the IRA administrator, the donor completes a beneficiary designation form for the IRA such as:

> The undersigned, being the owner of Individual Retirement Account No. [*number*] held at [*IRA administrator*] hereby designates that, upon my death, the assets [*or percentage of the assets*] remaining within the IRA shall be transferred to [*charity name, address, and tax ID*], pursuant to a Gift Annuity Agreement dated [*date of agreement*].

The next step is for the donor and the charity to execute a gift annuity agreement according to which the charity agrees to pay a life annuity to a named annuitant, which shall be equal to the value of the IRA assets transferred to the charity multiplied by the charitable gift annuity rate then published by the ACGA (assuming the charity follows ACGA rates) for a person of the annuitant's nearest age at the time of the donor's death. The agreement should also state the purpose for which the IRA assets are to be used by the charity in the event the named annuitant does not survive the donor. (See Appendix #2 for a Charitable Gift Annuity Agreement funded with a testamentary gift)

(c) *Estate tax*. If the estate is subject to federal estate taxes, the estate can take an estate tax charitable deduction for the difference between the full value of the IRA assets transferred to the charity and the amount of the investment in the contract (i.e. the present value of the annuity contract). If the surviving spouse is the annuitant, the estate can take an estate tax charitable deduction for the present value of the charitable portion of the annuity, and the marital deduction for the present value of the annuity contract.

(2) Testamentary charitable remainder trust funded with IRA assets

In a series of private letter rulings in the 1990s (see, for example, PLR 9634019 and PLR 9723038), the IRS took the position that an IRA can also be used to fund a charitable remainder trust at the death of the IRA account owner. The IRA can fund any of the variations of a charitable remainder trust, such as a charitable remainder annuity trust, a charitable remainder unitrust, a net income charitable remainder unitrust, etc. The charitable remainder trust is a tax-exempt entity, enabling the estate to avoid paying income taxes on the IRA assets at the time of transfer. The funding assets are considered to be 100% ordinary income, so according the four-tiers-of-income rules that govern charitable remainder trust distributions, all this ordinary income must be distributed before the trust can distribute any other kind of income that may be taxed at a lower rate. As with the charitable gift annuity, the estate will receive an estate tax charitable deduction for the present value of the amount of the gift that will ultimately be used for charitable purposes. A best practice is for the charitable remainder trust agreement to be in existence at the time of death of the IRA account owner. Once the trust document is in existence, the donor should change the beneficiary designation of the IRA account to show that the charitable remainder trust will be the beneficiary. The donor's advisor should consult state and federal laws to ensure that the gift structure will qualify for tax benefits.

(3) Case studies

(a) Oscar and Mary – Testamentary CGA

Oscar, age 77, died and is survived by his wife Mary, age 76 at her nearest birthday. Oscar owned an IRA at his death valued at $100,000, completely funded with pre-tax dollars. If the IRA is inherited by Mary, she must withdraw each year the amounts as determined by the Uniform Lifetime Table. For example, at age 76 Mary would need to withdraw 4.55% of the account. At age 82 Mary will need to withdraw 5.85% of the account. If Oscar had provided that the IRA account go to their favorite charity to fund a CGA for Mary, the CGA would look like the following.

Annuity funding	$100,000
Source of funding	IRA (IRD asset)
Annuity rate (ACGA)	6.4%
Annual annuity amount	$6,400
Taxation of payments	All ordinary income (funded with IRD assets)
Estate tax charitable deduction	$46,407 (3.4% discount rate)

The benefits to Mary from Oscar having provided for a CGA from his IRA account:

- Mary receives lifetime annuity payments with a rate of 6.4%;
- The payments are fixed and are a general obligation of the charity;
- Mary will not have the market risk that an inherited IRA could have depending on the investments, including the possibility that the IRA will be completely depleted while Mary is living;
- A gift has been made to a charity Oscar and Mary wanted to support.

(b) Harold -Testamentary CRUT - Harold, age 77, died survived by his sister, Agnes, age 65 at her nearest birthday. Harold had supplemented Agnes's income and wanted to continue to do so in the event he predeceased her. Harold segregated $250,000 in an IRA account to fund a standard charitable remainder unitrust with a 5% pay-out rate to benefit Agnes. The CRUT to benefit Agnes would look like the following.

Funding amount	$250,000
Source of funding	IRA (IRD asset)
Pay-out rate	5%
Charitable deduction	$112,828 (3.4% Discount Rate)
Payment in year 1	$12,500
Taxation of payments	All ordinary income unless unlikely event that ordinary income tier reduced to 0

IX. Blended Gifts Using IRA Assets

IRA assets present unique opportunities for blended gift plans. A donor can use QCD gifts for outright giving, coupled with testamentary gifts from IRA or other tax qualified retirement accounts.

A. Case study – Funding a $1M research project

Frank, age 77, has been a loyal donor to a university hospital that has been responsible for groundbreaking research. Frank wants to make a significant gift to further research for the disease that caused his wife's death. Frank has committed to a $1M gift. Frank is unwilling to fund the entire gift during his lifetime, concerned that he might outlive his assets. However, he would like to see the research proceed while he is alive. The hospital research department will start the research when funding reaches $250,000 and a commitment to receive another $250,000 over the next five years. The gift plan worked out by the hospital development staff is:

Year 1	
Cash	$ 50,000
Stock	$100,000
QCD	$100,000
Rec'd in Year 1	**$250,000 (research program begins)**
Years 2-5	
QCD gifts (legally binding pledge)	$250,000 (varying annual QCDs depending on RMD)
Total lifetime funding	**$500,000**
Gifts to be rec'd at death	
5% CRUT funding	$300,000 (remainder value unknown)
IRA Beneficiary	$200,000
Total projected funding	**$1,000,000**
Testamentary will back-up	Formula clause – if total funding does not reach $1M, assets to come from Frank's estate

The remainder value from the charitable remainder trust cannot be definitively determined at the time of funding. Also, Frank's IRA account may not have $200,000 at the time of his death. Therefore, Frank's will has a clause that to the extent the hospital does not realize $1M from these gifts, Frank's estate is to make up the difference. A skilled estate planning attorney should implement this plan.

B. Case study – Funding a $250,000 endowed scholarship

Marsha and Alex, spouses who are ages 73 & 75, respectively, want to fund an endowed scholarship at their alma mater, where they met. Marsha has an IRA worth $500,000. Alex has an IRA worth $300,000. They have minimal other savings for retirement but have strong pension income. They have $400,000 equity in their home, which they plan to sell in the next two years. They no longer itemize their deductions. The gift plan worked out by their alma mater development office in consultation with their financial advisor is as follows.

QCD from Marsha IRA	$ 75,000 (payable over 5 years)
QCD from Alex IRA	$ 25,000 (payable over 5 years)
Pledge due within 5 years	$ 50,000 (from sale of house)
Gifts during lifetime	**$ 150,000**
Beneficiary designation Marsha IRA	$ 75,000
Beneficiary designation Alex IRA	$ 25,000
TOTAL GIFT	**$ 250,000**

X. SUMMARY

The trillions of dollars in IRA accounts, coupled with the favorable tax treatment of charitable gifts from these accounts, warrants the attention of every gift officer. The skilled gift planner will craft gift plans combining outright, QCD, and testamentary gifts enabling a donor to give more than they thought they could – all while minimizing taxes to the donor and possibly her heirs. The IRA, once a bit player in charitable giving, has now become the star of the show.

APPENDIX 1

Sample Contemporaneous Written Acknowledgement
from Charity to Donor

[Charity Letterhead]

[Date]

[Donor Name]
[Donor Address]

Dear [Donor]:

Thank you for your gift in the amount of $___________ from your Individual Retirement Account. I am writing to acknowledge that [Charity] received your gift directly from your plan administrator and that it is your intention for your gift to qualify as a qualified charitable distribution from your IRA, as provided for in Section 408(d)(8) of the Internal Revenue Code of 1986, as amended.

In that connection, [Charity] is qualified under Section 170(b)(1)(a) of the Internal Revenue Code, your gift was not transferred to either a donor advised fund or a supporting organization as described in Section 509(a)(3) of the Internal Revenue Code, and no goods or services were provided to you in exchange for your contribution.

Please retain this letter with your important tax documents and provide a copy to your tax preparer.

Thank you again for your generous contribution to our organization.

Sincerely,

[Name]
[Title]

Sample Agreement for Testamentary Gift Annuity Funded with IRA Assets

APPENDIX 2

Serial Number ____________

ABC Charity

Gift Annuity Agreement
One Life, Donor is Not Annuitant
(Modified for Testamentary Contribution)

This Agreement is made between [*name of donor*], of [*street address*], [*city*], [*state*] [*zip code*] (hereinafter “the Donor”), and ABC Charity, of 1234 Main Street, Seattle, Washington 98000 (hereinafter “Charity”).

1. Transfer of Property by Donor
Charity certifies that the Donor, as an evidence of [*his/her*] desire to support the work of Charity and to make a testamentary charitable gift, has arranged to contribute to Charity upon [*his/her*] death the property described in Schedule A, attached hereto, the fair market value of which, for purposes of this Agreement, is to be determined upon [*his/her*] death. This transfer shall be deemed an irrevocable gift to Charity, and the property contributed shall be deposited in the general fund of Charity.

2. Payment of Annuity
In consideration of the property to be transferred to Charity upon the death of the Donor, Charity shall pay from the general fund of Charity to [*name of annuitant*] of [*street address*], [*city*], [*state*] [*zip code*] (hereinafter “the Annuitant”), for so long as the Annuitant may survive the Donor, an annual annuity equal to the fair market value of the property described in Schedule A multiplied by the charitable gift annuity rate [*then published by the American Council on Gift Annuities* or *then paid by Charity*] for a person the age of the Annuitant upon the date of death of the Donor.

3. Payment Dates; First Installment
The annuity shall be paid in equal [*monthly, quarterly, semi-annual, annual*] installments. The first installment shall be payable on the last day of the calendar [*month, quarter, half-year, year*] in which occurs the date of death of the Donor, and shall be prorated on the basis of the number of days in the initial payment period. Subsequent installments beginning on the last day of the following [*month, quarter, half-year, year*] and continuing every [*month, quarter, half-year, year*] thereafter shall be for the full [*monthly, quarterly, semi-annual, annual*] amount.

4. Birth Date of Annuitant
The birth date of the Annuitant is [*month, day, year*].

Prototype Materials: agreement-IRA.doc

APPENDIX 2

5. Irrevocability; Non-assignability; Termination

This annuity is irrevocable and non-assignable, except that it may be assigned to Charity for no consideration. In no event shall the Annuitant’s interest be commuted, nor shall any prepayment or refund be made. Charity’s obligation under this Agreement shall terminate upon the death of the Donor, if the Annuitant does not survive the Donor, or with the regular payment preceding the Annuitant’s death, if the Annuitant does survive the Donor.

6. Uses and Purposes of Gift

Upon Charity’s satisfaction of its obligation under this Agreement, an amount equal to the residuum of the gift or, in the event the Annuitant does not survive the Donor, the property described in Schedule A, shall be used by Charity for [*“its general purposes” if unrestricted; if restricted, state purpose*].

7. Entire Agreement; Governing Law

This Agreement, together with Schedule A attached hereto, constitutes the entire agreement of the parties. This Agreement shall be governed by the laws of the State of [*state*].

This Agreement is effective as of [*month, day, year*].

DONOR:

____

ABC CHARITY:

By:

____

[*Name and title of officer*]

ATTEST

By:

____

APPENDIX 2

Gift Annuity Agreement Between [*Name of Donor*] and ABC Charity

Schedule A

Description of Property

[*All* or *name a specific portion*] of the proceeds of the Donor's individual retirement account at [*name of IRA custodian*], Account Number [*number*].

Note: The agreement should also include any disclosure language or other provisions required by the state where the donor resides.