

**CHARITABLE ESTATE  
PLANNING**

***NAUMF NATIONAL  
CONFERENCE***

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# CHARITABLE ESTATE PLANNING

*\*Bracing for Future Tax Changes*

*-- Charitable gifts?    -- Roth IRA conversions?*

*\*Charitable IRA Rollover –Strategy For Legal Limbo*

*\* Bequests of Retirement Assets*

# FUTURE OF ESTATE TAX ?

<u>Year</u>	<u>Threshold</u>
2001	\$ 675,000
2002-2003	\$ 1,000,000
2004-2005	\$ 1,500,000
2006-2008	\$ 2,000,000
2009	\$ 3,500,000
2010	REPEALED ! [* <i>carryover basis</i> ]
2011	\$ 1,000,000

# Federal Estate Tax Returns Filed

2009 (est)	14,300	25% charit
2007	38,000	20%
2004	62,700	18%
2001	108,000	17%
1998	97,900	17%
1995	69,780	19%
1992	59,200	19%

# THE YEAR 2010:

## The “Perfect Storm” for Taxes

- The “Bush Tax Cuts” expire in 2010
  - Return to Clinton-era tax rates in 2011
- New Health Care Tax in 2013 if income over \$200,000 (\$250,000 joint returns)
  - 3.8% investment income surtax
  - 0.9% earned income (wages, etc.)

# FUTURE INCOME TAX RATES

<u><i>Highest tax rates on:</i></u>	<u>2010</u>	<u>2011</u>	<u>2013</u>
■ Investment income	35%	39.6%	43.4%
■ Earned income (wages – 1.45% health)	36.4%	41.0%	41.9%
■ Dividends	15%	39.6%	43.4%
■ LT Capital Gains	15%	20%	23.8%

**PLANNING FOR  
CHARITABLE GIFTS  
OF APPRECIATED STOCK  
IN LIGHT OF FUTURE  
TAX RATE CHANGES**

# DONORS LIKE TO CONTRIBUTE APPRECIATED STOCK

## DOUBLE-TAX ADVANTAGE

- Charitable Income Tax Deduction for the Full Appreciated Value of the Stock
- Never Pay Income Tax on the Growth of the Value of the Stock
- **Loss Property?** Sell for tax loss; give cash

# DOUBLE BENEFIT FROM GIFT OF APPRECIATED L.T.C.G. PROPERTY



<< AVOID LONG-TERM  
CAPITAL GAIN TAX

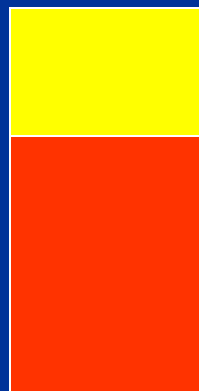
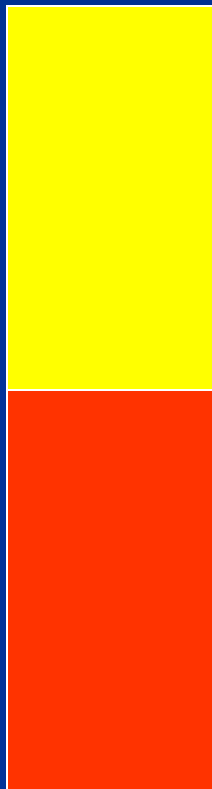
<< CHARITABLE INCOME  
TAX DEDUCTION

# \$ Benefits

# Max Federal Taxes Saved

## Person

50%



\* 25% RE Dep Recap

\* 28% Collectibles

<< 15%\* LTCG Tax Rate

<< 35% Marginal Tax Rate

IMPACT OF  
INDIVIDUAL INCOME  
TAX RATE CHANGES  
IN 2011 AND 2013

# FUTURE INCOME TAX RATES

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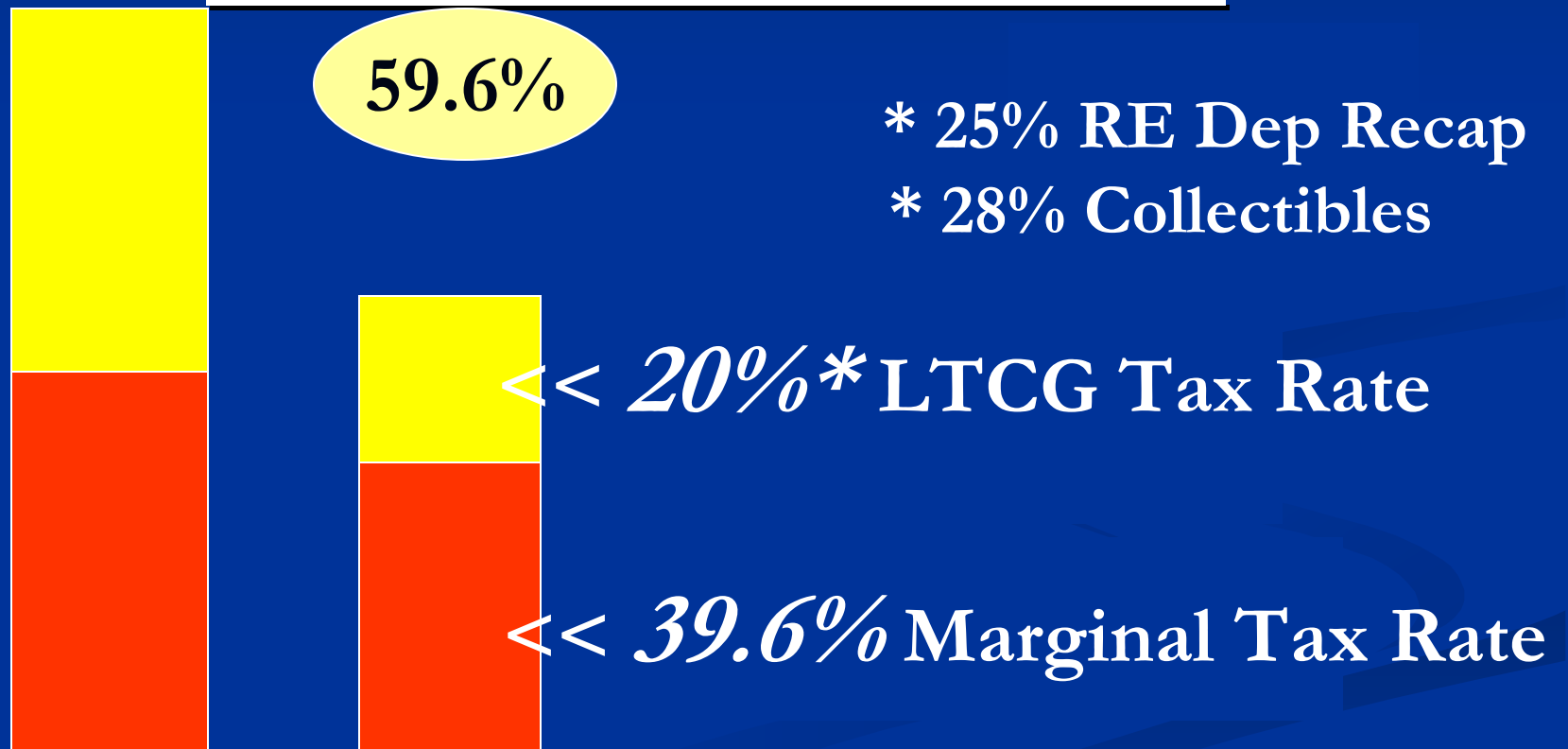
\$ Benefits    Max Federal Taxes Saved

Person in the Year 2010



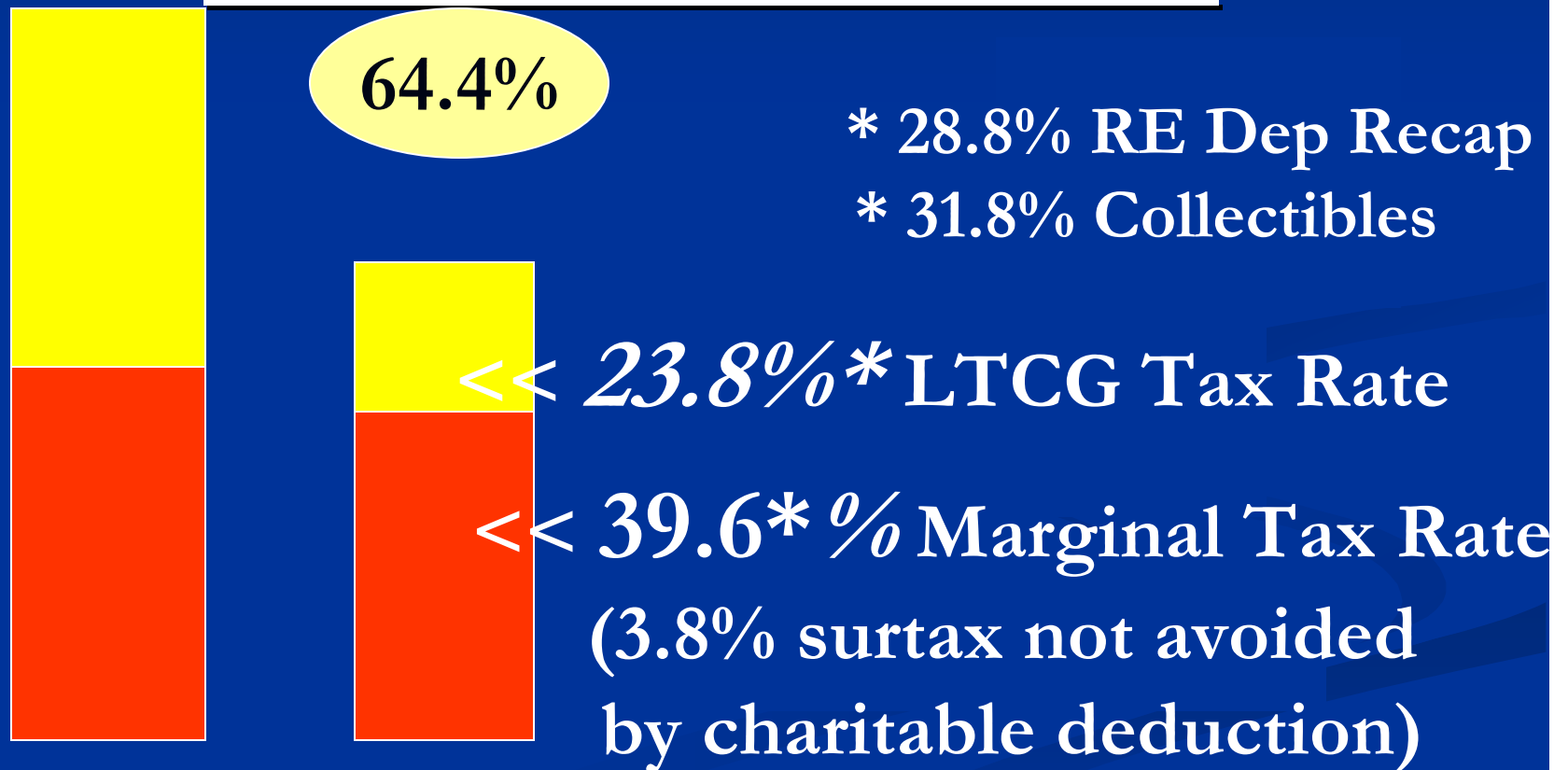
\$ Benefits    Max Federal Taxes Saved

Person in the Year 2011



\$ Benefits    Max Federal Taxes Saved

Person in the Year 2013



# Obama Budget Proposal:

## TAX BENEFIT FROM CHARITABLE GIFTS & MORTGAGE INTEREST *LIMITED TO 28%*

Example: Rich person has \$100 income

\$ 39.6 <<-- Pay tax at 39.6%

-28.0 <<-- Tax savings from \$100 gift

\$ 11.6 <<-- Cost of making \$100 gift

# FUTURE INCOME TAX RATES

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# FUTURE INCOME TAX RATES

## STRATEGIES FOR HIGH-INCOMES

- Municipal bonds
- Roth IRA conversion in 2010 [not 2013]
- Avoid spikes in income from major gains on property sales
  - tax-exempt CRTs & installment sale

# **ROTH IRA CONVERSIONS**

**in 2010**

**– Pros and Cons**

# Roth IRA, Roth 401(k), or Roth 403(b)

INVERSE OF TRADITIONAL:

- No tax deduction at contribution
- Accumulate in tax-exempt trust
- Not taxed upon distribution

# ROTH IRA CONVERSION IS A TAXABLE EVENT

Treated as taxable withdrawal from traditional IRA or QRP, followed by a non-deductible contribution to a Roth IRA

Can do even in year with no compens

No 10% penalty if do a Roth IRA conversion before age 59 ½ (but there is the income tax liability)

## THE YEAR 2010: ROTH IRA CONVERSIONS

- In 2009, a person could convert into a Roth IRA only if income (“MAGI”) was under \$100,000.
- In 2010, there is no income limit for *conversion* (limit stays the same for regular contributions)

# ROTH IRA CONVERSION IS A TAXABLE EVENT

Example of \$100,000 Roth IRA Conversion:

Taxable Income in Year:

<u>Conversion Year</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
■ 2009	\$100			
■ 2010		-0-	\$ 50	\$ 50
<i>(2010 election &gt;)</i>		<i>\$100</i>		
■ 2011			\$100	

# WHO IS THE BEST CANDIDATE FOR A ROTH IRA CONVERSION ?

- A rich person who is always in the highest income tax bracket
- A wealthy person who will likely pay the estate tax
- A person now in a low tax bracket who will be in higher tax bracket later

# TWO BIG ADVANTAGES OF ROTH IRAs

- Unlike a regular IRA, a Roth IRA has no mandatory lifetime distributions after age 70  $\frac{1}{2}$  (compare: Roth 401(k) must make RMD)
- Shrinking estate may reduce estate tax

# REQUIRED MINIMUM DISTRIBUTION (“RMD”)

BACKGROUND: 50% penalty if not receive distribution from IRA, 401(k), etc:

#1 – lifetime distributions from own IRA:

→ beginning after age 70 ½

#2 – an inherited IRA, 401(k), etc –

→ beginning year after death \*

# REQUIRED MINIMUM DISTRIBUTIONS

## \*LIFETIME DISTRIBUTIONS\*

Age of Account Owner      Required Payout

70 1/2	3.65%
75	4.37%
80	5.35%
85	6.76%
90	8.75%
95	11.63%
100	15.88%

# ADVANTAGES OF ROTH IRAs

- Unlike a regular IRA,  
no mandatory lifetime  
distributions from a  
Roth IRA after age 70 ½
- Yes, there are mandatory  
distributions after death

# ADVANTAGES OF ROTH IRAs

- Unlike regular IRAs, no mandatory lifetime distributions after age 70 ½
- Shrinking estate may reduce estate tax

# Roth IRA & Estate Tax

## Assets

Cash, etc.           \$ 2.6 million

IRA (*taxable IRD*) 1.0 million

Tx-exmp Roth       - 0-

Liab               -0-

Net Estate           \$ 3.6 million

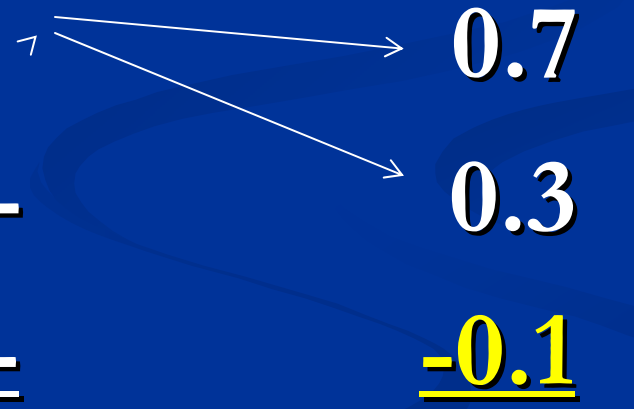
# Roth IRA & Estate Tax

	<u>Before</u>	<u>After</u>
Cash, etc.	2.6	2.6
IRA	1.0	0.7
Tx-exmp Roth	- 0 -	0.3
Liab	<u>-0-</u>	
Net Estate	3.6	

The diagram illustrates the distribution of IRA funds. A value of 1.0 in the 'Before' column for 'IRA' is split into 0.7 in the 'After' column for 'IRA' and 0.3 in the 'After' column for 'Tx-exmp Roth'.

# Roth IRA & Estate Tax

	<u>Before</u>	<u>After</u>
Cash, etc.	2.6	2.6
IRA	1.0	0.7
Tx-exmp Roth	- 0-	0.3
Liab	<u>-0-</u>	<u>-0.1</u>
Net Estate	3.6	3.5



# Roth IRA & Estate Tax

	<u>Before</u>		<u>After</u>
Cash, etc.	2.6	paid >	2.5
IRA ( <i>taxable IRD</i> )	1.0		0.7
Tx-exmp Roth	- 0-		0.3
Liab	<u>-0-</u>	paid >	<u>-0-</u>
Net Estate	3.6		3.5

# DISADVANTAGE OF ROTH IRA

Income might be subject to  
higher income tax rate

# FUTURE TAX RATES FOR WEALTHIEST TAXPAYERS

<u><i>Highest tax rates on:</i></u>	<u>2010</u>	<u>2011</u>	<u>2013</u>
■ Investment income	35%	39.6%	43.4%
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■ LT Capital Gains	15%	20%	23.8%

# WHAT ABOUT THE MIDDLE CLASS?

- Planning question: if someone will be in a lower tax bracket in retirement, do the advantages of a Roth IRA beat higher tax rate that might be paid on a conversion?
- The benefits:
  - No mandatory distributions age 70 ½
  - Reduce estate tax

## PLANNING STRATEGIES

Client might never have a year with more taxable income than a Roth IRA conversion year.

Income tax deductions in the year of a Roth IRA conversion could produce greater benefit than in other years.

# PLANNING STRATEGIES FOR CHARITABLE CLIENTS

## THREE CHARITABLE STRATEGIES:

- Clients with charitable deduction carryforwards
- Major outright gift or planned gift in year of Roth IRA conversion – tax deduction
- Client's objective to make biggest charitable bequest possible? Then avoid a Roth IRA conversion

# PLANNING STRATEGIES

**DEDUCTIONS:** Identify clients who have carryforwards & consider Roth IRA conversion

- Charitable deduction carry-forwards
  - *especially if expire in 2010!*

**WILL REDUCE COST OF CONVERSION**

# ROTH IRA CONVERSION IS A TAXABLE EVENT

Example of \$100,000 Roth IRA Conversion:

Taxable Income in Year:

<u>Conversion Year</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
■ 2009	\$100			
■ 2010			\$ 50	\$ 50
		<i>(2010 election &gt;)</i>	<i>\$100</i>	
■ 2011			\$100	

# PLANNING STRATEGIES

**DEDUCTIONS:** Accelerate income tax deductions from future years into conversion year

- Major Charitable Gift– prepay pledge
- Philanthropy – gift to a private foundation or donor advised fund

**Charitable IRA Rollover**  
**-- Lifetime Gifts from IRAs --**

WHAT SHOULD DONORS DO  
IN A YEAR LIKE 2010 WHEN  
THE LAW HASN'T BEEN  
EXTENDED?

# Charitable IRA Rollover

## -- Lifetime Gifts from IRAs --

### -- OVERVIEW OF THE LAW --

- IRA owner must be over age 70 ½
- Maximum: \$100,000 per year
- Yes! Charitable gift satisfies required minimum distribution requirement from IRA!

## WHO WINS?

- Donors who do not itemize tax deductions (“standard deduction”)
- Donors who live in states where state income tax laws have no charitable deduction

# WHO WINS ?

- Donors subject to annual charitable deduction limitation (50% of AGI)
- Wealthy individuals who want to reduce the proportion of retirement assets in their estates

# WHO SHOULD AVOID CHARITABLE IRA ROLLOVER ?

- Donors about to sell highly appreciated stock and make a cash gift
  - >> better to donate that stock to charity
- Donors who live in states where the state income tax exempts retirement income from tax but allows tax deductions for charitable gifts

*Colorado, Kentucky, New York*

# LEGAL REQUIREMENTS

- Over age 70 1/2
- IRA (only) – not 403(b), 401(k), etc.
- “Directly” from the IRA to charity
  - OK to send check to donor who forwards to charity

# LEGAL REQUIREMENTS

- ELIGIBLE CHARITY – Public charity or private operating foundation  
-- however, a donor advised fund or supporting org is not eligible
- Must qualify for full charitable deduction – no dinners; no CGAs

# LEGAL REQUIREMENTS

- Taxable part of IRA distributions (only)
  - tax-free distributions protected
- Donor must have letter from charity that donor received no goods or services in exchange for the gift

# TECHNICAL ISSUES

- Yes! Charitable IRA gifts can satisfy legally binding pledges!
- Joint return? Up to \$200,000
- No withholding taxes
- Beneficiary of an inherited IRA who is over age 70 1/2 can make charitable gifts of required distributions

# Will Law Be Extended to 2010?

Proposed: Public Good IRA Rollover Act of 2009

Expand law to include deferred gifts; DAFs; SOs

## > Planning strategy for 2010

if, like in 2008, law hasn't been  
extended until October:

➤ Give RMD to charity;

➤ can't lose ! (Some IRAs balk)

# **THREE STAGES** **of a RETIREMENT ACCOUNT**

- **Accumulate Wealth**
- **Retirement Withdrawals**
- **Distributions After Death**

# Distributions After Death

- > Income taxation
- > Mandatory ERISA distributions
- > Estate taxation

Collision of three tax worlds at death

# INCOME IN RESPECT OF A DECEDENT - “IRD” – Sec. 691

- No stepped up basis for retirement assets
- After death, payments are *income in respect of a decedent* (“IRD”) to the beneficiaries
- Common mistake in the past: children liquidate inherited retirement accounts.

# CHARITABLE BEQUESTS FROM QRPs

- Best type of bequest: taxable income !
- Easier than formality of a will: Name charity as beneficiary on form of plan
  - no need for attorney to draft
  - no need for witnesses, etc.

**“You can’t make a charitable bequest unless you have a will”**

Wrong. A retirement plan is a trust with its own beneficiary designations. Like other trusts, assets can pass outside probate.

Name a charity as a beneficiary

- the cheapest “charitable remainder trust”

**LIFETIME GIFTS: *ONLY IRAs***  
**BEQUESTS: *ANY QRP***

- 1. Sec. 401 – Company plans
- 2. Sec. 408 – IRAs
  - SEP & SIMPLE IRAs
- 3. Sec. 403(b) & 457–Charities
- 4. Roth IRAs & 401(k)/403(b)

# WHAT CAN GO WRONG ?

## TWO WAYS TO MAKE A CHARITABLE BEQUEST FROM A RETIREMENT ACCOUNT

#1 – NAME CHARITY AS BENEFICIARY OF THE ACCOUNT

#2 – PAY ACCOUNT TO ESTATE OR TRUST THAT THEN MAKES A CHARITABLE BEQUEST

# WHAT CAN GO WRONG #1?

- Other beneficiaries cannot do stretch IRAs if charity is beneficiary?
- Solutions:
  - \* cash out charity's share by Sept 30
  - or
  - \* separate account for charity

# WHAT CAN GO WRONG #2 ?

## TWO WAYS TO MAKE A CHARITABLE BEQUEST FROM A RETIREMENT ACCOUNT

#1 – NAME CHARITY AS BENEFICIARY OF THE ACCOUNT

*#2 – PAY ACCOUNT TO ESTATE OR TRUST THAT THEN MAKES A CHARITABLE BEQUEST*

## WHAT CAN GO WRONG #2?

Estate or trust has taxable income from receiving IRA distribution, but maybe there is no offsetting charitable income tax deduction when the IRA check is given to a charity.

# WHAT CAN GO WRONG?

- IRS Chief Counsel Memorandum ILM 200848020
- Decedent left his IRA to a trust that benefited his six children and several charities
- Trust received cash from IRA; paid entire charitable share, leaving the six children as the only remaining beneficiaries of the trust.
- IRS: “Taxable income from IRA, but no charitable deduction.” Reason: trust had no instructions to pay income to charities

# WHAT CAN GO WRONG?

## SOLUTION: USE METHOD #1

It is better to name the charity as the beneficiary on the retirement account beneficiary forms (method #1) than to have the retirement account payable to an estate or trust that will make a charitable bequest (method #2).

# ESTATE PLANNING WITH RETIREMENT ASSETS

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