

# IRA's: *the Queen on the Chessboard*

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**NORTHWEST PLANNED GIVING ROUNDTABLE**

# **Today's Topics**

**I. History of the IRA**

**II. Gifts During Life**

**III. Gifts at Death**

**IV. Over the Horizon: Creative Estate Planning  
with IRAs**

**V. Inheritor IRAs and YOU**





# Booming of the Boomers

**At one time, defined benefit pension plans (a pension plan in which an employer promises a specified monthly benefit at retirement) were commonplace. This was partly due to the fact that many employees worked for one company for their entire careers. As employment patterns changed and individuals began working for multiple employers over their careers, defined benefit pension plans failed to meet the retirement needs of workers.**

**This fact, along with the costs of sponsoring these plans, led to the growth of alternative retirement plans known as defined contribution plans.**

# Studebaker Drove Us to the IRA



# History of the IRA

**- Studebaker** Company that started in 1852 in South Bend, Indiana, making wagons for farmers, miners, and the military.

**- Ten years after the first gasoline-powered car was tested in the U.S., Studebaker entered the car manufacturing business and it was, at one point, the largest automobile maker in the world. By the 1960s, however, the company was having financial and labor difficulties and the last Studebaker car rolled off the assembly line on March 16, 1966.**

**- Studebaker had a legacy that was bigger than cars. In the 1960s, as Studebaker was shuttering its plants, the company realized that its pension plan was so poorly funded that it could not afford to pay all its employees their pensions. As a result, thousands of workers received no pension or only part of their pensions.**

**- As a result of that story and others like it, the public began to put pressure on Congress to do something to protect pension plans. In 1974, Congress enacted the Employee Retirement Income Security Act, often referred to as ERISA.**

**- ERISA was huge...**

**Ted Benna**





# The Day I Designed The First 401(K) Savings Plan

## By Ted Benna

**It was a quiet Saturday afternoon during September 1979.**

**I was redesigning the retirement program for one our bank clients. The bank wanted to replace its cash bonus plan with a tax-deferred profit sharing plan where employees wouldn't have access to the money until they left the bank. The president wanted to add this type of plan because the president wanted the tax break.**

**Many people, including me, were aware of the portion of the IRS Code that I used to design the first 401(k) savings plan. Because this provision was added to the Code for an entirely different purpose, no one had considered using it in the manner that I was about to propose.**

**I realized I could use this section to design a plan allowing each employee to put into the plan whatever portion of their cash bonus he or she wanted. The only catch was that I had to get the lower-paid two thirds to put enough money into the plan to allow the top one third to contribute as much as they wanted.**

**Employees who put money into the plan would get a tax break but I knew this wouldn't be enough to get many of the lower-paid employees to put money into the plan. This is when I thought of adding a matching employer contribution as an additional incentive.**

**It was at this point when the potential of what I had just "created" hit. Most large employers had savings plans at the time where employees put money in after-tax and received a matching employer contribution. I immediately realized it would be possible to change all these plans so that employees would be able to put their money in pre-tax rather than after-tax.**

**The bank actually rejected the idea because their attorney didn't want them doing something that had never been done before. As a result, the first plan we did was for our employees at The Johnson Companies. This is what started the 401(k) savings plan revolution.**



# History of the IRA

- 1978: Congress passed the Revenue Act of 1978, including a provision — Section 401(k) — that gave employees a tax-free way to defer compensation from bonuses or stock options. The law went into effect on January 1, 1980.
- Ted Benna, a benefits consultant at the Johnson Companies, saw the law as an opportunity for employers to create a tax-advantaged savings account for their employees.
- "I knew it was going to be big, but I was certainly not anticipating that it would be the primary way people would be accumulating money for retirement 30 plus years later," Benna now tells Workforce.
- 1981: The IRS issued rules that allowed employees to contribute to their 401(k) plans through salary deductions, which jump-started the widespread roll-out of 401(k) plans in the early 1980s.
- 1983: Nearly half of all large firms offered, or considered offering, a 401(k) plan. Companies liked the option because it was cheaper and more predictable to fund than pensions. Employees were attracted to a new savings vehicle that, they were told, could put them in a better position to retire.
- "Two bull-market runs in the 1980s and 1990s pushed 401(k) accounts higher," The Journal reports. Then, "two recessions in the 2000s erased those gains and prompted second thoughts from some early 401(k) champions."
- 1990: 401(k) plans held more than \$384 billion in assets, with 19 million active participants.
- 1996: Assets in 401(k) plans exceeded \$1 trillion, with more than 30 million active participants.
- Today: 401(k) plans hold more than \$4.8 trillion in assets. And pensions, in the private sector, are increasingly rare.

# History of the IRA

Defined contribution plans come in a variety of forms including **401(k)** plans for commercial businesses, **403(b)** plans for nonprofit organizations, and **457** plans for government workers. Each of these plans allows participants to defer tax on current income and subsequent gains until they begin taking withdrawals from the plans, generally in retirement.

# Retirement Plan Lifecycle

Roll

- 401(k)

Roll

- 403(b)

Roll

- 457 Govt

# IRA

# Summary of Common Retirement Plans

	Defined Benefit Plan	401(k)	403(b)	457	Traditional IRA	Roth IRA	Roth 401(k) Roth 403(b) Roth 457
Plan sponsor	Employer	For-profit business	Nonprofit organization	Governmental entity	Individual	Individual	Business, non-profit, or governmental entity
Contributions to plan are	Pre-tax	Pre-tax	Pre-tax	Pre-tax	Pre-tax	After-tax	After-tax
Lifetime distributions from plan are	Taxable	Taxable	Taxable	Taxable	Taxable	Tax-free	Tax-free
Give to charity during life?	No	No	No	No	Yes <sup>1</sup>	Yes <sup>2</sup>	Yes <sup>2</sup>
Primary benefit to donor of gift during life	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Avoid tax on distribution	Income tax deduction	Income tax deduction
Give to charity at death?	Possibly	Yes	Yes	Yes	Yes	Yes	Yes
Primary benefits of gift at death	Heirs and estate avoid taxes on distribution	Heirs and estate avoid taxes on distribution	Heirs and estate avoid taxes on distribution	Heirs and estate avoid taxes on distribution	Heirs and estate avoid taxes on distribution	Estate tax deduction	Estate tax deduction

<sup>1</sup> Up to \$100,000 per year in total to most qualified charities; donor must be over age 70½.

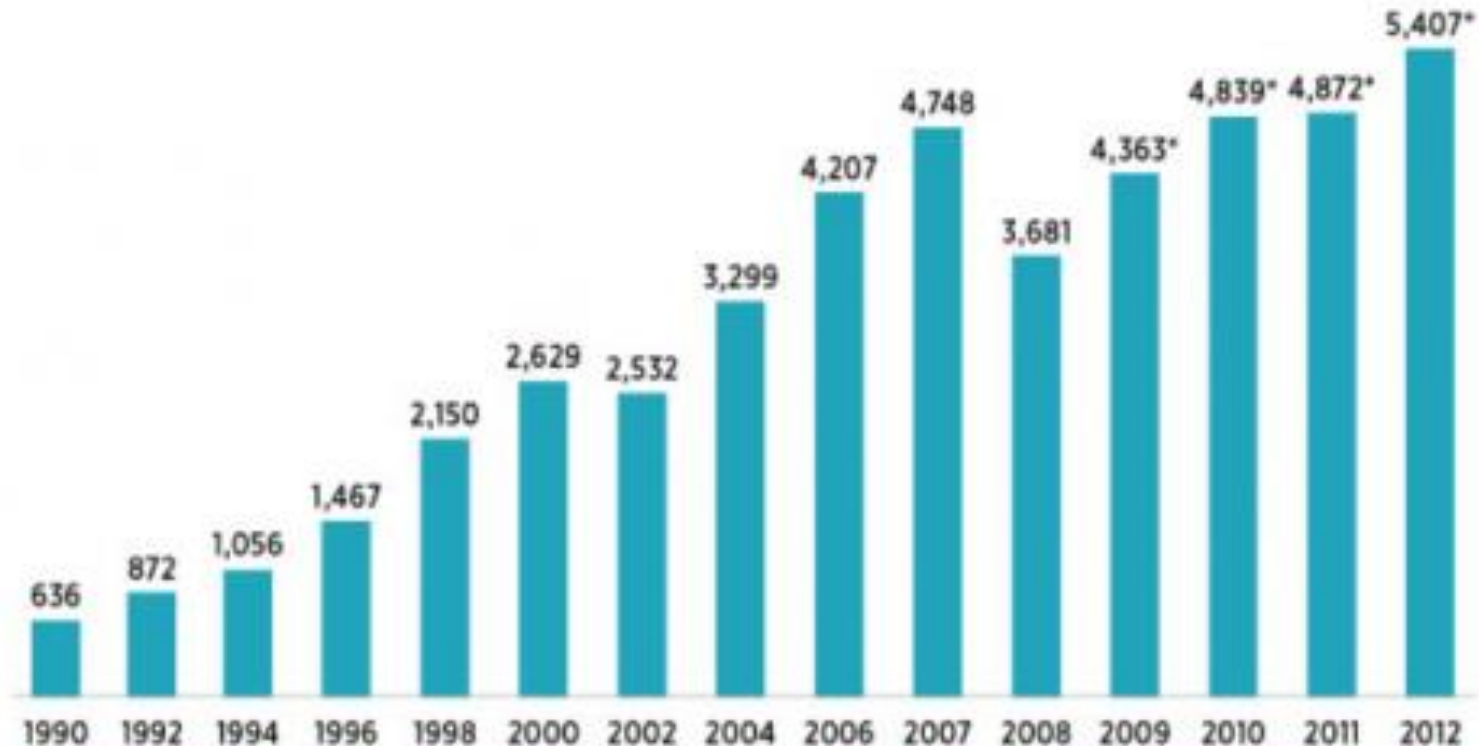
<sup>2</sup> Donor must be over 59½ and the account must have been open for more than five years to avoid tax on distribution.



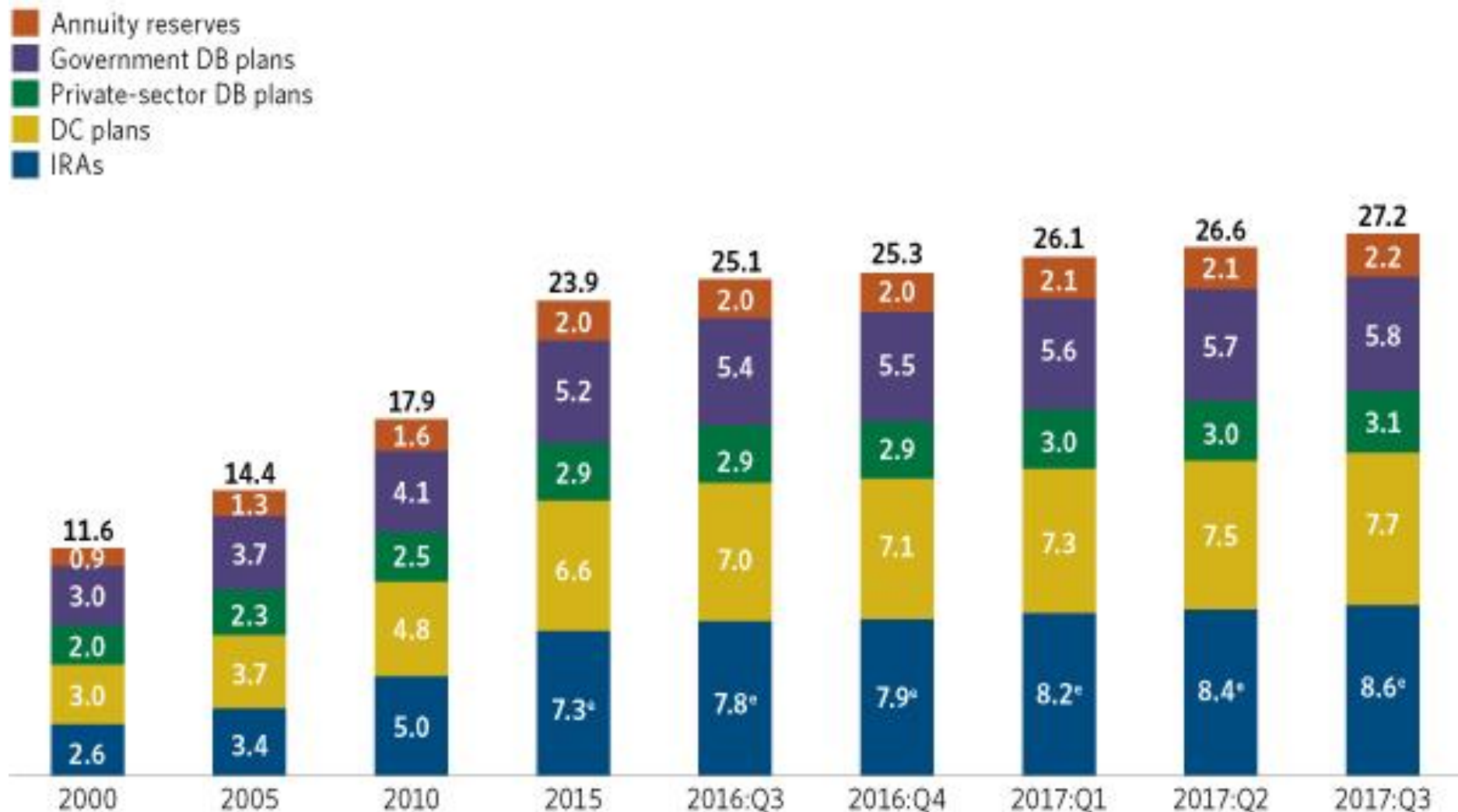
# Booming of the Boomers

## IRA Assets

*Billions of dollars, selected years*



# Booming of the Boomers



# Booming of the Boomers

- **Assets in IRA's have grown 10% per year**
- **Nearly 49 million households have a traditional IRA**
- **That's about 40% of the population**
- **46% of IRA's are invested in mutual funds**
- **The rest are in brokerage accounts**
- **The IRA breakdown is 38% in stock funds, 13% in world equity funds, 21% held target date and lifecycle funds, 20% are in bond funds, 9% in money markets**

# **Give to charity during life?**

**Donors over the age of 70½ may transfer traditional IRA assets by means of a qualified charitable distribution (QCD). A QCD is a direct transfer from the donor's IRA administrator to the charity and is permissible up to a maximum of \$100,000 per year. A QCD is not treated as a taxable distribution to the donor; nor does the donor receive an income tax charitable deduction for the gift. It is important to note that a QCD (sometimes referred to as an IRA charitable rollover) can only be for an outright gift. It cannot be used to fund a life income gift such as a gift annuity or charitable remainder unitrust**



# **Tax Reform: The Bad ...well maybe**

- **Lower income tax rates for most individuals.**
- **Standard deduction almost doubles to \$12,000 for single filers and \$24,000 for married couples filing jointly.**
- **Limitations on deductions for state and local taxes, and mortgage interest.**

# Will Fewer Itemizers Impact Charitable Giving?

- **Doubling the standard deduction is estimated to reduce the number of itemizers from 37 million to 16 million, or about 1 in 7 taxpayers (14%).**
- **The 16 million who will continue to itemize historically account for 60% of individual giving.**
- **The 21 million who will no longer itemize account for about 18% of individual giving.**
- **Middle-income households claiming the charitable deduction will drop from 17% to 5.5%.**
- **A study by the Lilly Family School of Philanthropy projects a potential decline in charitable giving of 1.7-4.6% due to the increased standard deduction.**

# **Support Charity with an IRA Rollover**

- **Taxpayers over age 70½ must take Required Minimum Distributions from IRAs and other qualified retirement plans.**
- **RMDs are 100% taxable to recipient.**
- **Strategy: Taxpayers may direct up to \$100,000 of annual Required Minimum Distribution from an IRA to charity as a Qualified Charitable Distribution.**
- **Benefit: Saves taxes by reducing taxable income even if donor doesn't itemize deductions.**



## CONSIDER AN IRA ROLLOVER IN 2017

*Great news for donors age 70½ with mandatory distributions*

With stock markets at an all-time high, **I would like to remind you that the IRA Charitable Rollover has been permanently extended.** This is great news for donors who have IRAs with mandatory distributions!

As in previous years, this provision allows individuals age 70½ or older to make tax-free gifts totaling up to \$100,000 from a traditional IRA account directly to qualified charities, like the OSU Foundation, **provided they are completed by December 31.** While you cannot claim a charitable deduction for IRA gifts, the distribution counts towards your minimum required distribution and does NOT trigger income tax.

In order to complete an IRA Charitable Rollover for 2017, **please contact your IRA provider** for exact instructions. Also, please let us know so that we can watch for it. For additional assistance, please contact [Julie Irmer](#) at 800-336-8217 or visit our [website](#) to learn more.

Thank you for considering a gift to support Oregon State University. Your dedication and support are sincerely appreciated.

With best wishes,

**Jeff Comfort**

Vice President of Principal Gifts and Gift Planning  
OSU Foundation





## CONSIDER AN IRA ROLLOVER IN 2018

*Great news for donors age 70½ with mandatory distributions*

### **ITCHING TO MAKE A DIFFERENCE AT OSU — AND ENJOY THE TAX BENEFIT?**

Donors age 70 ½ with mandatory IRA distributions can make a gift directly through their IRA custodian *and* avoid income tax. **Last year, OSU donors gave more than \$2 million through this special opportunity**—creating scholarships, supporting faculty, and benefiting the library and the Linus Pauling Institute.

Still a puppy? If you're too young to roll over your IRA, you can still [name the OSU Foundation a beneficiary](#).

In order to complete an IRA Charitable Rollover for 2018, **contact your IRA provider** for exact instructions. Also, please let us know so that we can watch for it. For additional assistance, contact [Julie Irmer](#) at 800-336-8217 or visit our [website](#) to learn more.

Thank you for considering a gift to support Oregon State University. Your dedication and support are sincerely appreciated.



**ROLLOVER!**  
Good IRA.

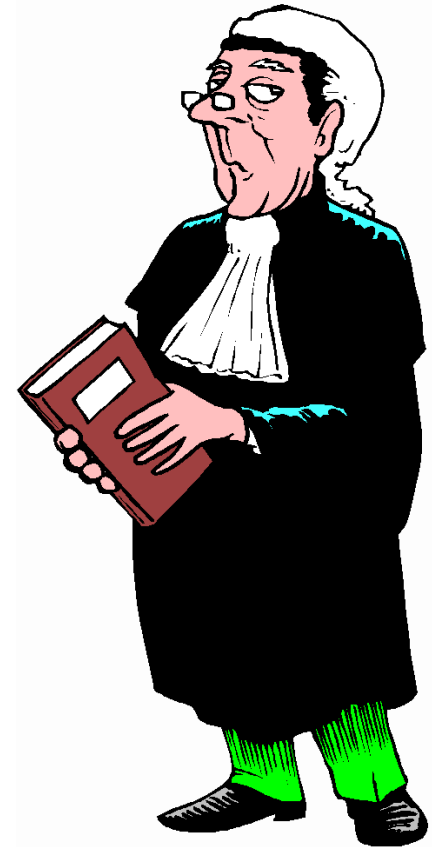




# Give to Charity at Death?



# Qualified Retirement Plan Beneficiary Designation Lawyers...?



# Give to Charity at Death?

- Another advantage for donors and fundraisers alike is that these gifts are easy to complete. Instead of making a trip to an attorney to draft a provision in the donor's will or living trust, the donor need only complete a simple beneficiary designation form. Also, these gifts are revocable and can be changed easily during the donor's life.



# Give to Charity at Death?

- The largest asset in many if not most donors' estates is their **retirement plan**, such as a 401(k), IRA, etc., Donors may be surprised to learn that the IRS will impose income tax on the remaining balance in the account.
- This tax is *in addition* to the estate tax that may be imposed on the account. For estates fully subject to the estate tax, the result can be that up to *60 percent* of the value of your retirement plan will be consumed in taxes before your child, relative, or friend receives it.
- **There is a sensible charitable alternative**
- Name The Oregon State University Foundation as the beneficiary of your retirement plan, then use other assets not subject to income tax to make gifts to your heirs. The Oregon State University Foundation, as a qualified 501 (c)(3), won't pay income tax on our distribution and your heirs will receive their share of your estate without the burden of extra taxes.

# **Give to Charity at Death?**

**It is important to recognize that retirement plan assets pass at the donor's death according to the beneficiary designation form, irrespective of the donor's other estate planning documents such as a will or living trust.**

**Suppose that many years ago Theresa filled out the necessary forms with her IRA administrator to designate her two nieces as the beneficiaries of her IRA. Earlier this year, and shortly before her death, Theresa executed a valid will naming your charity as the 100% beneficiary of her IRA account. Despite the provision in her will, her IRA assets will pass to her nieces and not to your charity. The beneficiary designation form will control. While it is possible for a donor to designate her will or living trust as the beneficiary of a retirement account, and thereby allow the terms of the will or living trust to govern the distribution of assets received from the retirement account, it is usually not advisable to do so for tax reasons.**

# **Give to Charity at Death?**

- **Designating an IRA to an estate or Living Trust which then designates a gift to charity**

**Versus**

- **Designating the IRA gift directly to charity**

## **IRA: Combination Charitable Non-charitable Designations**

- Must distinguish between individual beneficiaries and non-individual beneficiaries (e.g., charity beneficiaries).**
- The rules as to individual beneficiaries are complex.**
- The rules as to charity beneficiaries are relatively simple.**

# **Example 1: Charity as Sole Beneficiary**

- **Donor dies November 1, 2018, owning several IRAs. IRA #1 is for the sole benefit of College.**
- **College must take full distribution of IRA #1 by December 31, 2023 (5-year rule).**
- **College may take full distribution of IRA #1 any time before that date.**

# Example 2: More Complex

- Sally dies at age 68 on November 1, 2018. She dies owning one IRA. The IRA has four equal beneficiaries: Charity and Sally's three children.
- The children are Alice (aged 42), Ben (aged 39), and Carrie (aged 36).
- If Charity takes its full distribution by September 30, 2019, the children may take "stretch out" distributions from the IRA using **Alice's** life expectancy.
- If Charity does not take its full distribution before September 30, 2019, the children must take their full distributions by December 31, 2023, according to the 5-year rule.



# **Example 2: More Complex**

- **A GPO's (non-lawyer) perspective:**
- ✓ **For a donor with multiple assets, including an IRA with charitable and non-charitable beneficiaries, it is almost always best to give a portion or all of the IRA to charity and other assets to the non-charitable beneficiaries.**
- ✓ **For an IRA “left” to charitable and non-charitable beneficiaries, it is usually best to leave the charitable portion directly to the charity via a beneficiary designation form as opposed to by Will or Trust.**
- ✓ **“But I want my IRA gift designated to a Fund...”**

# **Example 3: Even More Complex**

- Same basic facts as Example 2, except that Sally dies at age 73 on November 1, 2018. [In this situation, Sally had begun receiving RMDs at the time of her death.]
- If Charity takes its full distribution by September 30, 2019, the children may take "stretch out" distributions from the IRA using **Sally's** "life expectancy" just before she died.
- If Charity does not take its full distribution before September 30, 2019, the children must take their full distributions by December 31, 2023, according to the 5-year rule.

# **A VASTLY MORE COMPLEX MATTER: IRA MONEY LEFT TO CHARITY BY WILL OR (FORMERLY REVOCABLE) TRUST**

- Donor dies on November 1, 2018, owning an IRA. The IRA does not have a beneficiary, so by federal tax law the beneficiary becomes Donor's estate.**
- [We could assume the IRA named Donor's revocable trust as beneficiary, but substantively that would be the same fact pattern.]**
- Donor's will provides for a bequest to Charity.**
- Donor's executor proposes using the IRA money that pours into the estate to satisfy this bequest.**

# **A VASTLY MORE COMPLEX MATTER: IRA MONEY LEFT TO CHARITY BY WILL OR (FORMERLY REVOCABLE) TRUST**

- **Will Donor's estate owe income tax on the IRA money paid to Charity by the executor?**
- **Yes, unless the estate can take an income tax charitable deduction for the payment.**
- **The estate is subject to income tax on its income.**
- **The IRA money pouring into the estate is IRD.**
- **Estates and trusts are allowed an unlimited income tax charitable deduction under Code §642(c) if certain requirements are satisfied.**

# **A VASTLY MORE COMPLEX MATTER: IRA MONEY LEFT TO CHARITY BY WILL OR (FORMERLY REVOCABLE) TRUST**

- **An estate or trust is allowed an income tax charitable deduction for**
  - income [i.e., gross income of the estate or trust] paid to charity
  - pursuant to the terms of the "governing instrument" (the will or the trust instrument).
- **Limitation: There is a "catch", however.**
- **If the will or trust specifies that a payment to charity is to come from a particular source of income, no income tax charitable deduction will be allowed for the payment unless the amount of the payment depends on the type of income to be paid. Income Tax Reg §1.642(c)(3).**

# **A VASTLY MORE COMPLEX MATTER: IRA MONEY LEFT TO CHARITY BY WILL OR (FORMERLY REVOCABLE) TRUST**

- **A will provides for a \$100,000 bequest to Charity and requires the executor to use estate IRD before any other estate asset to satisfy the bequest.**
- **No income tax charitable deduction will be allowed.**
- **A will leaves all estate IRD to Charity.**
- **An income tax charitable deduction will be allowed for the IRD paid to Charity.**



# Looking Over the Horizon...



# **IRA Designation to CRT**

- **Donor, age 84, has a \$2 million estate**
- **\$1 million in IRA and \$ million in house and investments**
- **Donor has 2 children, ages 60 and 62**
- **Donor is concerned children will “blow through” their inheritance in short time and not have funds for older age**
- **Donor is considering a CRT...**
- **What is your advice?**

# **IRA Designation to CRT**

- If a donor is looking to both support charities and benefit family members after death, a charitable remainder trust (CRT) could be a tax-efficient solution.**
- With a CRT, the donor's heirs could receive a steady income stream from the trust for their lifetimes, or for a set period of years.**
- A CRT also serves to postpone (but not avoid) income taxes on the IRA assets, which provides an additional benefit to heirs.**
- Because a CRT is exempt from income taxes as a charitable trust, the receipt of the IRA by the CRT will not require the payment of any income tax.**

# **IRA Designation to CRT**

## **➤ Process:**

- A charitable remainder trust instrument is drafted during the donor's life.**
- The trust will benefit family members or friends after the donor's death.**
- The IRA beneficiary designation names the CRT to receive the IRA funds after the donor's death.**
- Normal trust administration duties do not begin until the funding occurs**

# **IRA Designation to CRT**

## **➤ Process Questions:**

- Attached to the IRA beneficiary designation form?**
- In the donor's last will and testament?**
- In an unfunded or nominally-funded irrevocable charitable remainder trust?**
- In a funded or unfunded revocable living trust?**

# **IRA Designation to CGA**

**Private Letter Ruling 2002 30018**

- The value of the IRA at the death of the taxpayer will be included in the taxpayer's estate;**
- An estate tax deduction will be allowed for the value of the IRA assets less the present value of the annuity payable to the income recipient;**
- If the charity is named as the designated beneficiary of the IRA, then the proceeds will be income in respect of a decedent to the charity under IRC Sec. 691(a)(1)(B) and will not be income in respect of a decedent to the taxpayer's estate.**



# **IRA Designation to CGA**

**Private Letter Ruling 2002 30018**

- The critical point of this ruling is that the donor's estate will not have to pay income tax on any part of the IRA at the time the gift annuity is funded.**
- Prior to the ruling, it was considered possible that the present value of the annuity payments would be immediately taxable to the taxpayer's estate as income in respect of a decedent.**

# **IRA Designation to CGA**

**Private Letter Ruling 2002 30018**

- The IRS did not rule on the "investment in the contract," so it is probably advisable to take a conservative position and presume that the investment in the contract is zero, unless the IRA was partially funded with after-tax dollars.**
- This means that the annuity payments will be entirely taxable as ordinary income when received, but distributions from the IRA would likewise have been fully taxable as ordinary income.**

# Good News!

- **Your organization has been named the primary beneficiary for 100% of your donor's IRA account.**
- **Shortly after the initial notification and providing confirmation that your charity is the correct recipient, another package arrives from the financial institution.**
- **It is a rather thick package (your first warning signal).**

# Good News!

- **So let's just fill out the forms..**
- **The IRA administrator asks you to open a Beneficiary IRA Account (including completing an Inherited IRA Adoption Agreement).**

# Good News!

- **Social Security Number**
- **Copy of Drivers License**
- **“That’s OK, a copy of Your Passport will work...”**
- **But...This is a Corporate gift, right?**

# Survey Says...80 Replies; 7 Phone Calls

## ● Compliance

- Complete the forms anyway
- The most cited reasons for completing the paperwork were: “It’s a compliance issue” with several pointing to **The Patriot Act**
- “...if it takes too much effort to convince them to do it a different way, it might be easier to just fill out the forms they want and do it their way – as long as the charity gets a check either way.”

# Inherited IRA

## Retirement Dictionary

- **Definition.** Also referred to as '**Beneficiary IRA**'. An **IRA** that is established for the non-spouse **beneficiary** of the **IRA** owner, or qualified plan , 403(b) or 457(b) participant; or a spouse **beneficiary** who chose not elect to treat the **IRA** as his/her 'own **IRA**'.
- **Purpose: Tax Collection?**
- **Terms: Lump; 5 year or Stretch RMDs**



# The USA PATRIOT Act



**“Uniting and Strengthening America by  
Providing Appropriate Tools Required to  
Intercept and Obstruct Terrorism Act of 2001”**

- **“...regulations setting forth minimum standards for financial institutions that relate to the identification and verification of any person who applies to open an account.**

# **The Internal Revenue Code**

- **Internal Revenue Code Section 408**
  - **Top of the Pyramid Law written by Congress and signed by the President.**
  - **IRC Section 408 specifically refers to “individual” beneficiaries.**

# **The Internal Revenue Code**

- **Internal Revenue Code Section 408**
  - IRC Section 408 specifically refers to “individual” beneficiaries
- **Specifically, an Inherited IRA is an IRA Acquired from an Individual Who is not a Spouse.**
- **Only an Individual can Acquire an Inherited IRA.**
- **Only an Individual Human Being can Establish an Inherited IRA.**

# Strategy

- **What is your Legal Basis for Requiring my Charity to Open this Account?**
- *The assets in the XXX IRA that YYY Financial is holding lawfully belong to the Foundation and we ask for them to be delivered promptly, please. We have provided you with our Foundation name, address and EIN. Please promptly deliver the funds or provide us with you legal basis for withholding them.*

