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The Use of IRAs and Trusts in Charitable Planning

By David J. DelFiandra, Partner, Leech Tishman

As we await an upcoming Presidential election, we as advisors must always be cognizant of current tax law, prospective tax law and the interest rate environment when counseling clients with regard to their charitable giving.

TAX CONSEQUENCES

Federal Income Tax – The IRS allows a charitable income tax deduction for charitable contributions so long as you itemize your deductions on your personal income tax return. Since the passage of the Tax Cuts and Jobs Act in late 2017, the standard deduction has been greatly increased. This caused most taxpayers to no longer itemize and consequently not be able to deduct contributions made to charity. Most advisors recommend a client "bunch" their planned charitable contributions into one year so that the client can take advantage of itemization on their income tax return and obtain a charitable deduction.

Federal Estate and Gift Tax– As of 2020, each taxpayer has a Federal Estate and Gift Tax applicable exclusion amount of $11.58 million ($23.16 million for a married couple). Assets transferred during life as taxable gifts or at death as part of a client's estate in excess of the applicable exclusion amount are taxed at 40%. Any assets passing to charities either during life or at death qualify for a 100% unlimited charitable Gift or Estate tax deduction. Clients wishing for a potential income tax deduction would need to make charitable gifts during life and be above the standard deduction in order to itemize. Under current law, the $11.58 million exclusion will revert to $5 million on January 1, 2026, as indexed for inflation. However, Congress could always lower the exclusion amount prior to that date.

WAYS TO GIVE UNDER CURRENT LAW

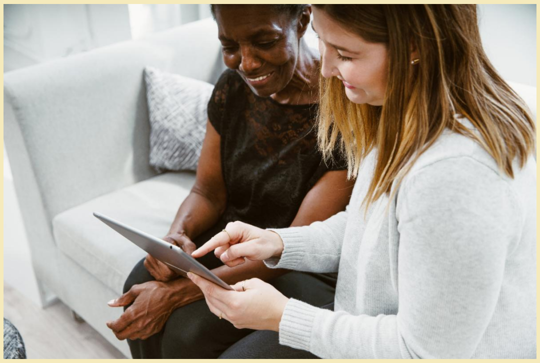
Outright and Donor Advised Funds - We are all aware of how to give outright to specified charities. It is easy to do and does not require much preparation. A client wishing to have more structure to their giving could elect to create a Donor Advised Fund ("DAF") under the Washington County Community Foundation's umbrella which is a Publicly-Supported Foundation and a 501(c)(3). DAFs serve as an alternative to a client creating their own Private Foundation. DAFs offer your client a vehicle to establish a legacy without the costs and administrative burdens of a Private Foundation. Your client would advise on which charities benefit from the DAF. Succeeding family generations can provide charitable recommendations in the future. Anyone making contributions to the DAF is eligible for a Federal income tax deduction.

Charitable Trusts– A more formal way to give involves a client establishing a Charitable Trust drafted by a lawyer. A Charitable Trust can take the form of a Charitable Remainder Trust or Charitable Lead Trust.

With a Charitable Remainder Trust, a client contributes assets (usually low basis securities) to a Charitable Trust. The client (or another non-charitable beneficiary) retains an annuity or unitrust interest of at least 5% for a term of years not to exceed 20 or for life. The client can serve as Trustee. At the end of the term or the life of the income beneficiary, a designated charity receives the remainder of the Charitable Trust. The benefits to the client are that they part ways with an asset that, had they sold it, would have generated high capital gains, yet still obtain a charitable deduction based on the asset's fair market value. The charitable deduction is calculated as the present value of the amount projected to pass to the charity at the end of the term. The client also retains a safety net of an annuity for the remainder of their life.

A Charitable Lead Trust is the opposite. It provides that the Charity gets an upfront income interest and a non-charitable beneficiary obtains a remainder interest. Charitable Lead Trusts are great vehicles to implement in this historically low interest rate environment since the gift of the remainder will be based on a very low IRC 7520 rate.

IRAs AS A CHARITABLE ASSET



Traditional IRAs and other qualified plans usually make up a large portion of our client's net worth. These assets have never been subject to income tax and, when taken by our client through required minimum distributions during life or by the IRA beneficiaries after our client's death, will be subject to ordinary income tax. To avoid this income tax burden, if a client wants to provide a charity $500,000 at death, the client should direct IRA assets to the charity since the charity does not pay income tax on the IRA proceeds. The client can then give more tax efficient assets to non-charitable beneficiaries.

The Secure Act passage in 2020 has, for the most part, eliminated the ability of non-charitable beneficiaries to stretch the deferral of ordinary income over the beneficiaries' remaining life expectancy. Most of these beneficiaries are now limited to a maximum 10-year deferral at which time the full amount of the IRA would be subject to ordinary income tax to the beneficiary.

Some clients are choosing to implement a testamentary Charitable Remainder Trust (discussed above) and designate the Charitable Remainder Trust as the beneficiary of some or all of their IRA to try and replace the stretch IRA eliminated by the Secure Act. The clients' child is designated as the income beneficiary of the Charitable Remainder Trust for the remainder of the child's lifetime. This accomplishes two objectives – it fulfills a charitable intent of the client and stretches the income from the IRA over the child's remaining life.

In conclusion, a client has many options with regard to charitable giving. Structuring their charitable plan to meet their objectives and provide the best tax consequences must always involve analysis under current law and interest rates, with awareness of potential law changes.

The information contained in this publication is not intended as legal advice.

About David J. DelFiandra

David J. Delfiandra is a Partner and Chair of Estates & Trusts Practice Group with Leech Tishman. He works closely with individuals and businesses on sophisticated estate planning and administration issues impacting wealth preservation. This includes the preparation of sophisticated estate plans designed to control and preserve wealth from one generation to another, and asset protection trusts offering maximum protection from future creditors.

He focuses his practice on the preparation of simple and complex wills, living wills and powers of attorney, estate, trust and guardianship planning and administration, planning for individuals with special needs, pre-marital agreements, and the development of lifetime gifting programs and estate litigation.

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