

# Make the Most of Charitable Giving with Your IRA

Philanthropy plays a significant role for many high-net-worth families in their wealth planning. When we think about leaving a charitable giving legacy, making a bequest from our estate naturally comes to mind. However, individual retirement accounts (IRAs) can be an attractive and flexible way to manage charitable gifts and meet estate planning needs.

Here are several approaches that can enable you to achieve important family goals and make the most of your charitable giving via your IRA.



## Trusteed IRA

Many IRA owners want to see their funds last for as long as possible following their death, which enables their IRAs to benefit from growth on a tax-deferred basis. When your beneficiary takes control of the IRA assets upon your death in an IRA, however, they can withdraw all or part of the IRA funds at any time: There's nothing to prevent the rapid dissipation of funds. In addition, a beneficiary in an IRA is responsible for investing the IRA assets after the death of the original owner. That may be a real problem if the beneficiary does not have the investment experience and knowledge to make sound decisions.

Trusteed IRAs are designed to address these issues by giving the IRA owner greater control over the account even after death.

In the case of a trust as beneficiary of an IRA or plan, if the election is made to base post-death distributions on the beneficiary's life expectancy, the oldest beneficiary of the trust (i.e., the one with the shortest life expectancy) generally must be used for this calculation.

In the case of a charity as beneficiary, this life expectancy payout method is not available. This is because a charity is not an individual, and therefore has no life expectancy to calculate annual distributions.

The charity will have to take required post-death distributions from the IRA or plan at the fastest possible rate, generally either in a lump sum or according to one of the following methods:

- If you pass away prior to your required beginning date for required minimum distributions (RMDs), the charity must distribute the IRA or plan funds within five years after your death (the "five-year rule").
- If you pass away after your required beginning date for RMDs with a charity as beneficiary, the IRA or plan funds must be distributed over your remaining single life expectancy, calculated in the year of death (maximum 17 years)

For any other type of beneficiary, these post-death distribution options would be considered unfavorable from a tax standpoint, because they generally accelerate distributions. Therefore, because a qualified charity named as beneficiary doesn't pay income tax, it does not matter how quickly or slowly the IRA or plan funds are distributed to the charity—the result will be the same.

What happens if you have named both a charity and an individual as beneficiaries of your IRA or plan? Is the individual beneficiary allowed to use the life expectancy method to distribute his or her share? The answer is maybe. It depends on whether certain rules are followed. If you have left your IRA or plan to a charity and one or more individuals in fractional amounts (as opposed to dollar amounts), the account may be divided into separate accounts up until December 31 following the year of your death. Then, the individual beneficiary can use his or her own life expectancy for his or her separate account. Or, the benefits due to the charity can simply be paid out to the charity before September 30 following the year of your death. If the charity has been fully paid off by the date indicated above, it is no longer considered a beneficiary for distribution purposes.



## Third-party trusts and special needs

In a third-party trust, you designate the trust as the IRA beneficiary and select the trust's beneficiary. In most cases, when you name an IRA beneficiary that isn't an individual such as a trust or a charity, the entire amount of your IRA must be distributed to that beneficiary within five years after your death.

However, the IRS will usually look beyond the trust to find the real IRA beneficiary if special IRS rules are followed and a see-through trust is established. See-through trusts are generally structured as conduit trusts, where all distributions received by the trustee from the IRA may be passed on to the beneficiary. As a result, the trust beneficiary rather than the trust is considered the IRA's beneficiary. Because the trust beneficiary's life expectancy and not the trust's will be used to calculate RMDs, the five-year payout rule is avoided.

Third-party trusts are often used to help family members with special needs who need help with daily living. A special needs trust supplements benefits the person with special needs who may receive from government programs. The trust distributions need to be made in a manner to support the individual without disqualifying them from further participation in the programs they have qualified for as a result of their disability.

An IRA-funded special needs trust set up as a conduit trust is established by the person who placed the IRA funds in the trust, i.e., the IRA owner. There is no limit to the size of the trust fund, and the funds can be used for a wide range of the beneficiary's needs.

A third-party trust used for a special needs beneficiary differs from a first-party trust. In the former, because the funds in the trust never belonged to the beneficiary, the government is not entitled to reimbursement for Medicaid payments made on behalf of the beneficiary after they die. In a first-party trust, the assets in the trust were owned by the beneficiary before being placed in the trust, and funds are used for the beneficiary's benefit while they are living. Upon death, however, any remaining trust assets are used to reimburse the government for the cost of the beneficiary's medical care.

Many families select a nonprofit as the trustee to provide support for the beneficiary and coordinate benefits. A parent often converts a 401(k) to an IRA, which then goes to a charity that manages it via a trust. If the charity is named as the beneficiary rather than the dependent

**To qualify as a conduit/accumulation trust, several requirements must be met in a timely manner:**

1. The trust beneficiaries must be individuals clearly identifiable as designated beneficiaries as of September 30 following the year of the IRA owner's death.
2. The trust must be irrevocable or become irrevocable following the death of the IRA owner.
3. The trust document, all amendments, and the list of trust beneficiaries including contingent and remainder beneficiaries must be provided to the IRA custodian or plan administrator by October 31 following the year of the IRA owner's death.
4. The trust must be valid under state law.

with special needs, the five-year rule is triggered. However, elections are not an “all or nothing” proposition, meaning an IRA owner can name multiple beneficiaries for the trust, of which the Special Needs Trust Beneficiary may be one. Working with a specialist is essential to ensure that the right language is used, the correct beneficiaries are designated, and the five-year rule is not triggered.

If your objective is to provide for a family member with special needs and to support a charity, a conduit trust funded by IRA assets can be an attractive vehicle. It can maximize the funds available to meet important needs over the family member’s lifetime. And, upon the death of the beneficiary, whatever remains in the trust — or some portion of it — may pass to a charity as a remainder beneficiary.



## Qualified charitable distribution

Qualified charitable distributions (QCDs) enable you to make tax-advantaged donations from your IRA during your lifetime.

An individual who is 70 1/2 or older can take a non-taxable distribution of up to \$100,000 from their IRA if that distribution is made directly to a charity.

Unlike donor-advised funds and private foundations, public charities generally qualify for a non-taxable distribution. There is no requirement that the entire amount must go to one charity or be made in one transfer, and eligible donors may give as much as \$100,000 in gifts in a given year.

The distribution can satisfy or help satisfy the RMD from your IRA. And because the qualified charitable distribution is excluded from your adjusted gross income for the year in which it is taken, you gain an important tax break. It is important to remember to itemize charitable contributions, as otherwise you will gain no income tax benefit at all.

For more information about using your IRA as part of your giving plan, **please contact your Key Private Bank Advisor.**



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