What Should My Donors Do With Their Retirement Assets?

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Presented by:

Jeff Lydenberg, Vice President, Consulting

PG Calc

129 Mt. Auburn St.

Cambridge, MA 02138

617-497-4997

jeff@pgcalc.com

I. INTRODUCTION

Your donors have substantial assets in these retirement accounts that can be used to make charitable gifts. Your role is to understand their options and, where appropriate, to bring to their attention giving strategies that will meet their financial and philanthropic goals. In this paper, we will consider the rules and procedures for making successful charitable gifts using retirement plan assets, both during life and at death. Through a series of donor cases, you will learn what questions to ask, what strategy fits with which donor goals, and the profiles of ideal retirement asset donors. We will also offer guidance on the often difficult process of processing death benefits from donor retirement accounts.

The universe of retirement accounts a donor might hold is diverse. See Appendix A for an expanded description of the plans described below.

Broadly speaking there are two types of retirement accounts. **Defined-benefit plans** include traditional pension accounts. A defined-benefit plan is an employer-sponsored retirement plan where employee benefits are computed using a formula that considers the employees length of employment and salary history. The retirement benefit to the employee does not depend on investment returns. A beneficiary can make charitable gifts of income received from a defined-benefit plan after paying tax on that income. These plans are not available for post-death charitable giving since the beneficiary has no assets in the plan post-death.

A **defined-contribution plan** is a retirement plan that's typically tax-deferred, like a 401(k) or a 403(b), in which employees contribute a fixed amount or a percentage of their paychecks to an account that is intended to fund their retirement. There is no guaranteed or fixed benefit to the employee with a defined-contribution plan. The benefit to the plan owner depends on the contributions and investment returns. There are significant opportunities for tax-advantaged lifetime charitable giving as well as post-death planning from these accounts.

For purposes of this paper, “retirement funds or plans” refers to defined-contribution plans including IRA’s, 401(k) plans, 403(b) plans, SIMPLE IRAs, and SEP IRAs.

II. LIFETIME GIFTS OF RETIREMENT PLANS

A. Withdrawals subject to income taxes and penalties

Withdrawals from a traditional IRA account and most qualified retirement plans prior to age 59½ 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 retirement plan assets directly from the account to a charity is a taxable withdrawal from the account. It is difficult to conceive of a

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situation where it would be advisable for a donor under age 59 ½ to use retirement plan assets to make a gift to charity.

Example: Elaine, age 55, withdraws $20,000 from her retirement plan 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.

Alternatively, rather than withdrawing $20,000 from her IRA account, Elaine has $20,000 transferred directly from her IRA to her alma mater. The result will be the same as above. The 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 59½ and 72 are much like withdrawals prior to age 59½, except there is no penalty for an early withdrawal. There is no IRS requirement for any withdrawals from a retirement plan 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 retirement plan withdrawals can be deducted.

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 2021 the standard deduction for those married filing jointly is $25,100), 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 72 and older

Once a retirement plan account owner reaches age 72, they must start taking withdrawals from their IRA (but not from a Roth IRA) for what are known as required minimum distributions (RMD). See the IRS Uniform Lifetime Table below. The first distribution must take place in the year the account owner turns 72, or by April 1 of the year thereafter. RMDs must be taken annually in all subsequent years. The amount distributed from the retirement plan 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 retirement plan account owners 72 and older

When an individual reaches age 72, they are required to start taking required minimum distributions from their IRA and other tax qualified retirement accounts. Withdrawals from IRA

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accounts are added to the account owner's gross income and become subject to income taxes. The amount of the required withdrawal each year is a percentage of the fund balance as of the end of the previous year and is due by the end of the current year. The percentage increases gradually with the owner's age according to the table below:

Uniform Lifetime Distribution Table*

Age	Minimum Withdrawal	Age	Minimum Withdrawal	Age	Minimum Withdrawal
70	3.65%	80	5.35%	90	8.77%
71	3.77%	81	5.59%	91	9.26%
72	3.91%	82	5.85%	92	9.80%
73	4.05%	83	6.14%	93	10.42%
74	4.20%	84	6.45%	94	10.99%
75	4.37%	85	6.76%	95	11.63%
76	4.55%	86	7.09%	96	12.35%
77	4.72%	87	7.46%	97	13.16%
78	4.93%	88	7.87%	98	14.08%
79	5.13%	89	8.33%	99	14.93%

* New Uniform Lifetime Distribution Tables for calculating RMDs take effect January 1, 2022. The new table predicts longer life expectancies and reduces the RMD amount.

To the extent that a donor needs to withdraw retirement funds to meet her required minimum distribution, it is reasonable, although not specifically advantageous, for the donor to use those funds to make charitable gifts. She must withdraw the funds and recognize the income, regardless, so if she doesn't need the income, it would be reasonable for her to give it to charity. If she itemizes deductions, she may be able to completely offset this income with a charitable deduction. Alternatively, she could use appreciated stock to make the gift and, if desired, repurchase the stock with the funds she withdrew from her retirement plan. See Section C for more on this strategy.

As a rule, it doesn't make sense from a tax standpoint for a donor to withdraw funds from a retirement plan beyond her required minimum distribution for the year to make a charitable gift. It is better for the donor to let the funds remain in the retirement plan where income and dividends can be reinvested tax-free and to use other assets to make charitable gifts.

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E. Adverse Financial Impact of the RMD

The required minimum distribution and all other sources of income determine a taxpayers adjusted gross income (AGI). 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.

* *Note that for cash contributions made in 2021, the donor can elect to deduct up to 100 percent of their AGI.*

This section describes various ways gifts of retirement funds may be made during the donor's lifetime. In each case, both the giving method and its application to donor situations are discussed.

B. Make a Qualified Charitable Distribution from an IRA.

The Qualified Charitable Distribution (QCD) has been permanent law since 2015. The QCD enables qualifying donors to transfer funds from their traditional IRA or Roth IRA directly to a public charity without recognizing any income from the withdrawal or receiving an income tax charitable deduction. Because the donor doesn't declare the withdrawal as income on his or her tax return, a QCD never results in additional income tax charitable deduction for the donor.

The terms of the QCD are:

- QCDs count towards the required minimum distributions from an IRA, and they are not to be included in the taxable income of the donor.

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- The IRA owner must be age 70½ or older on the date of distribution, not merely turning 70½ sometime that year.

- The gift is made to a public charity and not to a private foundation or supporting organization or a donor advised fund maintained by a charity.

- The gift would otherwise entitle the donor to a 100% deduction. The donor cannot receive any benefit in exchange for the gift. (This rules out gifts for life income arrangements and quid pro quo benefits.)

- The gift, combined with other qualifying QCD gifts made during the year, do not result in the total of such gifts exceeding $100,000 per taxpayer.

- The donor must receive an acknowledgement from the charity that the QCD was received and that he or she received no benefits.

- Gifts may only come from the donor's traditional Individual Retirement Account or Roth IRA. While legally permissible, there are few tax reasons to make a QCD from a Roth IRA since the Roth IRA distributions are tax-free. Nonetheless, there is a 5-year required holding period before Roth distributions qualify for tax-free distribution treatment so a donor in that situation might consider a Roth IRA rollover. QCDs are permitted from a SEP IRA or a SIMPLE IRA if it is not an ongoing plan. A plan is treated as ongoing if it is maintained under an employer arrangement under which an employer contribution is made for the plan year ending with or within the IRA owner's taxable year in which the charitable contributions would be made. Gifts from 401(k) or 403(b) plans are not permitted.

- Funds transferred using the QCD can fulfill a pledge to the charity. See IRS Notice 2007-7, Question 44.

The QCD is beneficial to donors who:

- Do not itemize their charitable deductions. The Tax Cuts and Jobs Act doubled the standard deduction for tax years beginning in 2018. These increases are adjusted for inflation. For 2021 the standard deduction is $25,100 for those married filing jointly. Fewer than 10% of Americans now itemize.

- Itemize and regularly contribute 50 percent of their adjusted gross income to charity, in which case they could deduct only one-half of an amount they withdrew from an IRA and then contributed (this assumes other charitable gifts equal exactly 50% of AGI, excluding the IRA withdrawal).

- Donors who want to reduce their Medicare premiums. This is because the minimum required distribution is included in the donor's income used to determine their Medicare Part B and Part D premium costs two years down the

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road. For example, a married couple with income of $220,000 in 2019 will owe an additional $713 annually in Medicare Part B premiums in 2021. If their income is just $1 over $220,000, they will have to pay the full extra premium.

- Live in a state with a state income tax that does not permit charitable deductions, such as Massachusetts. The IRA withdrawal is included in taxable income for state taxes with no offsetting income tax charitable deduction.
- Like the simplicity of transferring money from an IRA rather than the two-step process of taking a taxable withdrawal and then contributing it to charity.

The QCD is not as appealing to donors who:

- Itemize and live in a state that exempts all or a portion of retirement distributions from state income tax and that allows a deduction for charitable gifts on the state income tax return. Those donors would generally benefit more from taking a taxable distribution, then contributing it to charity and claiming a deduction on both the federal and state income tax returns.
- Itemize and have highly appreciated securities which could be contributed. (See below for a description of an alternative involving appreciated stock.)
- Have an uncooperative IRA administrator.

III. TESTAMENTARY GIFTS OF RETIREMENT PLAN ASSETS

A. Non-probate assets

Qualified retirement plan assets are not subject to probate, as the assets are distributed to the beneficiaries named by the account owner on a form provided by the account administrator. The account owner's will does not control the distribution of qualified retirement plans. If no beneficiary has been named by the account owner, then the qualified plan 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 are IRD assets. While individuals named as a beneficiary can roll over the decedent's retirement 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

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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 retirement 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 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 beneficiary designation 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 as 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 retirement account equal to the dollar amount distributed, causing the donor's estate to pay income taxes on the 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 a beneficiary designation 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

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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. The community property 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 a retirement account.

General rule: Upon death, it is better to make charitable gifts with IRAs and qualified retirement funds (or with other "income in respect of a decedent" ("IRD"), such as savings bonds and commercial annuity contracts) and give cash, securities, and real estate to heirs. This is true even for donors whose estates are not large enough to be subject to federal estate tax because the benefit is in avoiding income tax on the retirement funds.

Caution: The donor must make the charity a direct beneficiary of the retirement fund. If the estate is the beneficiary, and the will provides for a certain sum to be paid to the charity, the distribution will be taxed on the decedent's final income tax return, and there will be no offsetting deduction unless the will specifically states that charitable bequests shall be made, to the extent possible, with the retirement funds or with IRD assets, which includes taxable retirement plan distributions. (See below for a further explanation of IRD).

D. Establish a Charitable Remainder Trust for Survivors with Remaining Retirement Fund Assets

An individual may be willing for a charity to be the ultimate beneficiary of her remaining retirement funds, but in the meantime wants to provide for family members. She could accomplish both goals by making a charitable remainder trust the beneficiary of a retirement plan. The trust could make payments to a surviving spouse for life or to surviving children for life or a term of years. If the spouse is the only income beneficiary, the entire amount distributed to the CRT is deductible for federal estate tax purposes. The remainder interest qualifies for the estate tax charitable deduction and the income interest for the estate tax marital deduction. If someone other than the spouse is an income beneficiary, the value of the income interest will be subject to estate tax. Whether tax is owed will depend on the size of the estate and the amount of other taxable gifts.

A major benefit of this arrangement is that no income tax will be payable on the retirement fund assets when they are paid to the charitable remainder trust because the trust is tax-exempt. (Multiple PLRs support this conclusion. See PLRs 199901023, 9237020, 9253038, 9723038, 9634019.) Unless the distribution that establishes the trust comes from a Roth IRA or designated Roth 401(k) or 403(b) account, payments to the income beneficiary will be

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taxable entirely as ordinary income, at least until total payments exceed the distributions subject to ordinary income tax. Payments would also have been fully taxable this way had the donor made the individuals the beneficiaries of the retirement plan.

It is important to make the trust the beneficiary rather than to name the estate as beneficiary and provide in the will for the creation of a testamentary charitable remainder trust. The latter course results in unnecessary taxation.

The trust could be a unitrust established during the life of the donor and minimally funded; it could begin as a living trust that automatically converts to a charitable remainder trust at the death of the trustor; it could be unfunded until the death of the donor if this procedure is acceptable in the jurisdiction where the trust is sited; or the will might provide for its creation now of death. The donor's advisors can recommend the best procedure whereby the trust can be named as beneficiary.

Example: John creates a charitable remainder unitrust and names it as beneficiary of 50 percent of his IRA. The trust will pay to his wife Marjorie six percent of trust assets, as revalued annually, for the duration of her life. Then the trust will terminate, and the remainder will be distributed to a charity. Following John's death, approximately $500,000 from his IRA will be paid to the trust, and Marjorie will receive about $30,000 in the first full year of the trust, an amount that will increase over the years if the trust assets grow in value. When the IRA funds are distributed to the trust, they are subject neither to estate tax nor to income tax. The trust payments will be taxed as ordinary income to Marjorie. The arrangement enables John to provide for Marjorie, if he predeceases her, and it gives both the satisfaction of assuring a future gift to a charity.

Variation: If John and Marjorie have children, and Marjorie's income needs are otherwise met, John might make the children beneficiaries of the trust, perhaps for a term of 20 years. A portion of the IRA (the value of the children's income interest) would be subject to estate tax, but none of the IRA assets would be subject to income tax when paid to the trust. The children would be taxed on the income they receive from the trust.

This arrangement, too, assures a future gift to a favorite charity while providing for the children. It also preserves assets for the family and for charitable purposes that otherwise would have been consumed by taxation.

Issues Regarding Funding the Trust: Under Reg. Sec. 1.664-1(a)(5), a testamentary charitable remainder trust is deemed created at the death of the donor. However, the actual distributions for funding the trust are made following death, and there may, in fact, be several distributions occurring over weeks, or even months, before the trust is fully funded. For example, the trust might be designated as beneficiary of an IRA and of a certain percentage of the donor's living trust. The IRA distribution is made two months after the donor's death, and there are two distributions from the living trust, the larger one six months after death, and a smaller clean-up distribution seven months after death.

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The general rule is that additions cannot be made to a charitable remainder annuity trust once it is funded. However, Reg. Sec. 1.664-2(b) provides that all property passing to the trust by reason of the death of the donor shall be considered as one contribution. Thus, in the example above the later distributions from the living trust would not be considered impermissible additions to the trust. The payment to the income beneficiary would be the total amount distributed to the trust multiplied by the payout percentage calculated as if the full amount had been received on the date of death. (Treasury Regulations 1.664-1(a)(5)(i) and 1.664-1(a)(5)(ii) provide detailed instructions on how to calculate the amount by which a testamentary charitable remainder trust has underpaid or overpaid its income beneficiaries during the period between the donor's death and the full funding of the trust, if permitted by applicable local law or authorized by the governing instrument.)

E. Establish a Gift Annuity with All or a Portion of Remaining Retirement Fund Assets

This gift arrangement was addressed in PLR 200230018. The most important conclusion in the ruling was that the proceeds payable to the charitable beneficiary will be IRD to the charity under IRC Sec. 691(a)(1)(B) and will not be IRD to the taxpayer’s estate. Since the charity is tax-exempt, none of the retirement plan proceeds will be taxed at the time the annuity is funded. Though the IRS did not rule directly on the matter, it is presumed that payments would be taxable entirely as ordinary income, unless some portion of the retirement plan was funded with after-tax contributions. Distributions from a qualified retirement plan left to an heir would likewise have been fully taxable.

A testamentary gift annuity funded with remaining retirement plan assets could be appealing when:

- the donor wants to provide fixed, guaranteed payments to a surviving friend or relative and make a charitable gift, or
- the donor wants to provide for a survivor and make a charitable gift, but the contribution would be too small for a charitable remainder trust to be practical, or
- The donor wants to assure payments to a surviving spouse for as long as he or she lives without concern that they might cease because of market losses or ever-escalating required minimum distributions.

Example: Mona executes a gift annuity agreement during her life. The agreement provides that, if her sister survives her, the charity will pay an annual annuity to her sister, the amount of which shall be the value of the distribution to the charity, as beneficiary of her IRA, multiplied by the annuity rate then paid by the charity to an annuitant her sister’s age at the time of Mona’s death. Mona also names the charity as beneficiary of her IRA. She dies when her sister is 78. The amount distributed from her IRA to the charity is $300,000. The charity pays her sister $18,200 per year (6% x $300,000). Included in Mona’s taxable estate

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is the present value of her sister's annuity. The sister's payments are taxable entirely as ordinary income since the IRA distributions have a zero basis.

The SECURE Act that became law in 2020 says that non-spouse beneficiaries who inherit an IRA or other qualified plan must distribute the entire account within 10 years of the account owner's death. A testamentary gift annuity or charitable remainder trust funded with retirement plan assets might be attractive for some donors. These vehicles offer a way to assure payments over the lifetime of beneficiaries.

F. Back up a Pledge with a Provision to Pay the Outstanding Balance with Retirement Funds

Example: Rachel pledged $1,000,000 to her charity's capital campaign, and she wanted to assure that the pledge would be fulfilled if she died with an outstanding balance. She and the charity executed a pledge agreement which contained this language:

> "In consideration of my interest in benefiting XYZ Charity (the "Charity"), and with the intent of making a major commitment to the Charity in response to the comprehensive campaign conducted during the period 2014-2018, and specifically for the ______ Center, which, in consideration of this gift, shall be named the "Rachel G ______ Center," I, Rachel G ______ pledge and promise that my estate shall be obligated to pay the charity, subsequent to my death, the sum of $1,000,000, less any amounts distributed to the Charity from my duly probated Will, Living Trust, or Individual Retirement Account that are designated to be in fulfillment of this pledge."

She could then make the charity a beneficiary of her IRA to the extent of the unpaid balance, thereby fulfilling her pledge obligation in the most tax-efficient manner.

Whether the pledge is enforceable depends on whether it satisfies the conditions of enforceability under applicable state law.

G. Gifts of Other IRD Assets at the End of Life

Income in respect of a decedent (IRD) was discussed above and refers to taxable income to which a deceased person was entitled but not yet paid at death. It includes unpaid wages, interest, and dividends unpaid at death, defined contribution retirement funds (other than a Roth IRA or funds resulting from after-tax contributions), accrued interest on U.S. savings bonds, and the value of an annuity that exceeds the investment in the contract. The IRD is taxable to the beneficiary, which could be the estate of the decedent or named individuals. IRD assets are not eligible for a step-up in basis. The entire IRD is taxable as ordinary income.

The end-of-life giving methods proposed for retirement funds would also apply to certain of these IRD assets. For example, suppose that many years ago Gloria purchased a commercial deferred variable annuity for $100,000, she has made no withdrawals from it, and the cash value of the annuity is now $210,000. If she names her brother as the beneficiary, the $110,000 of accrued gain will be taxed to him as income as he receives distributions from the annuity.

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She could name a charity as beneficiary of the annuity in which case there would be no tax payable because the charity is tax-exempt. If she wants both to make a charitable gift and to provide income to her brother, she could name the charity as beneficiary of the deferred variable annuity and execute a gift annuity agreement stipulating that her brother is to receive an annuity equal to the amount received by the charity from the insurance company multiplied by the annuity rate then paid by the charity to a person her brother's age. Unlike a gift annuity funded with funds from a regular IRA, 401(k), or other qualified plan, some portion of the payments would be tax-free because the commercial annuity was purchased with after-tax funds.

The results would be similar if U.S. Savings bonds were used to fund a gift annuity for a survivor. Again, a portion of the payments would be tax-free because of her cost basis in the bond. The charity would not be taxed on the accrued interest in the bonds because of its tax-exempt status.

Commercial deferred variable annuities and savings bonds constitute part of the available retirement savings for some people, and if they do not need income from them, they pass them to beneficiaries. These assets, like IRAs and qualified retirement funds, are excellent candidates for end-of life gifts.

IV. Collecting Post-death Retirement Plan Distributions

While the beneficiary designation is a quick, easy way to leave a testamentary gift of retirement plan assets, charity's face significant challenges in collecting these gifts. Primarily, these gifts are from IRAs but other qualified plan distributions face similar problems. Some IRA custodians delay paying death claims based on the company's internal policies for what procedures and paperwork are necessary to pay an IRA death claim. These procedures are often invasive, cumbersome, and time consuming. There are some common problems faced in collecting IRA accounts and some potential solutions.

A. The Problem with Collecting IRA and Other Retirement Account Proceeds

A beneficiary designation, whether on an insurance policy, a bank account, or an IRA should operate as a payable on death account. Upon proof of death, the claim should be paid. Instead, charitable and non-charitable beneficiaries are required to set up a second account – called an inherited IRA. The account administrator transfers the donor's balance from the original IRA into the inherited IRA. The beneficiary can then ask the account administrator to liquidate the account to get the money. Each retirement plan administrator has varying procedures and requirements to access these accounts at the death of the plan owner.

The plan administrator requires extensive disclosure from the representatives of the charity to open an inherited IRA. While the charity is the owner of the inherited IRA, in the account opening process the plan administrator may require personal information of individuals employed by the charity. These forms require the date of birth, home address, personal

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phone number, Social Security Number, copy of a driver's license and personal financial information. Of course, this ignores the fact that the charity owns the inherited IRA, not the individuals completing the account opening paperwork.

B. Possible Solutions

I wrote an article in 2018 offering three alternatives for navigating how to receive post-death distributions from retirement plans. The article focuses on IRAs, but the same advice applies to other testamentary distributions from qualified retirement plans.

The first approach is to take the path of least resistance. This means the charity provides the personal, sensitive information as if the signer were opening the account. Why would a charity do that? To get the money!

The second approach is to open an inherited IRA as a charitable beneficiary. This means the charity enters its name, tax identification number, and the address and contact information for the person administering the distribution for your organization. Mark N/A for each field that is irrelevant or inapplicable. Have an officer of the charity sign the application and include a certificate of the Board Secretary showing that the signer has authority to engage in financial transactions on the part of the charity.

The third approach is to stand your ground. Don't accede to the administrator's request for opening an inherited IRA and request a distribution of the IRA proceeds. If you choose this approach consult the RIFT (Release IRA Funds Timely) Project. https://charitablegiftplanners.org/ira-distribution-resource-center The RIFT Project is the brainchild of Johni Hays, JD, Senior Vice President at Thompson & Associates.

The RIFT database is accessible on a complimentary basis for all nonprofits to help expedite their claims. The database includes the names of various IRA custodians and their requirements and contact information. This database is available to the entire planned giving industry and all nonprofits to access freely on the National Association of Charitable Gift Planner's website. The project is a fluid one as the IRA custodians' policies and procedures can and do change frequently.

V. Concluding Word

This paper has presented both *inter vivos* and testamentary gift options for retirement plans that will increase awareness of other options and stimulate mentioning them in marketing materials and in conversations with donors. The largest source of philanthropic dollars during a donor's life from an IRA is the QCD for donors aged 70 ½ and older. There are some situations where a donor may take a withdrawal from a qualified retirement plan and make a charitable gift of the proceeds. Such a withdrawal is possible from any qualified plan if the donor is under 70 ½ or if the donor wants to make a gift from a qualified plan other than an IRA.

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Testamentary gifts from qualified plans are a tax-smart way to make end-of-life charitable gifts. The donor has access to the money during life and avoids income tax on the funds remaining at death. Testamentary gifts of retirement plans to CRTs and CGAs are useful ways to stretch out the benefits of such a plan over the life of heirs.

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APPENDIX A

A. Classification of Retirement Plans According to How Benefits are Determined

1. **Defined-benefit plan**
A defined-benefit plan guarantees a certain payout at retirement according to a formula, which takes into consideration the employee's salary and years of employment. The employer must invest enough, determined by an actuary, to meet the payment obligations, but because returns on investments and future benefits to be paid cannot precisely be known in advance, the assets in the fund are sometimes insufficient to meet the benefits. When that is the case, the plan is said to be underfunded. Many defined benefit plans are guaranteed by the Pension Benefit Guaranty Corporation. In the past, it was common practice for companies to offer defined-benefit plans to employees, but in recent years the trend has been towards defined-contribution plans.

2. **Defined-contribution plan**
In a defined-contribution plan, contributions are made to individual participant accounts, and the retirement payments to each participant depend on the amount contributed to his or her account and the returns on the investment of the contributions. Depending on the type of defined-contribution plan, contributions may be made either by the company that sponsors the plan, the participant, or both. In many instances, the participant can choose the types of investments for the funds in his or her account. IRAs, 401(k) plans, and 403(b) plans are all defined-contribution plans.

B. Defined-Contribution Plans

1. **Tax benefits**
All defined-contribution plans offer these benefits.

- Employer contributions are deductible on the participant's federal income tax return (and generally on state income tax returns as well) to the extent they do not exceed contribution limits.
- Employee contributions are likewise deductible on income tax returns, again to the extent they do not exceed contribution limits.
- Earnings on the invested contributions are not currently taxed.

In summary, amounts contributed, and earnings aren't subject to income tax until they are received.

Naming someone other than the spouse as a beneficiary for an ERISA account, such as a 401(k), a SIMPLE IRA, a SEP IRA, an ESOP, or profit-sharing plan, requires consent from the spouse. Thus, a charity may not be named as a primary

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beneficiary without the consent of the account holder's spouse. Such consent is not required in a traditional IRA or Roth IRA unless the company managing the accounts decides to add such requirements.

2. **401(k) plan**
   A 401(k) plan must be sponsored by an employer, which is typically a for-profit corporation. The employee can elect to have a portion of his or her wages paid into his or her 401(k) account, and, as noted above, these contributions are pre-tax dollars. The plan will spell out the extent of employer matching contributions. The employer's contribution might be a percentage of net profits each year (profit sharing plan), or a percentage of each employee's annual salary (money purchase plan). In both cases, the contributions would be allocated to employee accounts.

   The employee contributions are immediately vested. The plan could provide that employer contribution are likewise immediately vested, or it might have a vesting schedule whereby the employee's right to employer contributions becomes non-forfeitable after the elapse of a certain period. Employer contributions must meet non-discrimination requirements.

   Most 401(k) plans are participant-directed, meaning that the employee can select from several investment options. Some plans also offer the option to purchase company stock.

   Beginning in 2006, a 401(k) plan could be designed to allow employees either to contribute on a pre-tax basis with all distributions fully taxable, or to allocate some or all their contributions to a separate Roth account. Contributions to this account would be after-tax, but distributions would be tax-free. A 401(k) must have the proper amendments to make a Roth account possible. (See below for a description of Roth accounts.)

   Contributions limits to a 401(k) plan for 2021 are:

   - Elective contributions by the employee $19,500
   - Catch-up contributions for individuals 50 and older $6,500
   - Combined limit for employer and employee contributions $58,000 ($64,500 if age 50 or older)

3. **403(b) plan**
   A 403(b) plan can be established by a:

   - Public school, college, or university, or
   - A charitable entity tax-exempt under IRC Sec. 501(c)(3)

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403(b) plans offer the same tax advantages as a 401(k) plan, for amounts contributed and income earned aren't subject to income tax until received.

As with 401(k) plans, employers may make matching contributions. Often, they function like a money-purchase plan since the employer contributes a percentage of the participating employee's annual compensation. In many instances, that percentage depends on the age of the employee.

Participants in a 403(b) plan may choose among annuity and variable annuity accounts with insurance companies and a custodial account generally made up of mutual funds. An example of the latter is TIAA/CREF where the participant can allocate assets in his or her account among various equity and fixed income investments. If an individual chooses to invest in a variable annuity, there will likely be a surrender charge if he or she wants to transfer the money elsewhere.

Like the 401(k), beginning in 2006, a participant can contribute after-tax dollars to a Roth 403(b). It is also possible to allocate a portion of the contribution to a Roth 403(b) and a portion to a regular 403(b), subject to the contribution limitations.

As with a 401(k), employee contributions are immediately vested in a 403(b) plan. In most instances, employer contributions vest automatically as well. Monies can, and often do, stay in the plan after termination of employment.

Contributions limits to a 403(b) plan for 2021 are:

- Elective contributions by the employee $19,500
- Catch-up contributions for individuals 50 and older $6,500
- Combined limit for employer and employee contributions $58,000 ($64,500 if age 50 or older)

4. **Traditional IRA**

Unlike 401(k) and 403(b) plans, which require employer involvement, a qualifying individual can establish a traditional IRA. Cash or cash equivalents would be transferred to the custodian, and the IRA owner may choose the investments (self-directed IRA).

The tax benefits are the same as for a 401(k) and 403(b) plan. The amount contributed is deductible, provided it is within the allowable limit, earnings are not taxed, and distributions are fully taxed, except for any portion that is derived from after-tax contributions.

The contribution limit in 2021 for traditional IRAs is $6,000. Employees aged 50 or older are eligible to contribute an additional $1,000, for a total of $7,000.

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IRA Rollovers
Assets in a 401(k) plan, a 403(b) plan, or a Keogh plan can be rolled over to a traditional IRA. In the case of a 401(k) plan, this frequently happens when an employee changes jobs and is entitled to a distribution from the employer's 401(k) plan. Money is more likely to be retained in a 403(b) plan when the employee ceases to work for the organization, but a rollover to an IRA is possible. Sometimes individuals have millions of dollars in their IRAs. This is usually the result of rollovers from qualified plans where substantial assets accumulated.

Funds can be transferred from a Traditional IRA to another without tax consequences.

Rollovers can be direct or indirect. If "direct," assets are transferred from the employer plan to the employee's IRA (or from one IRA to another). If "indirect," the employee receives a distribution check and has 60 days to transfer all, or a portion of the amount received to an IRA. A direct transfer avoids any IRS mandatory withholding rules.

5. **Roth IRA**
Contributions are not deductible; they are made with after-tax assets. Earnings on Roth IRA assets are not taxed, and withdrawals are usually tax-free. At the death of the owner, distributions to individual beneficiaries are not subject to income tax provided the account has been in existence for at least five years. In the case of a contribution to a Roth IRA, the five-year holding period begins on January 1st of the tax year for which a contribution was made. In the case of a conversion from a Traditional IRA to a Roth IRA, the holding period begins on January 1st of the year in which the conversion occurred.

The contribution limit in 2021 for traditional IRAs is $6,000. Employees aged 50 or older are eligible to contribute an additional $1,000, for a total of $7,000. The ability to contribute to a Roth IRA does not depend on whether the individual participates in an employer retirement plan.

Roth IRA Conversions
Beginning in January of 2010, the income ceiling for converting a traditional IRA to a Roth IRA was lifted. In the past, persons whose income exceeded $100,000 were precluded from a conversion. A person might want to convert because distributions from a Roth IRA, whether made to the owner or heirs, are not taxable and because there are no minimum distributions. A person might hesitate to convert because the amount transferred from a traditional IRA to a Roth IRA is fully taxable in the year of the conversion.

Usually, a person, upon leaving an employer, and who had a 401(k) through the employer will convert the 401(k) to a regular IRA, and subsequently the funds in that IRA could be transferred to a Roth IRA. Subject to certain conditions, a

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direct conversion of the 401(k) to a Roth IRA may be possible without the intermediate step.

6. **SEP IRA**
SEP is an acronym for "Simplified Employee Pension."

The SEP IRA functions as a low-cost pension plan for small businesses. It is an employer-contribution plan only; employees cannot make additional optional contributions. The money contributed by the employer goes into individual employee IRA accounts, and the individual owns all the assets from day one.

Employees may exclude from taxable income the SEP contribution. As with a traditional IRA, the earnings are not currently taxed, and distributions are taxed only when received.

A SEP IRA may be established by a self-employed individual who has no employees, or by a business owner with employees. In the latter case, eligibility must be extended to all employees who are at least age 21, have worked for the employer three of the last five years, and received at least $500 of compensation during the tax year. Eligibility can be less but not stricter.

Contributions an employer can make to an employee's SEP-IRA cannot exceed the lesser of:
1. 25% of the employee's compensation, or
2. $58,000 for 2021

Note: Elective salary deferrals and catch-up contributions are not permitted in SEP plans.

Simple IRA
"Simple" is an acronym for "Savings Incentive Match Plan for Employees."

A Simple IRA may be established by firms with no more than 100 employees. The employees may choose to make salary reduction contributions. The plan requires a minimum contribution by the employer, which may either match employee contributions dollar-for-dollar up to three percent of compensation or a non-elective flat two percent of compensation for every employee who earns at least $5,000 during the year. All contributions are made directly to an IRA (either an account or an annuity) for each employee. The employee is the owner of the account from the beginning.

The contribution limit for an employee in 2021 is $13,500 and a catch-up contribution of $3,000 for a total of $16,500 for those over age 50. The tax benefits are the same as those for a SEP IRA.

7. **457 Plans**
Non-qualified deferred compensation plans are explained in IRC Sec. 457. The plan is made available to employees who work for the state or local government.

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(Certain nongovernmental employers may be eligible for these plans as well.) 457 plans don't penalize employees the 10% penalty tax for withdrawals prior to age 55. Withdrawals from a 457 plan are still subject to normal income taxation.

The contribution limit for elective deferrals to a 457 plan is $19,500 in 2021. Employees aged 50 or older may contribute up to an additional $6,500 for a total of $26,000. Employees taking advantage of the special pre-retirement catch-up may be eligible to contribute up to double the normal limit, for a total of $39,000.

8. **Keogh Plan**
   A Keogh plan is designed for a self-employed professional or the owner of a small, unincorporated business.

   The Keogh plan can be either a defined-benefit or defined-contribution plan. If it is the former, the business owner would contribute each year whatever is required to pay the formula amount upon retirement. If it is the latter, the contribution could either be a percentage of profit or a percentage of compensation, and the retirement benefits would depend on the total contributions and the earnings on them. Older business owners often opt for a defined-benefit plan because, with fewer years to retirement, a larger percentage of tax-deductible contributions can be allocated to themselves.

   The tax benefits of a Keogh plan are comparable to a traditional IRA: deductible contributions, deferred taxation of earnings, and taxable distributions upon receipt.

   If the business owner has employees, eligibility requirements can be set, but they cannot discriminate in favor of highly compensated employees.

   Vesting could occur over a five-year period. A Keogh plan is more complex to establish and administer than the SEP or Simple IRA.

   Keogh plans can be set up as qualified defined-contribution plans, in which the contributions are made on a regular basis up to a limit. Profit-sharing plans are one of the two types of Keogh plans that allow a business to contribute up to 100% of compensation, or $58,000 as of 2021, according to the IRS.

9. **Rabbi Trusts**
   The Rabbi Trust is a non-qualified deferred compensation plan, so named because it was first set up for the benefit of a rabbi. A portion of the current income of an employee is deferred and not taxable. The assets of the trust are reachable by the employee's creditors, so there is a risk of forfeiture. However, the money in the trust cannot be used by the employer. Unless the employer becomes insolvent, the money is protected.

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