GIFT PLANNING WITH RETIREMENT ASSETS

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Northern California Planned Giving Council
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Agenda & Goals

- What are retirement benefits and how do they work?
  - **Speak knowledgably with donors about such benefits**
- Why use them for charitable gifts?
  - **Explain tax advantages of retirement plans as charitable gifts**
- The 2015 pre-holiday "gift" of the PATH Act
  - **Charitable IRA Rollovers (Qualified Charitable Distributions under IRC § 408(d)) made permanent**
- Further details on IRA Charitable Rollovers (QCDs)
  - **Details make the difference**

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WHAT ARE RETIREMENT BENEFITS AND HOW DO THEY WORK?

1. IRAs
2. 401(k), 403(b) and 457 plans
3. Traditional plans vs. Roth plans
4. Beneficiary Designations and Distribution Rules

What are IRAs

- IRAs are Individual Retirement Accounts set up by individuals
- Funded by the individual owner with pre-tax $$$
- Annual inflation-based funding limits in 2016:
  - IRA — $ 5,500 (under age 50)
    $ 6,500 (age 50+)

    $ 1,000 (catch up age 50 +)

What are IRAs (cont'd.)

- Pre-tax dollars fund so distributions bear income tax at owner's income tax rate
- Penalty of 10% on pre-age 59 ½ distributions (with certain exceptions)
- Penalty-free, voluntary distributions from age 59 ½ on
- Mandatory distributions (required minimum distributions or RMDs) from age 70 ½ based on life expectancy provided in IRS charts

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What are IRAs (cont'd.)

- On owner's death IRA passes via Beneficiary Designation (not by Will or Revocable Trust) to **designated beneficiary with a life expectancy or to charitable organization.**
- <u>Goals for individual beneficiaries</u>: Spread out distributions to benefit from (i) tax-free growth of assets in retirement account; and (ii) lower marginal income tax rate as beneficiary ages.
- <u>Goals for charitable beneficiaries</u>: Tax-free distributions!

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What are 401(k), 403(b) and 457 Plans?

- 401(k), 403(b) and 457 plans are employee benefit plans
- Such plans are often funded by the employer and employee with pre-tax $$$
- Distributions similar to those for IRAs (*i.e.*, penalty on pre-59 ½ distributions; no penalty on distributions at age 59 ½ ; RMDs from age 70 ½ based on owner's life expectancy in IRS charts)

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What are 401(k), 403(b) and 457 Plans? (cont'd.)

- Annual inflation-based funding limits in 2016:
  - 401(k), 403(b) & 457 plans — $ 18,000 (under age 50)
$ 24,000 (age 50 +)
$ 6,000 (catch up age 50 +)
  - SIMPLE plans — $ 12,500 (under age 50)
$ 15,500 (age 50 +)
$ 3,000 (catch up age 50+)

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What are 401(k), 403(b) and 457 Plans? (cont'd.)

- On owner's death plan assets pass via Beneficiary Designation (not by Will or Revocable Trust) to **designated beneficiary with a life expectancy or to charitable organization**

- Gift to charity bears no income tax – very desirable outcome!

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Traditional Plans vs. Roth Plans

- Traditional plans: Funded with pre-tax dollars
- **Roth** plans: Funded with after-tax dollars

- Traditional plans: Distributions bear income tax
- **Roth** plans: Distributions bear no income tax

- Income limitations on ability to create **Roth** plans

- Traditional plans may be converted to **Roth** plans by paying income taxes on plan assets

- Conversion to **Roth** plan may provide charitable income tax deductions

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The Beneficiary Designation

- Retirement assets pass by Beneficiary Designation a form provided by the account administrator or trustee
- Beneficiary Designation must be completed to accomplish gifts to individuals and to charitable organizations
- Relatively easy to complete – no need for legal documents; however, **ALWAYS check in with professional advisor**
- **Great care** needs to be paid to language of designation

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The Beneficiary Designation (cont'd.)

- **Designations to individual beneficiary must include**: Name, birthdate, Social Security number, relationship to owner, full contact information and amount to be distributed to individual beneficiary
- **Designations to charity must include**: Full name and location of charity, tax ID number, purpose of gift (if any) and amount to be distributed to charitable beneficiary

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The Beneficiary Designation (cont'd.)

- A word about **CONSENT**:
  - Consent is required from a spouse if the retirement account owner wishes to leave the account to anyone other than the spouse
  - IRS rules governing ERISA accounts (*i.e.*, 401(k)s, SIMPLE IRAs, SEP IRAs, ESOPs or profit sharing plans) require such consent
  - IRS rules governing IRAs and Roth IRAs do not require such consent; however, in community property states like California, such consent likely will be required

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No Beneficiary Designation = No Gift

Without a valid beneficiary designation your individual or charitable gift will fail

No attorney or judge can direct distribution of your retirement assets to a charity

A properly executed beneficiary designation should help avoid post-death disagreements on property distributions and maintain family harmony

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Required Minimum Distribution Basics (after age 70 ½)

	Death BEFORE RMDs Begin	Death ON/AFTER RMDs Begin
Designated B		
	• DB's Life Exp w/ Single Life Table	• Life Exp Choice – DB's or decedent's w/single life
	• SS gets Uniform Life Table	• SS gets Uniform Life or decedent's Single Life
Non-Designated B (Charity)		
	• Five Year Rule	• P's Life Expectancy with P's Single Life Table

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Why Use Retirement Benefits for Charitable Gifts?

- Charities are NOT individuals, have no life expectancy and are tax-exempt – no gift, estate or income taxes payable
- Charities receive more from retirement accounts than individual beneficiaries who must pay taxes
- Permit donors to make larger charitable gifts than otherwise possible

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Why Make Charitable Gifts with Retirement Benefits? (Cont'd.)

- Enables larger gifts to charities that do not pay income taxes
  - *E.g.*, IRA holding $100,000 would yield gift of $72,000 to individual beneficiary in the 28% federal income tax bracket; while a charity would received the entire $100,000
- Gifts from IRAs and 401(k)/403(b)/457 plans are tax-free to charities

HOWEVER

- IRAs now have permanent advantage over 401(k)/403(b)/457 plans:

THE IRA CHARITABLE ROLLOVER

(the "Qualified Charitable Distribution" or QCD)

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The PATH Act of 2015

- The Protecting Americans from Tax Hikes Act ("PATH" Act) was passed by Congress and signed by the President in December 2015
- The PATH Act included several helpful charitable provisions that had been considered as "extenders" each year since 2007
- The PATH Act made the provision that applied to charitable gifts from IRAs (but not from 401(k), 403(b) or 457 plans) permanent
- The Qualified IRA Charitable Rollover provision applies **ONLY TO IRAs** and not 401(k), 403(b) or 457 plans
- To reap benefits of Qualified IRA Charitable Rollover gifts detailed rules in § 408(d) *et seq.* must be ***strictly*** followed

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Rules for IRA Charitable Rollovers

- **Age:** Only from age 70 ½
- **Timing:** By end of calendar year (best with notice to charitable beneficiary to ID and ensure time for processing)
- **Gift limits:** Up to $100,000 (which may include donor's RMD)
- **Procedure:** (i) Distribution must be directly from IRA administrator or trustee to the charity; charity should have been put on notice of distribution and its status as a QCD (Qualified Charitable Distribution);

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Rules for IRA Charitable Rollovers (cont'd.)

- (ii) charity, fully aware that the gift is a QCD, provides donor letter stating that it has received a distribution in "X" amount from donor's IRA on [date] and no goods or services were provided in exchange; (iii) donor neither recognizes income nor takes a charitable deduction for income tax purposes; (iv) letter is provided by donor to IRS with donor's tax return
- These procedures apply to both a single donor's gift, or, if s/he has a spouse, both can make such gifts up to the $100,000 limit with no goods or services provided in exchange (for a full, non-taxable $200,000 gift to charity!)

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Rules for IRA Charitable Rollovers (cont'd.)

- The IRA Charitable Rollover/QCD rules will remain in force making the QCD a permanent benefit to donors and the charitable community
- Donors considering such gifts should discuss them with their estate and tax professional advisors to be sure IRA assets are "not otherwise spoken for" in a complex estate plan
- **Always urge donors to seek advice of their advisors!!**

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Failure to Adhere to Rules: Failure of Gift

- **Proper procedure:**
- **Limits of distributions:**
- **Re-characterization of distributions:**
- **Quid pro quo:**

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Scenario 1

- Donor age 65 informs both university and IRA administrator in March of his desire to make an immediate IRA Charitable Rollover /QCD to his alma mater's baseball team in the amount of $100,000
- Charity is delighted and, unbeknownst to donor, arranges to give donor 4 behind the plate tickets to an upcoming baseball game and 4 invitations to the post-game reception
- Transaction successfully concludes at the end of March and donor, spouse and two friends enjoy the winning baseball game and the lovely reception that follows
- Problems? What if donor was age 72?
- Solutions?

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Scenario 2

- Museum's PG officer visits donor age 80 knowing that annually she makes large donations (typically $50,000 to $75,000) from her IRA and informs donor of availability of the newly permanent IRA Charitable Rollover /QCD provisions and how they work
- Donor is very excited to use the QCD provisions and informs PG officer that she will make a gift of $100,000 to Museum. PG officer is pleased and makes mental note to be on lookout for gift
- Donor contacts her IRA trustee and instructs trustee to send $100,000 directly to Museum as her annual gift. Ten days later, Museum receives donation of $100,000 from.
- Problems?
- Solutions?

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Scenario 3

- Same facts as Scenario 2, however, Donor is so excited to make the gift that she writes a check on her IRA account in the amount of $100,000 and presents it to PG officer of Museum
- PG officer, beside himself with glee, readily accepts check promising donor 4 tickets to highly sought after opening reception to upcoming exhibit on Old Masters paintings, which donor gladly accepts
- Problems?
- Solutions?

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Scenario 4

- Donor takes his $150,000 RMD from his IRA in February. Donor learns in August that same year that his favorite charity – the pediatric hospital that saved his first grandchild's life – was soliciting QCD gifts from donors' IRAs, a very attractive gift alternative to Donor
- Donor contacts his IRA administrator in August to (i) request the administrator accept return of $100,000 of Donor's $150,000 February RMD distribution and (ii) send a check in the amount of $100,000 to the hospital as a QCD
- IRA administrator acquiesces in Donor's request
- Problems?
- Solutions?

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Scenario 5

- In March, City Symphony Donor age 75 consults with his estate planning attorney and CPA regarding a QCD to CS to pay his current year's pledge amount. While the permitted QCD limit of $100,000 was discussed, Donor later discovered his amount due was $125,000
- Donor's RMD was $135,000, which he received in June of that year
- Believing that making a QCD gift to CS of only $25,000 more than the $100,000 limit would do no harm, he advised his IRA trustee in August to make the gift of $125,000 directly to CS
- CS was pleasantly surprised by Donor's gift and supplied Donor with required QCD recognition letter for his $125,000 gift for which no goods or services were provided
- At tax time, Donor reported the $125,000 as income and took a corresponding charitable deduction
- Problems? Solutions?

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Charitable Gifts of Retirement Assets Are . . .

- Easily accomplished through Beneficiary Designations (after donor consultation with professional advisors)
- May be made from IRAs (traditional and Roth), 401(k)/403(b)/457 plans, *etc.* with appropriate consent
- Provide charitable income tax deduction to donor
- May allow certain donors to make larger charitable gifts than otherwise possible
- IRAs now have permanent benefit of the IRA Charitable Rollover/Qualified Charitable Distribution (QCD) pursuant to provisions of the PATH Act for donors age 70 ½ and over
- Great way for donors and charities to build meaningful relationships

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