Effective Gift Planning Strategies in Turbulent Times

PG Calc Webinar

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I. Introduction

Since January 2020, America has experienced a pandemic the likes of which haven't been seen since the 1918 Spanish Flu. The first coronavirus case was identified on January 22. By February, the effects of the coronavirus, Covid-19 were seen around the world. On March 21, 2020, the state of California instituted the first state-wide shut-down. State and local governments across the country soon followed suit and imposed stay at home orders and prohibitions on crowd gathering that brought the U.S. economy to a near standstill. On March 23, 2020, the S & P 500 had lost 34% of its value since December 2019.

The announcement of the Federal Reserve's relief measures and economic stimulus legislation fueled a steady stock market run-up through April and May. U.S. stock prices were driven higher with early signs of economic recovery and business activity resumed after rolling back the shutdowns imposed to combat the coronavirus pandemic. Uncertainty over the development of a Covid-19 vaccine and China-U.S. trade continue to roil stock markets. Nonetheless, stocks rallied during the first half of June 2020 but accompanied by continued volatility.

Despite the stock market rally, more than 40 million people have applied for unemployment benefits during the pandemic, and roughly 21.5 million are currently receiving them, that wiped out a job market that saw unemployment at historic lows as recently as February. With the reopening of the economies of many states there was some good news as May unemployment dropped to 13.3 percent from 14.7 percent.

II. The high-net-worth donor

A. What's on the mind of the high-net-worth donor?

There are various definitions of HNW, but those considered high-net-worth includes those with a net worth of at least $5 million. There are about 3 million households considered HNW. The higher a person's net worth, the more likely they are to own stocks, real estate, closely held business, and other private equity.

The pandemic has not affected the ultra-wealthy in the same way as others. In fact, the rebound in the stock market led by technology stocks erased all of the year-to-date losses. Experts predict that technology stocks will outperform market indexes amid the pandemic and through a recession.

Hedge funds and private equity firms often purchase distressed businesses at bargain prices, sell their assets and turn a tidy profit. There are currently businesses (Hertz, J. Crew) that have already or will shortly declare bankruptcy and seek an exit strategy that could yield big returns for the HNW.

Nonetheless, the watchword for 2020 is uncertainty. In mid-June 2020 Eric Rosengren, president of the Federal Reserve Bank of Boston said, "So far, in the United States efforts to contain the virus have not been particularly successful." Randal K. Quarles the Fed's vice chair for supervision said, "There's probably never been more uncertainty about the economic outlook."

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Anecdotally, gift discussions continue. Some of these were under way prior to the pandemic, others are about giving opportunities that began after the pandemic. Six, seven, even eight figure gift discussions are underway.

The increase in the standard deduction that became law in 2018 (The Tax Cuts and Jobs Act) reduced the number of itemizers by around 30 million taxpayers. Taxpayers who do not itemize their deductions received no tax incentives for charitable gifts under this law. Nonetheless, charitable giving increased in 2019 despite fewer taxpayers itemizing their deductions.

B. Talking to donors about giving during the pandemic

a. What conversations should I be having with donors/prospects?

The pandemic and its accompanying economic disruption continue. There are predictions these conditions will continue well into 2021. The disruption will continue at least until the administration of an effective Covid-19 vaccine produces wide-spread immunity to the virus.

For the most part, as of the date of this webinar most donor interaction is via telephone, email, video conferencing and sometimes old-fashioned U.S. postal service. These interactions continue to be the norm for most individuals. In-person meetings have begun on a limited basis.

What should you say to your donors regardless of the means of communication? Stay in contact with legacy society members, high value prospects, and continue identification and cultivation of prospects as best as you can. In the past, the purpose of these contacts would be for stewardship or to move a gift discussion along.

As of June 2020, the conversations have to change. Communications, particularly initially, should focus on what could generally be defined as stewardship. Even with prospects, the first thing on your mind is how the person is doing. Acknowledge the existence and impact of the virus and its impact on daily life. Planned giving donors are typically older and may suffer from ailments that make them particularly susceptible to Covid-19.

Ask about them, their families, their work if they are still employed. Ask open ended questions and let them talk. For example, "How have you been affected by the pandemic?" or "Tell me how you have changed your lifestyle during the pandemic?" Expect expressions of anxiety, frustration, and uncertainty. Nearly everyone has been affected by the pandemic, but reactions to the disruptions will vary.

Follow the donor/prospect's lead. Some will be angry about government-imposed restrictions, others will be grateful they and their families have been spared becoming ill. In every case, be particularly sensitive to death references. Always a delicate discussion in planned giving, be thoughtful in discussing the pandemic and sickness and mortality.

b. Having a planned giving discussion in the pandemic

In spite of these turbulent times, some donors may be ready for a planned gift discussion. Dr. Russell James has taught us that people engage in estate and financial planning activity around

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important life events. We traditionally think of examples of these milestones as reaching a certain age, moving into a retirement community, or the death of a spouse and similar life events.

Covid-19 is a landmark event of the type that can motivate people to engage in planning decisions. Dr. James also taught us that people show strong negative reactions to death reminders. Therefore, just as we did prior to the pandemic, make oblique references to death. Say, "When the trust ends, whatever is left is distributed to us." Don't say, "Upon your death, the trust makes a distribution of its assets to us."

Discussions of end-of-life planning should focus on getting your affairs in order, making sure your wishes are carried out, and an orderly distribution of the things you own. Anecdotally, estate and financial planning professionals report an uptick in activity. Guarantee your place in the donor's planning by continuing planned gift donor communication and marketing.

III. Cares Act and other charitable giving incentives

The Coronavirus Aid, Relief, and Economic Security Act, or CARES Act was signed into law on March 27, 2020. It provides more than $2 trillion in relief touching nearly every corner of the U.S. economy: large and small businesses, health care providers, non-profits, individual citizens, and on and on. Included in its 880 pages are several provisions of particular interest to gift planners and to fundraisers generally.

A. Provisions of the CARES Act affecting philanthropy

100% of AGI limit available in 2020 for cash gifts to most public charities: For the 2020 tax year only, donors may elect to waive the AGI limit on cash gifts to public charities ("50% charities"), creating, in effect, a new 100% of adjusted gross income (AGI) limit for these gifts. The election appears to be available separately for each contribution. That is, the donor could elect to waive the limitation for one qualified cash donation and not wave it for another. Gifts to donor advised funds (DAFs) or supporting organizations (SOs) are not eligible for this special election. The Act is silent on whether cash gifts to life income plans are eligible for the waiver. Our best advice is for donors who are considering a life income gift in 2020 to consult their own tax counsel on this question.

The 100% limit is reduced dollar-for-dollar by other itemized charitable deductions. This means that in 2020, a donor who deducts 30% of her AGI in long term appreciated property gifts and elects the 100% of AGI limit for qualified cash contributions will be able to also deduct up to 70% of her AGI for qualified cash gifts, a total deduction of up to 100% of AGI. If this donor uses all her available deduction for qualified cash gifts, she will pay no federal income tax in 2020! Ordinarily, this donor's total deduction would be limited to 60% of AGI and she would have to carry forward the rest. This change presents a big opportunity for attracting major gifts and planned gifts in 2020.

A donor who makes the 100% of AGI election can carry forward unused qualified cash gift deductions up to 5 years. The carryforward will be subject to the normal 60% of AGI limit, as are cash deductions carried forward from past years.

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The 100% election may not always be the tax-wise choice: Because federal income tax rates are progressive, it is not a given that it will be to a donor's advantage to make the 100% of AGI election. For example, a single donor who has taxable income of $200,000 is in the 32% federal income tax bracket. If the donor makes $200,000 in qualified cash contributions, makes the 100% of AGI election, and itemizes no other deductions, he will pay no federal income tax in 2020, saving $45,015.50 in tax as a result. However, if he doesn't make the election, he would deduct $120,000 and carry forward $80,000 to 2021. Assuming he can deduct the remaining $80,000 in 2021 and again has taxable income of $200,000, he will save $31,625 in federal income tax in 2020 and approximately another $22,136 in 2021, a total tax savings over the two years of $53,761. A donor in the highest federal tax bracket, 37%, could see an even larger tax benefit by not taking the 100% election. Donors should consult their tax advisers to determine whether the 100% election makes sense for them.

Non-itemizers eligible for $300 adjustment to income: A reduction in taxable income is available in 2020 for donors who do not itemize their deductions. It is an "above-the-line" adjustment to income that will reduce a donor's AGI and thereby reduce taxable income. This adjustment is available for cash gifts to public charities ("50% charities") only and is limited to $300 per individual. It is not available for gifts to DAFs or SOs, nor for cash deductions carried forward from prior years.

While many read the CARES Act provision to be $300 per individual, a Joint Committee on Taxation report describing provisions in the CARES Act, released March 23, states in a footnote that the $300 deduction is per "tax-filing unit." That would mean a married couple who files jointly and doesn't itemize may deduct up to $300 in qualified charitable contributions, not up to $600.

While far more limited than above-the-line deductions or the "Universal Charitable Deduction" previously proposed by the charitable sector, this change will encourage the 90% of taxpayers who do not itemize to make more cash gifts in 2020. Donors who prefer to itemize their deductions can still itemize them (see (1) above).

Required minimum distributions waived in 2020 for most donors: Most donors will not have a required minimum distribution from their retirement plan in 2020. Minimum distributions will not be required from IRAs, 401(k)s, 403(b)s and most other defined contribution plans maintained by an employer for individuals. Minimum distributions that have already started are still required from defined benefit pension plans and some 457 plans. However, required minimum distributions that would have had to start in 2020 don't have to start until 2021, including distributions from defined benefit pension plans and 457 plans. This change will dampen somewhat the incentive for a donor to make a qualified charitable distribution (QCD) from her IRA in 2020. Even so, making a QCD this year will still allow itemizers and non-itemizers alike to direct up to $100,000 from their IRA to charities in a tax efficient manner.

B. Potential additional legislative incentives

The Wall Street Journal reported in its June 15, 2020 edition on a bipartisan effort to expand tax breaks for charitable donations. Senators, including James Lankford (R., Okla.) and Jeanne Shaheen (D., N.H.), want to let taxpayers deduct charitable donations, even if they don't itemize their deductions. Their plan would greatly increase the $300 above-the-line deduction created in

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March. Their plan would limit that to one-third of the standard deduction. In 2020, that is $4,133 for individuals and $8,267 for married couples. https://www.wsj.com/articles/expanded-tax-break-for-charitable-gifts-gains-support-in-congress-11592218800

The doubling of the standard deduction in the Tax Cuts and Jobs Act greatly reduced the number of people who have enough deductions to make itemizing worthwhile. The number of itemizers fell to about one-tenth of households from about one-quarter. The top 1% of households now get 58% of the tax break, according to the Urban-Brookings Tax Policy Center.

Some oppose this proposed legislation as merely an additional tax cut that will have little impact on increasing charitable donations. Studies are under way to amend the legislation to effectively increase the benefit to charity through expanded tax incentives.

IV. Planned Gifts for Hard Times

We have firmly established that most of our donors are facing hard times. Donors are concerned about their health, the economy, their families, maintaining their lifestyle, and the future in general. Some have suggested that today looks like a world where the depression, the Spanish Flu, and the civil rights disruptions of 1968 happened all at once.

More than ever the planned gift may be the most appealing choice to support the charities they care about. Deferred gifts offer flexibility for timing, amount, and contingencies to ensure the donor's wishes are carried out.

The bequest and designated beneficiary offer the ultimate adaptability to suit the donor's needs. They are revocable and the donor maintains control of the asset throughout life. Life income gifts meet the needs of those making gifts who need an income stream in the future. Finally, a combination of an outright gift paired with a planned gift can allow donors to make large gifts with confidence and the satisfaction of supporting charities that are important to them.

A. Gift Annuities

A gift annuity is a contract under which a charity, in return for a transfer of cash or other property, agrees to pay a fixed sum of money for a period measured by one or two lives. A person who receives payments is called an "annuitant" or "beneficiary." The contributed property becomes part of the charity's assets, and the payments are a general obligation of the charity. The annuity is backed by all the charity's assets, not just by the property contributed.

Gift Annuity Rates

The gift annuity rates most charities follow are those suggested by the American Council on Gift Annuities ("ACGA"). The rates are reviewed continuously. Most typically, changes become effective on July 1. The ACGA reviews the annuity rates in force and announces rate changes based on their analysis of certain factors listed below. The ACGA published a new schedule of rates that become effective on July 1, 2020.

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Assumptions Underlying Suggested Maximum Gift Annuity Rates

Following is a summary of the major assumptions on which the July 1, 2020 suggested rates are based.

Target Residuum. Since 1955 the ACGA has targeted a residuum (the amount realized by the charity upon termination of an annuity) of 50% of the original contribution for the gift annuity.[1] The new rate schedules retain the 50% target residuum, and continue the requirement first applied for the July 2011 rate schedules that the present value (PV) of the residuum be at least 20% of the original contribution for the annuity.

The 20% minimum PV requirement has the effect of reducing rates for annuitants age 59 and under. It is designed to help charities realize a minimum value from gifts whose residua will not be realized for many years. Rates for younger annuitants (ages 5 to 50) were reduced as necessary to comply with the 10% minimum charitable deduction required under IRC Sec. 514 (c)(5)(A) using the 0.6% CFMR for June 2020. Particularly in low interest rate environments, charities should perform their own deduction calculations and lower their annuity rates if necessary, to meet the 10% minimum deduction requirement.

Mortality Assumptions. The National Association of Insurance Commissioners (NAIC) has recommended the use of a new mortality table for commercial and gift annuities issued after January 1, 2015. Known as the 2012 Individual Annuity Reserving Table (2012 IAR), the new table is designed to reflect annuitant mortality more accurately over time. ACGA commissioned a study by The Korn Ferry Hay Group in December 2014 to determine what set of assumptions provided the best “fit” for the 2012 IAR with the ACGA Gift Annuitant Mortality Study completed in 2010. The Korn Ferry Hay Group determined the new “best fit” assumption was a 50-50 blend of the 2012 IAR male and female mortality with no age setback.

Expense Assumption. Annual expenses for investment and administration are assumed to be 1.0% of the fair market value of gift annuity reserves.

Investment Return Assumption. The gross annual expected return on immediate payment and deferred payment gift annuity reserves is 3.75%. Both immediate and deferred payment annuity calculations use a net compounding rate of 2.75% (3.75% minus 1% assumed annual expenses).

Payment Assumption. Annual payments are made in quarterly installments at the end of each period. The rates for the oldest ages are somewhat lower than the rates that would follow from the above assumptions. Single life rates are capped at 8.6% for annuitants age 90 and above. Single life rates for annuitants between ages 81 and 89 are graduated downward from the rate cap. Two life rates are capped at 8.4% for annuitants above 90 and are graduated downward in a similar way.

The gift annuity market

The gift annuity has low barriers to entry. Typical gift minimums are $10,000. An exceedingly small number of annuities are funded with millions of dollars. While exceptionally large annuities are certainly possible, charities tend to shy away from these big gifts because they come with an unlimited liability to make payments to the annuitants. While the charitable

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remainder annuity trust (CRAT) shares many of the features of a gift annuity, it is more expensive to create and administer than the CGA. A gift annuity can do most of what a CRAT can do better and cheaper. For that reason, the CRAT is fairly rare.

Allowance of the income tax charitable deduction for gift annuities

A gift annuity is a form of bargain sale, for the present value of the lifetime annuity is less than the value of the property transferred to the charity. So, who is selling what to whom? The donor is buying an annuity contract from your charity in exchange for lifetime income. The rates are set so that the present value of the annuity purchased is lower than the amount donated. The difference between the donor's gift and the purchase price of the donor's annuity contract can be taken as an income tax charitable deduction.

The charitable tax deduction available to the donor is the difference between the amount transferred and the present value of the annuity. The IRS publishes tables and guidelines used to determine the value of the donor's annuity contract and the charitable portion. [See Reg. Secs. 1.170A-1(d)(1) and 20.2055-2(f).]

The Immediate Gift Annuity

The immediate annuity is the most popular form of gift annuity. An immediate annuity starts making payments at the end of the payment period immediately following the contribution. Payments can be made monthly, quarterly, semi-annually, or annually. The most common arrangement is quarterly payments at the end of the quarter.

Immediate payment gift annuity:

George and Rita are longtime supporters of your organization. They have been making annual gifts for decades and often volunteer. George and Rita are age 76 and 75 and don't consider themselves particularly wealthy. They have accumulated a comfortable nest egg conservatively invested in the stock market.

The events of early 2020 have spooked them about the reliability and long-term prospects for income from their investments. You have stewarded George and Mary for their support over the years. In response to a mailing on gift annuities, they return a reply card asking for more information on gift annuities. They requested an illustration of a gift annuity with a gift of $25,000.

The rates in this paper are based on those in effect as of July 1, 2020. Based on their ages, George and Rita qualify for an immediate annuity rate of 4.7%. Based on a gift of $25,000 paid quarterly they would receive $1,175 (4.7% x $25,000) a year for life. Of their $25,000 gift to fund the annuity they would be entitled to an income tax charitable deduction of $9,018 using a May 2020's 0.8% discount rate. Their payments are protected from fluctuations in the performance of the stock market. It is quite common for donors like this to create multiple annuities for larger and larger gifts. They like the simplicity of the annuity and the rates go up as they get older.

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Why aren't they eligible for a deduction equal to their gift? They retained the right to receive $940 a year for life that is not deductible. Another benefit to George and Rita is that 82% of their annuity payments will be tax-free over their projected life expectancy.

The Deferred Gift Annuity:

With a deferred gift annuity, the annuitant starts receiving payments at a future time, which must be more than one year after the date of the contribution. As with immediate gift annuities, payments can be made monthly, quarterly, semi-annually, or annually. Because payments are deferred, they are larger than for an immediate gift annuity that starts making payments to an annuitant of the same age. For example, the immediate annuity rate for a person age 55 who contributes $10,000 with payments to start immediately, the annuity rate would be 3.7%. If instead the donor defers payments for 10 years to when she is 65, the deferred annuity rate would be 5.5%.

Deferred gift annuities
Matt and Jenna are still working and make generous annual gifts. In addition, they have given two of their cars to your vehicle donation program netting several thousand dollars. Matt is 68 and Jenna is 65. Matt is one of those folks who can't imagine ever being fully retired. Jenna on the other hand, wants to fully retire once she is eligible for her highest Social Security benefit at age 70.

You discussed gift annuities with them on a recent stewardship call. They don't need income now and an immediate annuity would only pay 3.9%. You suggest creating a $25,000 gift annuity now, but payments would begin when Jenna is retired at age 70. The income tax charitable deduction for the deferred annuity is taken in the year of the gift. This gift would be entitled to an income tax charitable deduction of $6,864.

Beginning on June 30, 2025 the annuity would begin making payments of $1,225 per year for the rest of Matt and Jenna's life. In addition, 77% of each annuity payment would be tax-free for the first 19 years of payments, their joint life expectancy beyond the year payments will start.

Charitable remainder trusts:

The charitable remainder unitrust (CRUT) is typically the vehicle of choice for gifts in the six-figure range and up. Many gift acceptance policies still list the minimum funding amount for charitable remainder trusts at $100,000. It would be the rare situation that any institutional trustee would manage a CRUT for such a small amount. Some will consider a CRUT valued at $250,000 or more, many will set a minimum of $500,000 and some trustees will only trustee a CRT funded with $1,000,00 or more. The CRT is expensive to establish, requires professional investment management, complicated accounting and tax reporting, and must generate trustee fees sufficient to make the CRT worth administering.

The CRUT is far more flexible than the gift annuity or CRAT in funding, investment, payment structure and administration. In particular, a specialized form of the CRUT makes it the vehicle of choice when making a gift of real estate, closely-held businesses, tangible personal property, and other illiquid assets. A "unitrust" amount is a fixed percentage adjusted annually based on

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the current market value of the trust assets. Therefore, the performance of the trust assets drives the beneficiary's income. Here is an example:

Suppose a CRUT is established and funded on the first business day of the year. The examples below show how the beneficiary income would vary given the investment performance of the trust:

Year one: 5% payout, trust value $1,250,000; Unitrust payment **$62,500**

Year two: 5% payout, trust value $1,450,000; Unitrust payment **$72,500**

Year three: 5% payout, trust value $1,100,000; Unitrust payment **$55,000**

CRUT Example:
Trip and Bunny own commercial real estate valued at $2,500,000. The pandemic has played havoc with their other investments, but real estate values have so far held firm. They want to sell the property as quickly as possible to lock in their gains. Selling the building would generate significant capital gain liability and erode their net investment gain.

Instead, Trip and Bunny contribute the building to a charitable remainder unitrust. This isn't a plain vanilla CRUT, it has a special flip provision to accommodate sale of illiquid property. The flip provision specifies that the trustee will continue to pay Trip and Bunny the net income from their building until the year after the building is sold. The trustee will collect rents and other income from the property, pay expenses like taxes, insurance, and maintenance, and pass the net income to Trip and Bunny. Essentially, they receive substantially the same income as before contribution to the CRUT.

The building is occupied by a number of high-tech firms that have continued to thrive through the pandemic. One of these tenants specializes in tele-health applications. The pandemic has dramatically increased demand for this technology. The tenant quickly agrees to buy the building at its appraised value.

Pay careful attention to what happens to trust income after the sale of the building. The flip trust now makes distributions as a standard CRUT: it will distribute a fixed percentage of its value, as revalued each year, regardless of the trust's net income. This will allow the trustee to invest in a diversified portfolio without concern that earning net income that is less than the trust's unitrust percentage will limit the amount distributed to Trip and Bunny each year.

V. Creative planned gift solutions

a. The virtual endowment

The gift minimums to establish a name endowed fund vary widely**.** A large affiliate of the California state university system will establish a named chair for $1,000,000. A public university in the Midwest requires $2,000,000 to endow a chair. A private university in the Northeast requires at least $3,000,000 to endow a chair.

This exercise is not to discuss the appropriate minimum gift to create a named endowed fund. The purpose is to establish that the gifts commensurate with naming endowment opportunities require seven-figure gifts. Donors are attracted to named endowments because they offer

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perpetual recognition of the donor's generosity and leaves a lasting legacy. Donors must make significant commitments in exchange for recognition of this magnitude. A flexible solution can make these gifts happen when the donor thinks they can't afford it.

How it works

A donor balked at a $3,000,000 solicitation to fund a chair in the radiology department at a major academic medical center. The donors wanted to honor a doctor who cared for patients but also conducted innovative research into radiologic treatments for cancer. While the donors are quite wealthy and charitably inclined, they also worry about leaving a legacy for their children and grandchildren given economic conditions for the near future.

The medical center's endowment policy for 2020 permits distributions of 5% of the principal from endowed funds. The annual distribution from an endowment with $3,000,000 principal and a 5% spend rate is $150,000.

Instead of requiring the donors to donate $3,000,000 now, the medical center offers an innovative solution. The donors agree to make $150,000 annual gifts to the department of radiology for the rest of their lives. The agreement also encourages them to make additional gifts to "seed" the endowment during their lives.

The donors further agree that to the extent the endowment is not fully funded at their death, they direct their executor to make gifts to the medical center to fund the endowment at no less than the minimum amount. If the donors fail to fund the endowment, the medical center retains the right to remove their name from the endowment and offer recognition commensurate with the gift actually received.

b. Creative capital naming opportunities

The capital campaign and the planned gift usually mix like the proverbial oil and water. The point of the capital campaign is to raise money for building projects that require current cash. A promise to pay in the future doesn't pay contractors who won't wait for their money. Plus, if the donor wants their name on the building, the charity needs assurances that they donor will pay the pledge. There may be a way to blend an outright gift and a planned gift that meets the charity's needs and offers the donor flexibility.

The public phase of a capital campaign commonly runs for five to seven years. The campaign hopes to receive substantially all the cash pledged within the campaign period. Here is where the flexibility comes in and it will likely require a change in recognition policies.

The donor pledges to pay 75% of the price of the capital naming gift during the campaign period. The pledge for 75% of the total gift must be in cash and/or publicly traded securities that can be easily converted to cash. For reasons that will become clear, the donor must be older, perhaps a minimum of 75 years of age.

The balance of the gift, the remaining 25% of the naming gift is pledged in the form of a planned gift. The easiest solution is for the donor to enter a pledge in the nature of a promissory agreement. The testamentary pledge is an irrevocable agreement directing the donor's executor to pay the balance of the remaining pledge on the donor's death.

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The pledge agreements further permit the charity to change the naming recognition to be commensurate with the gift actually received. This protects the charity from giving away a naming opportunity for less than the amount required.

c. Testamentary CRT replacement for stretch IRA

The stretch IRA was an arrangement that permitted beneficiaries of an inherited IRA to spread payments from the IRA over their life expectancy. The arrangement allowed the IRA principal to continue to grow tax-free. The income tax due on the IRA distributions were delayed, reducing the tax burden on the income from the IRA.

The "Setting Every Community Up for Retirement Enhancement" Act (aka, the "SECURE Act") changed the law relating to inherited IRAs, effective January 1, 2020. The inherited IRA can no longer spread out payments over the life expectancy of the IRA beneficiary. Instead, the SECURE Act requires to distribute the entire IRA within 10 years of the IRA owner's death. The tax benefits of the stretch IRA were eliminated.

Stretch IRA alternative

The tax-wise alternative to the stretch IRA after the SECURE Act is to make a CRT the beneficiary of an inherited IRA. How does this testamentary IRA save taxes and still spread payments over the life expectancy of the IRA beneficiary?

Using this solution requires the donor to change their beneficiary designation to make the CRT the beneficiary of the IRA. The IRA principal has never been subject to taxation. If the entire balance in the account is paid to a non-charitable beneficiary, that amount will be subject to tax. But a CRT is a tax-exempt trust. If the CRT is the beneficiary of the IRA, there is no tax on the funding of the trust.

Since the IRA principal has never been taxed, the payments from the CRT are subject to income tax. Nonetheless, the CRT can spread out payments over the beneficiary's life expectancy and defer tax on the CRT payments. The net effect is the functional equivalent of a stretch IRA, although it is important to point out that the heir of a stretch IRA had access to all principal while the beneficiary of a testamentary CRT funded with IRA assets has access to the payments only.

Conclusion

As Thomas Paine said in 1776, "These are the times that try men's souls." Our health, our economy, and our very social and political order are in disarray. Charity plays a critical role in seeing our country through these times. Remember the basic planned giving tools. A simple bequest/beneficiary designation honors the donor's need for flexibility, yet are often the largest single gif the donor will ever make. Life income gifts provide tax-wise solutions that offer lifetime income, an income tax charitable deduction, and the satisfaction of making a substantial gift to charity. Finally, consider flexible, creative solutions that blend outright and planned gifts to meet the needs of the donor and your charity.

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